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AN INTRODUCTION TO

# Doing Business in China 2023

## Special Focus

Getting Ready for China's Rebound in 2023 and the New Opportunities

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This edition of Doing Business in China was produced by a team of professionals at Dezan Shira & Associates, with Qian Zhou as Editor.
Creative design of the guide was provided by Aparajita Zadoo.

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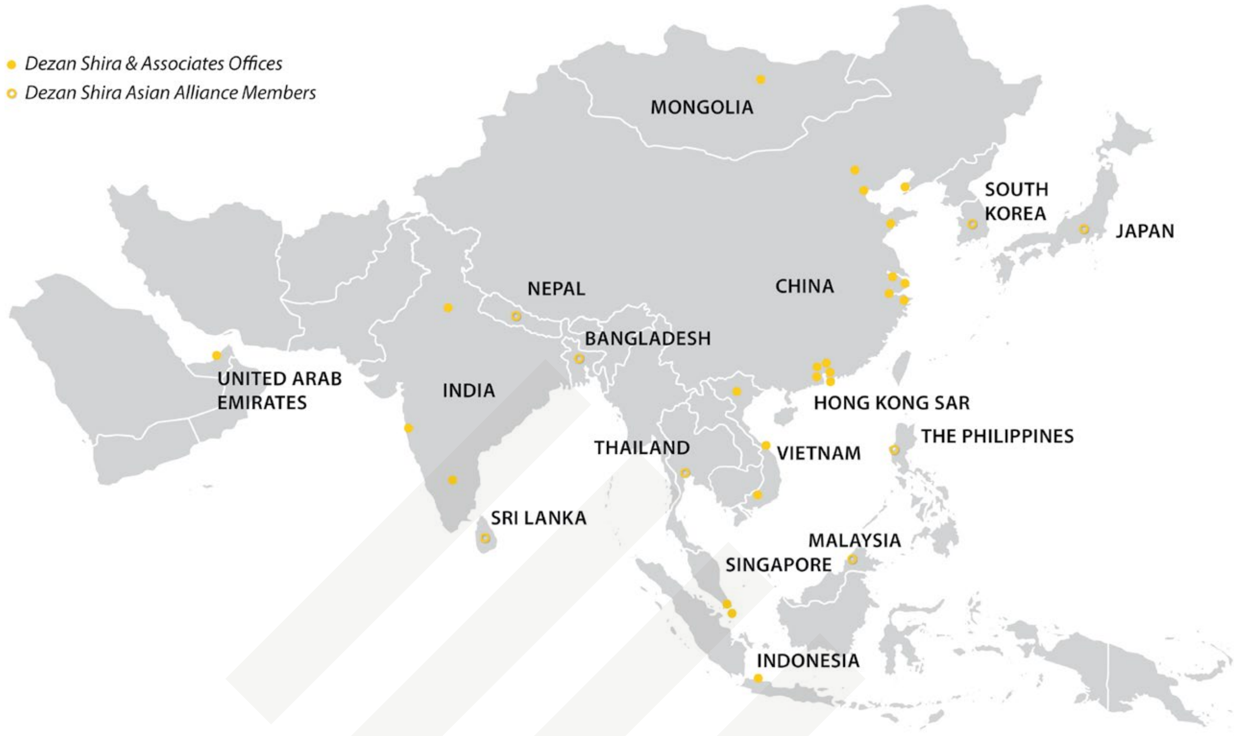


# About Dezan Shira & Associates

Dezan Shira & Associates is a pan-Asia, multi-disciplinary professional services firm, providing legal, tax and operational advisory to international corporate investors. Operational throughout China, India and ASEAN, our mission is to guide foreign companies through Asia's complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. With more than two decades of on-the-ground experience and a large team of lawyers, tax experts and auditors, in addition to researchers and business analysts, we are your partner for growth in Asia.

# Preface

**ALBERTO VETTORETTI**
Managing Partner
Dezan Shira & Associates

2022 turned out to be a difficult year for businesses operating in China. Unexpected lockdowns caused by COVID-19 outbreaks, weak consumption trends, a struggling real estate sector, and newfound geopolitical tensions caused serious disruptions to supply chains and damped global business confidence in the country.

Still, the actual use of foreign direct investment (FDI) in mainland China expanded in the first ten months of 2022 – growing 144 percent year-on-year to over US$152 billion from January to October. The whole year's FDI is expected to create double-digit growth.

Another silver lining has emerged out of the tough challenges overcome in 2022 – an easing of the zero-COVID policy is now in sight, with Beijing proposing a relaxation of the travel restrictions.

Economists expect China will fully reopen in the second half of 2023, pushing GDP growth to around five percent from three percent in 2022. Industries in line with Beijing's policy priorities, such as the healthcare sector, green sectors, consumer market, and sectors related to industrial automation, are expected to be the biggest beneficiaries.

Under these circumstances, it is vital that foreign investors are familiar with the changes happening in China's business landscape – to identify areas of risk in advance and take steps to prepare for new market opportunities. This is the only way investors can stay nimble in an otherwise difficult time.

Designed to introduce the fundamentals of investing in China, this publication is compiled by experts at Dezan Shira & Associates, a specialist foreign direct investment firm providing corporate establishment services, business advisory, tax advisory and compliance, accounting, payroll, due diligence, and financial review services to multinationals investing in emerging Asia.

Since its establishment in 1992, the firm has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore, Vietnam, and Indonesia. The firm also maintains partner firms across the ASEAN region and in Bangladesh and client liaison offices in the United States, Europe, and Russia.


**CONTACT**

**Dezan Shira & Associates**
china@dezshira.com
www.dezshira.com

# What's New in This Guide?

Doing Business in China 2023 introduces the fundamentals of investing in China. Compiled by the professionals at Dezan Shira & Associates in December 2022, this comprehensive guide is ideal not only for businesses looking to enter the Chinese market, but also for companies who already have a presence there and want to keep up to date with the most recent and relevant policy changes.

To be more specific, the below changes are noticeable for your attention:

**Why China:** A new section is added at the beginning to explain why China is still a market that cannot be overlooked by foreign investors. The section covers the country's growth outlook, market size, infrastructure and supply chain, workforce and labor market, market reforms and opening, and emerging city clusters.

**Business suspension:** A new section is added in the "How do I make changes to my business" chapter, introducing the requirements and benefits for companies to acquire a dormant company status amid business difficulty, while retaining its legal standing for a period of up to three years.

**Tax incentives:** The tax incentive policies are updated for each tax in the "What are the major taxes in China" chapter, including corporate income tax, value added tax, stamp tax, surtaxes, resource tax, and property tax, and information is added on the vehicle purchase tax.

**E-fapiao updates:** The "fully digitalized e-*fapiao*" is introduced in the "Value-added tax (VAT)" section, providing the latest developments in 2022.

**Accounting standards:** Two other accounting standards have been added – the *Accounting System for Business Enterprises* and *the Accounting System for Non-governmental Non-profit Organizations* (NGOs) – in the "Accounting and bookkeeping" section. The Accounting System for NGOs applies to NGOs and the representative offices of NGOs in China. This chapter also examines the discrepancies between the Chinese accounting standards (CAS) and China's tax laws, in addition to the differences between CAS and the *International Financial Reporting Standards* (IFRS).

**Human resources and payroll:** Brief introductions have been inserted on how to get approval for implementing the special work hour system and the calculation of severance pay in this chapter, both of which are among frequently asked questions by Dezan Shira & Associates clients.

**Cybersecurity and data protection:** This chapter is updated with developments under China's major cybersecurity and data protection laws and regulations in 2022, explaining key compliance requirements for businesses and providing practical tips on preparing for these new obligations.

# Why China?

## Growth outlook

Although China's economic growth rate is slowing after years of breakneck expansion, especially in 2022 amid multiple economic headwinds, the size of its economy dwarfs almost all others, both developed or developing countries. Simply put, foreign companies cannot afford to ignore the world's second largest economy.

China's economy is not done growing either. With a population of 14 billion, China's GDP per capita was US$12,551 in 2021, about six times lower than that of the US. While China is not guaranteed to eventually achieve GDP per capita on par with the US, the gap shows that there is still significant room for economic activity and household wealth to continue to grow before leveling off at a saturation point.

The British Consultancy Centre for Economics and Business Research (CEBR) projects China's economy to continue growing at 5.7 percent per year through 2025 and then 4.7 percent to 2030, at which point it will surpass the US to become the world's largest economy. Although these growth rates are slower than in the past, they come from a higher base and reflect China's transition towards becoming a high-income country.

### Why China Remains an Attractive Investment Destination

#### GDP Outlook

China's GDP per capita is about six times lower than the US, which means there is significant room for its economy to grow.

#### Workforce and Talents

China has the world's largest labor market, and workers in the manufacturing sector tend to be more experienced, more educated, and better resourced than their Asian counterparts.

#### Market Size

China's rising purchasing power, expanding middle class, and a population over a billion, positions it to become the largest retail market in the near future.

#### Market Reforms and Opening

China is continuously opening its market and improving the business environment. Between 2017 and 2019, China moved from 78th to 31st on the World Bank's Ease of Doing Business rankings.

#### Infrastructure and Supply Chain

China has a sophisticated manufacturing and logistics infrastructure set up.

#### Super City Clusters

China's emerging super city clusters offer great growth potential for foreign investors.

## Market size

China's rising purchasing power, expanding middle class, and a population over a billion, touts it to become the largest retail market in the near future.

Despite the weaker than expected consumption performance observed in 2022, in the longer term, the domestic market will benefit from China's dual circulation strategy, which intends to spur domestic demand and simultaneously create the conditions to increase foreign investment and boost production for exports. The focus on tapping into China's internal consumption patterns may also buffer the impact of global headwinds on the country's economic and financial stability. Bearing this in mind, it is not hard to understand why foreign investors are still betting big on China.

Many foreign companies have started to produce goods specifically for local consumption in China, rather than use the country as a production base for export-led manufacturing as in the past. For many companies, China is now their largest market for growth.

## Infrastructure and supply chain

China's sophisticated manufacturing and logistics infrastructure ensures it will not get replaced in the global supply chain easily. According to *Xinhua*, the state-run press agency, China is the only country that possesses all the industrial categories in the United Nations industrial classification, which allows firms to source goods easily. China also boasts of the largest network of high-speed rail and expressways in terms of mileage, which allows products to be transported efficiently.

The importance of these transport advantages became fully clear right from the start of the pandemic when global supply chains were seriously disrupted due to the aggressive implementation of infection control measures. From the production and supply of masks, protective suits, and medical equipment in the early stage of the outbreak, to consumer electronics, household goods, and festival products during later months, China's exports have made up for overseas shortages in all kinds of goods segments.

## Workforce and labor market

China has the world's largest labor market even though its working age population is shrinking. The labor force of China, which refers to the population aged between16 and 59 and capable of working, stood at around 880 million in 2020. And by the end of 2021, the number of employed people in China amounted to around 746.5 million people.

Despite the increasing concerns that China's labor costs keep rising, the country's workforce still earns considerably less than their counterparts in developed countries, while at the same holding advantages in experience and efficiency compared to lower cost emerging markets.

For example, in 2020, the average hourly cost for labor in the manufacturing sector was US$6.50 in China, compared to US$4.82 in Mexico and US$2.99 in Vietnam, two popular alternatives for manufacturing. However, while Vietnam's labor costs in manufacturing are less than half of China's, Vietnam's productivity per worker is about one-third of productivity levels in China.

Workers in China's manufacturing sector tend to be more experienced, more educated, and better resourced than in competing countries, often making China a more cost-efficient option despite slightly higher wages. The breadth of China's labor pool means that the country's human resources are highly adaptable to business needs, as companies will be able to find workers and technical specialists experienced in a wide variety of fields.

Further, China's labor market is becoming an asset not just for its size and cost efficiency, but for the quality of education. For instance, the Times Higher Education World University Rankings had 10 Chinese universities in its 2022 top 200 list – the most ever – including two in the top 20.

## Market reforms and opening

China has endeavored to attract greater foreign investment by relaxing more market access restrictions and continuously introducing improvements to the business and regulatory environment. Key among its reform actions, are changes to the negative lists. These lists indicate which industries are subject to special administrative measures for foreign investors, or in other words, supervised by authorities when determining market entry, scope of operation, and access to local market. The negative lists were shortened again in 2021.

The 2021 National Negative List removed two restricted items from its 2020 counterpart, cutting it 33 to 31, while the new 2021 FTZ Negative List removed three items, cutting it down to 27 from 30. Taking auto manufacturing as an example, the restrictions on the share ratio of foreign investment in passenger vehicle manufacturing has been liberalized. Before, the Chinese party shareholding percentage in passenger automobile manufacturing was to be no less than 50 percent.

Besides, with the *Foreign Investment Law* and supporting regulations coming into effect in 2020, together with other reforms in the areas of company establishment, tax, finance, reporting and compliance management – foreign investors in China are playing on a more even ground with domestic competitors.

China has also repeatedly and publicly stated its intentions to accelerate market opening reforms, most recently in President Xi Jinping's televised speech to kick off the fifth edition of the China International Import Expo (CIIE) in November 2022. And in 2022, a couple of well-known companies in the financial sector, including Credit Suisse, took full control of their Chinese joint venture. Such policy orientation towards high-tech innovation and market opening – that was initially an outcome of US-China trade tensions – will pave the ground for future and sustainable patterns of growth and investment in China.

## Innovation and emerging industries

Once known as an economy rife with copycats and counterfeits, China-based enterprises are leading on R&D and pursuing experimental business models. Companies that do not pay attention to China will not just miss out on the market, but also the country's increasingly dynamic pace of innovation.

China's spending on R&D is equivalent to about 2.5 percent of GDP, which is far higher than other countries at similar levels of development. This spending has contributed to the growth of business models in areas like e-commerce, fintech, and artificial intelligence that are competitive with – or even lead – advanced economies like the US.

One unique advantage for data-fueled innovation in China is the size of its internet-using population. China has close to a billion internet users, which is more than the US and EU combined. About 800 million people in China use mobile payments on a daily basis – over eight times more than the US – leading to a world-leading fintech industry.

Beyond operating in an enormous market, investing in China positions international companies to gain experience with innovative products that can make them more competitive in their home countries.

## China's emerging super city clusters

The scale of China's urbanization over the past four decades is a staggering feat in human history. City clusters, as the main form of China's new urbanization, are important pillars to support China's economic growth, promote coordinated development among regions, and enhance China's international competitiveness.

Among the 19 super city clusters, which cover most of the provinces throughout the country, four of these clusters - the Yangtze River Delta, the Pearl River Delta (or the Guangdong-Hong Kong-Macao Greater Bay Area), the Beijing-Tianjin-Hebei (or Jing-Jin-Ji), and the Chengdu-Chongqing Economic Circle - are among the most important, and areas which China is working particularly hard to optimize and improve.

These four city clusters, spread over just eight percent of China's land, account for over 50 percent of the country's economic output and foreign investment. The Yangtze River Delta alone accounted for 24.1 percent China's total GDP and 48.9 percent of China's foreign direct investment in 2021, while the Guangdong-Hong Kong-Macao Greater Bay Area accounted for 11 percent of China's total GDP and 15.7 percent of China's FDI the same year.

Businesses that have operations in China or that are planning to expand to this enormous market are advised to seriously consider and fully understand the potential of these city clusters.

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