NBR Special Report

Doing business in China

Kiwi businesses exporting to China have to learn to navigate a complex government-dominated historical, political and cultural culture

Changes from Beijing will have effects here

Johnathan Chen

Moves over the past several months to cool the residential property market, particularly in Auckland, by restricting foreign buyers, have taken the heat out of Chinese investment.

But many Kiwis may not be aware that a much bigger factor has been the Chinese government's tightening of capital outflows from China.

Beijing has laid down stringent rules on what its citizens and businesses can invest in overseas – and residential housing is one category that is strictly not allowed.

Investment money is still coming out of China into markets such as New Zealand but the channels are much more restricted; trade or innovation are the strongest conduits.

Money can go into infrastructure, research and development, innovation and the purchase of intellectual property. But activities such as land banking are no longer allowed – unless the action is accompanied by some form of innovation or trade objective.

This wasn't the only significant activity in China last year. On my most recent visit, it was again noticeable how the nature of Chinese business has changed and is continuing to do so rapidly.

Companies surprised me with the quality of their products and the innovative thinking behind them.

ZHANGJIAJIE BRIDGE: Tourists visit the remarkable glass-bottom bridge at Zhangjiajie Grand Canyon in Zhangjiajie, Hunan Province in China valley between two cliffs in the canyon area

Encouraged by the government, they are pushing hard for high-end innovation in markets where the demand is hot – and moving away from the factory model.

Creating brands

The prevailing view now is "we should make our own products, with our own brands, rather than do what others tell us." In the technology area, for example, the likes of Xiaomi and Huawei have gone after Apple's place as the epitome of technology design and innovative excellence; they are developing their own branding and look – not simply positioning as a cheap alternative.

A challenge from a major dairy company was: Watch out Fonterra. That company is looking well past the commodity nature of dairy goods to high-value product derivations.

I also saw some astonishing examples of infrastructure developments, in particular a tourism development at Zhangjiajie. It was effectively a platform that wound around a cliff and was carrying considerable human traffic.

The sheer engineering sophistication and scale of the development was astonishing. It illustrates that, while New Zealand may have many tourist gems to attract Asian visitors, it can't be complacent. Developments such as this offer a compelling holiday option for the Chinese, much closer to home.

The government is changing the culture (and the cultural perception) of its people and business. In the past the perception (which is largely true) is the Chinese make decisions solely driven by money. Although this has led to the economic rise of China, it has also led to some serious issues and negative consequences.

It is now the intention to expand and develop the business culture to be more moral and appreciative of proper business behaviour. An example of this is the education on the treatment of intellectual property (IP). This is now more aligned with international practice, though there's still room to improve.

Looking to 2018

Looking to the future, Kiwi businesspeople working in China, or interested in doing so, can expect it to be a dynamic environment in terms of regulations – as it was in 2017.

The vigorous encouragement of innovation also extends to Chinese entrepreneurs looking to New Zealand for innovation, new brands, companies with good reputations and good stories.

Innovative companies in New Zealand should be prepared for people out of China coming to them; there will be many potential opportunities to work together especially in areas such as new tech nology and in food and beverages.

Two interesting consumer markets are emerging – products for the elderly and pet foods. The former results from the "one-child" generation, which is at a point where the children are now grown up and wealthy. They are having to look after parents (and grandparents). Products that support senior living will be in demand.

The emergence of pet foods reflects growing wealth. In the past, pets (if

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CHRIS WAY: The Baldwins partner recommends checking whether you have the freedom to use your trademark in China before attempting it

How to protect your IP in China

Calida Smylie

China's booming e-commerce market provides plenty of opportunity for Kiwi businesses to flourish but there are still intellectual property challenges to overcome.

The world's largest e-commerce market is boosted by an increasingly affluent middle-class looking to part with their cash on Alibaba and other internet shopping behemoths.

At the end of last year China's e-commerce market was thought to be worth about $1 billion – and is expected to grow to $1.7 trillion by 2020.

This represents a huge opportunity for New Zealand exports – from food through to technology – given the world's second-largest economy is hungry for international, high-quality goods.

New Zealand products have the advantage of being considered clean, green and pure – and businesses marketing these online removes the necessity and cost of having people on the ground in China.

Just a decade ago, China was considered the place to have products manufactured on the cheap. As a result, counterfeits were rife and it was known as a country where intellectual property went to die.

> **"In 2017, IP filings in China soared with patent applications exceeding the combined total of applications received by the US, Japan, the Republic of Korea and the European Patent Office** – Chris Way

But this is no longer the case. As Chinese businesses innovate, the country's IP protection and enforcement has become as good as, if not better, than many other parts of the world, legal expert Chris Way says.

"As more and more Chinese companies are innovating, they've realised that it's best to have IP on their side. In 2017, IP filings in China soared, with patent applications exceeding the combined total of applications received by the US, Japan, the Republic of Korea and the European Patent Office."

E-commerce giants such as Alibaba are taking IP enforcement issues seriously as it's important to retain big brands. Software algorithms are being introduced that can auto-detect infringing brands in the photographs uploaded by sellers.

However, sellers are becoming more sophisticated in their methods to avoid infringement, such as deliberately obscuring brands to avoid detection.

"Be diligent, as providers will only do so much and have hundreds of thousands of listings every day," says Mr Way, who heads law firm Baldwins' China desk.

Chinese regulators are also moving to introduce new e-commerce legislation that covers IP protection, in addition to new security standards.

While China has come a long way in helping exporters protect their products online, there are still risks exporters need to be aware of.

One such challenge is "trade mark squatting," often done by unscrupulous operators targeting overseas companies for a payout once IP protections are breached, Mr Way says.

"Kiwi businesses might think because they've got a registration in New Zealand, they have an automatic exclusive right in China, which is not correct. They might fall down because they think they could use their trademark in China without any problems.

"But that's not the case, and there have been issues with trade mark squatters – they spot a foreign brand and copy it. China, unlike Commonwealth countries, operates on a first-to-file basis. The person who applied for the trademark first ultimately wins.

"What these people are looking for is a big cash handout and for you to hand over the trade mark, which is never going to be ideal."

Due diligence is key and Kiwis wanting to do business in China should first check whether their brand is already in use there (a surprising number leap in without doing this).

"Deal with this earlier rather than later," Mr Way says. "I understand companies don't want to invest too much at the outset but do it as early as you can before making a move over there."

He says it is generally better to change the brand completely for the Chinese market.

"The brand should create a feeling of clean, green New Zealand – English words don't mean a great deal to many people in China and having an existing brand in New Zealand means nothing in China."

While e-commerce is an attractive avenue with lower costs, make sure to "review any agreements you have and never make assumptions, particularly if dealing with people directly. Make sure you have everything tightened up with distributors, with formal agreements," Mr Way says.

One of the biggest differences between China and New Zealand is the level of competition.

"It's a huge market but that doesn't mean it doesn't take effort, which is where people fall down. They think even if they corner 1% of the market they're going to make billions of dollars – but it doesn't work like that," Mr Way says.

That makes it all the more important to be diligent and make sure you can market your goods in China, before leaping into the potentially lucrative market.

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Green industries gain traction

Oyvinn Rimer

After decades of fast industrialisation, China has made a meaningful change in direction and has begun cleaning up its own backyard.

Chinese consumers will welcome this change and demand that it continues. They will also start showing an interest in the environmental footprint of foreign brands and businesses, including New Zealand companies servicing China.

Although New Zealand has developed a strong green and clean image, the external pressures to live by these principles are likely to increase. A perception among Chinese consumers that a company or group of companies do not adhere to these values could easily dilute that collective brand quickly.

Enormous resources, both political and financial, are being invested in improving China's environmental footprint. Evidence of action, as opposed to lip service, is starting to emerge.

In October 2017, Xi Jinping became the first president in Chinese history to mention the "environment" more than the "economy" during his first address in his second term.

This is a sea change in rhetoric and illustrates a deep understanding of what the people are demanding. The challenge from here will be to make an impact and deliver on promises.

ELECTRIC VEHICLES RULE: China has more than 200 car manufacturers, with many making vehicles such as the Kaimali K50, a low-speed electric car

Saved the deal

The US withdrawal from the Paris Climate Agreement provided China with a golden ticket to emerge as a key backer of the deal. Its credibility would have been significantly undermined had China stepped away as well.

China is also emerging as an advocate for environmental protection at home. The most visible impact of this has been winter curtailments of coal, aluminium and steel capacity to combat increased pollution over winter months as citizens turn to coal to stay warm.

Another important part of the environmental policy framework is a gas-for-coal swapping scheme, and building more renewable energy generation. This could shape the future demand-equation for coal, oil, gas and materials used in the renewable energy supply-chain, such as lithium and graphite.

The push into renewables is nothing short of remarkable. By the end of 2017, China had installed approximately 170GW of wind generating capacity. In context, New Zealand's largest power plant, Huntly, is 0.9GW, meaning that China has 190 Huntly-equivalents of wind generation capacity.

Similarly, in 2015 China overtook Germany as the largest installer of solar photovoltaic (PV) generating capacity globally. It had 130GW of installed PV capacity at the end of 2017 (or 144 generating plants the size of Huntly), making up approximately 7% of China's total power generation capacity.

Coal the loser

Coal is the target industry with the most to lose. As an electricity fuel, it is dirty and the domestic Chinese coal industry has a poor health and safety record. There has been widespread closures of coal mining and coal generation capacity in the last couple of years. Ironically, the crackdown in China could (in the short-term at least) benefit Australian coal miners that have coal with lower emissions more suited for the Chinese market.

The liquid natural gas (LNG) market is also a clear beneficiary of the gas-to-coal swapping policies. China's demand for imported LNG is growing rapidly and was up 46% in 2017, benefiting Australian-listed producers, such as Oil Search.

China is also the largest producer and consumer of electric vehicles globally, supported by the largest lithium-ion battery industry in the world.

This is another part of the environmental protection efforts that specifically target inner-city pollution. Importantly, unlike the rest of the world, China has a strong preference for pure electric vehicles over hybrids.

China's new energy vehicle (NEV) fleet target for 2017 was two million NEVs – for 2020 the target is five million. China could exceed this target and outperform market expectations with demand for lithium-ion batteries a likely driver.

Companies producing materials for the anode (largely graphite and silicon) or the cathode (lithium, cobalt, nickel, etc) have a significant opportunity to establish themselves as preferred partners of battery or car manufacturers.

Oyvinn Rimer is a director and research analyst at Harbour Asset Management

Astonishing new infrastructure developments

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there were any) and livestock got what was left over after the family had eaten – no special favours! Pet owners can now afford to buy pet-specific food. But the products are relatively unsophisticated, with little consideration for health benefits. This is definitely an area of opportunity.

A successful Chinese business person I spoke with put the Chinese consumer market mindset succinctly and simply. "吃□了没事干 的人会想□什么 " – which basically translates to consider what a person would want, when they are full and have all of the necessities they need. Food for their pets is one thing – but what else might they be interested in given that mindset?

Post-election uncertainty

The election of a Labour-led government has thrown some uncertainty into the trading relationship between the two countries. Things may become clearer as 2018 unfolds. Any moves to make it tougher for China to invest in New Zealand will likely see a negative reaction from China.

It is fair to say the majority view is opposed to mainland Chinese buying land here or snapping up residential properties. But I don't see signs of the government being opposed to joint ventures and initiatives around technology and innovation. Doing business in that area may become easier, which would be good for New Zealand innovation.

We've seen no concrete adjustments yet so, until the policies come out, it's all speculation. But it looks as though it could be tougher for Chinese companies to do business in New Zealand unless they are resident here.

If that's the case, we will probably see a reaction over the next four years that may not be good for trade growth. So, while consideration of the policies covering foreign investment is needed, it is important for the government to consider all aspects of policy changes if collateral damage is to minimised, especially to exports.

Johnathan Chen heads the Asia division of James & Wells, an Auckland-headquartered law firm that specialises in intellectual property