

## ➔ POLITICS IN CHINA



Article by

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China Inroads supports innovative companies in their expansion to the Chinese market. "China belongs to the Chinese." This philosophy is the guidance for how we match companies with the right parties and markets in China, to create a successful and effective venture.



**Chinese politics can be quite complex and it is easy to get lost between all the CCP, NPC, AML and OGI abbreviations. As a country comparable in size and diversity to Europe, it has a wealth of policies that have the tendency to change every month. But which of these policies and laws are actually relevant to a Western company? In this article we will take a closer look at some important aspects of China's political system. By highlighting the system itself and important political issues, we will provide a trustworthy map for Western business travelers.**

### **How the political system works**

China's political system has a top-down structure with a government cabinet at the top, various ministries subordinated to it and street-level bureaucrats at the bottom. A major difference is that the Chinese system does not separate political powers into legislative, executive, and judiciary branches like other states. The Communist Party also reaches into all levels of administration through personal politics, ideology and political directives.

This might seem a very strange system to the Western eye, but it was carefully thought through before its implementation. It is the process of trying to improve on some weaker points of the parliamentary democracy. Democracy, for example, lacks efficiency because each candidate has to worry about re-elections. Therefore, unpopular and difficult matters are often not discussed or discussed from very different viewpoints, which often results in a weak and useless compromise.

Another contradiction within the democratic system is the fact that even though everybody is supposed to be eligible, in reality most politicians need a university degree or successful career to be credible. In other words, only the elite can really participate in the end. Lastly, politicians often receive the support of powerful lobbies such as the car or tobacco industry. This can make them more partial to big business groups than their own constituencies.

To devise a system without these faults, the One-Party system thus emphasizes unity and centralization. Decision-making processes are centralized as much as possible and conflicts are settled before the policy-making process starts. What we could then call the legislature in China is the National People's Congress (NPC). It is different from European parliaments and the American congress, in that it not only has legislative and supervisory power, but can also appoint state officials and decide on issues of the state. People congresses are present at each level of China's political system, from the constituencies to the provinces.

The executive power lies with the State Council, which drafts and manages the national economic plan and the state budget. Instead of a separate judiciary power, the third player is the People's Liberation Army. It is headed by two commissions under the leadership of the NPC and Central Committee of the Party (CCP). Above these three organs, there is the Party's political bureau (Politburo). The most power lies with the nine members of the Politburo standing committee who can reach into every part of the Chinese system. The NPC Standing Committee chairman for example, is also a Politburo member. This way, the Communist Party is always in control of what happens in China's parliament.

## Barriers and openings

Knowing how the Chinese political system works is not enough for doing successful business in China. The Dutch Ministry of Foreign Affairs yearly issues a research for trade and investment relations between China and the Netherlands. In the most recent outcome from 2013, Dutch enterprises say,

**“Access to the domestic market and stronger local competition are seen as the biggest challenges to doing business in China.”**

“Most frequently mentioned barriers for Dutch companies doing business in China concern government relations and the Chinese regulator environment.”

Policies that are meant to address these problems are, for example, the Open Government Information law (OGI) implemented on May 1, 2008 and the Anti-Monopoly law (AML), which came into effect on August 1, 2008. Regulatory transparency is particularly an issue for strategic or politically sensitive sectors like high tech industries and commodities. Since these regulations often change and can have an inconsistent application, it can sometimes be quite difficult to handle for foreign companies.

Behnam Sobhani, a lawyer at HIL International Lawyers & Advisors, acknowledges, “transparency is a problem, but I think that has to do with the cultural differences. It remains to be seen,



if this specific law will solve the problem. Having the right connections in China is still the most important and effective.” This is something that Pascal Bleeker, COO at Locamation, knows all too well. “Our company develops solutions to improve and secure the reliability, affordability and sustainability of electricity networks. We now cooperate with two partners in China and have experienced that knowing the right people is a huge advantage. For example, one of our partners has connections at the National Energy Administration. Even as a large multinational it is quite difficult to get a serious meeting with them, but because of our connections we have had some interesting talks there.”

Besides transparency issues, policies such as the AML, which mainly tries to control mergers and price fixers, are not very effective either and do not have a big impact on Western companies. Sobhani says that “market entry by foreign companies is only impacted by a Foreign Investment Guidance Catalogue review and in some cases an AML review. The Chinese Ministry of Commerce (MOFCOM) uses this to check foreign companies

who want to start a joint venture. The Foreign Investment Guidance Catalogue prescribes which foreign investments have to be checked because of security reasons. This happens mainly in very specific sectors such as defense, infrastructure, telecom etc.”

Bleeker has to deal with quite a closed market where two state-owned companies (SOE) have a monopoly, but yet has not noticed any effects of state policies. “In the Netherlands we have a market share of 40%, but in China State Grid Corporation of China has 82% of the electricity market and Southern Grid has the other 18%. It thus remains to be seen how big we can become in China.” The weak effects of policies can be due to the fact that China is still developing its legal framework as Sobhani explains,

## “The Chinese legal system is relatively young, so it is no wonder that they still have to figure out many things.”

“The large scale of the country is also slowing things down and hindering the effectiveness of some policies.”

### Being 100% prepared is impossible

When setting foot on Chinese soil, several things are of utmost importance from a legal perspective. We will look at the three most important aspects following Locamation’s route to China. Locamation started to look to the Chinese market two years ago. “The SASsensor line we developed in 2000 made it possible to measure the amount of electricity at substations very accurate. In the Netherlands where we have our basis, most of the electric network is underground. This is the same in Chinese cities, so our technology is also very interesting for them. We were contacted by two different Chinese companies to participate in some projects so we had a very advantageous position,” Bleeker explains.

Something that is very important when going to China, is being legally prepared. Bleeker mentions that Locamation got in touch with a law company immediately. This was also done because Locamation found out another company had already registered a similar product logo in China. “We are trying to find out through official and informal channels why this happened and who is behind it. We use our partner’s network and the help of third parties in this process.” A possibility would be to go to court, but Sobhani mentions that is “a costly process and you need a local Chinese lawyer for this.”



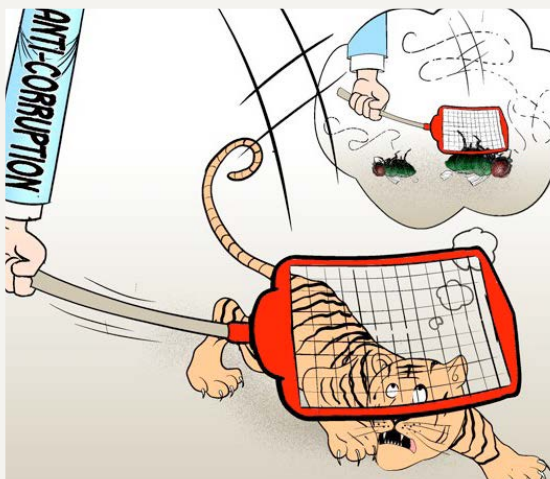
The second factor is being careful and thorough. Sobhani mentions that “looking for a Chinese distributor or partner is very difficult for a foreign company. It is vital to have on the ground knowledge and experience. You do not know directly with whom you are cooperating, so you have to stipulate all the regulations very clearly otherwise it is easy for conflicts to arise.” Brent Yuan, associate director at Yuan Associates which facilitates and improves communications and cooperation between multinational companies and governments, also stresses that companies should be careful. “Sound preparation is needed upfront. It can for example be that a certain business is forbidden in China. Besides that, compliance is also very important for foreign companies active in China. A certain contract may contain clauses that are not applicable to Chinese law or the other way around.”

Bleeker agrees with these statements and mentions that Locamation also took great care in looking carefully at who their partners were before signing the contract. “IP rights are still an issue and we are very careful in disclosing or keeping certain information a secret. We also spread information about technologies among our employees and have several suppliers. It is also possible for us to separate the hardware and software. Without the software our products won’t work so that can serve as a protection.” Constant innovation and staying alert are also beneficial in protecting one’s IP. “We often provide a proven mature version of our products and keep the newest one behind. Because there are such long lead times, this provides us with some time to develop new technologies and stay in front.”

Lastly, time and money is needed, and quite a lot of it too. This was not new to Bleeker: “In our field of work, we are used to having long lead times. Our technologies have to work for several decades, so after sales there are still pilots of half a year to a year. We had heard beforehand that it might go ‘quick’ in China, but many stakeholders were involved and there was a long sales chain, so it turned out to be more of a marketing term.

## “But the Chinese are curious and have a great interest in innovating, so it is definitely worth going there.”

Yuan concludes by saying that “there are five words every person active in China should be aware of. The first is ‘official’. What does official mean in China and why are officials important? Second is ‘planning’, the planning of the CCP through the 5-year-plans and annual planning give insight in important micro-directions of the government, imply certain focus areas or investments etc. These offer opportunities for foreign companies. Third is ‘policy’. There are changes throughout China on a regular basis. Remaining up to date allows you to deal with the details properly. Fourth is ‘relations’, guanxi. Connections are very important to get things done. The Chinese government consists of many departments, each department has sub divisions. You need to know where to go. Fifth is ‘face’, mianzi. By acting in line with the government’s planning and policy, a company can give face to the government and receive face in return. This is a very important element of doing business in China.”



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### The future

The Sino-Europe relationship has gotten a boost since President Xi Jinping visited Europe during the Nuclear Security Summit (NSS). Sobhani sees a bright future for the collaboration of both countries. “If we do not mention Tibet too often, we should be able to have fruitful cooperation in the future. China is also showing goodwill by making the market more attractive for Western companies. There has been an amendment in the trademark law which has taken effect at the beginning of May, shortens the time for trademark applications and enables companies to apply for a review if the trademark is initially objected.”

Bleeker also sees that the market is opening up further and is calling for further cooperation and integration. “The Chinese government is very keen on keeping control over the market and we can provide technological tools for them to use. For the electric market it would be effective to split the transmission and the distribution market and separate public and private projects. Our technologies are very useful if a city’s electricity network is split up in several ‘islands’, thus the government could create a win-win situation by opening up the market and remaining in control at the same time.”

Yuan is also positive about the current developments in Chinese politics, especially President Xi’s anti-corruption policy. “It is very important that the political system will be based more and more on organizational relations between companies and the relevant government departments, rather than accomplishments through individual guanxi.” Sobhani agrees that excessive corruption should be tackled, “but it is also another way of doing business which we should not have to look at so negatively in the West. There have been some high-profile corruption scandals, but that is not necessarily the system’s fault. There are similar scandals elsewhere, so I think it would be better to adapt our mindset.”

China is still changing and will keep on changing for the following years. Keeping an eye on Chinese politics has become much easier with many social media outlets and online blogs. With some sound preparation, there should thus be enough room for some foreign footprints on the Chinese shore!

## What CI can do for you to increase your chances of success?

From our offices in Amsterdam en Beijing China Inroads supports innovative companies in their expansion to the Chinese market. We represent your company in China and aid you in creating a successful and effective venture.

We assist you in setting up a sound strategy and its implementation. Therefore during the entire process – from start to finish – we are deeply involved in your China activities. What starts with detailed market research, often goes further with conducting matchmaking activities; managing these relations and taking care of the daily paperwork. All designed to service you.

You are welcome to visit us for a free consultation at one of our offices. We are of course happy to visit your office as well.