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Westpac AustCham Shanghai Business Sentiment Survey

Reflections on the Chinese regulatory landscape

A “new phase of opening up”: Update on China’s foreign investment environment

2018 marked the 40th anniversary of China’s journey towards economic reform. However, it was also the year in which the US and China engaged in a trade dispute which has resulted in hundreds of billions of tariffs being imposed.

Despite the rising US-China bilateral trade tensions, China’s regulators continued to implement new laws and economic policies in the spirit of reform and with a view to opening up China to foreign businesses wishing to access or expand their Chinese presence.

Chinese President Xi Jinping’s remarks at the 2018 Boao Forum for Asia affirmed China’s continued commitment to improving its foreign investment environment. President Xi emphasised that China would enter into a “new phase of opening up”, and that China would “enhance alignment with international economic and trading rules, increase transparency, strengthen property right protection, uphold the rule of law, encourage competition and oppose monopoly”.

This note briefly surveys the developments in China’s regulatory landscape in the last year. It is not intended to describe all of the changes in Chinese regulation that have occurred across a variety of sectors and the plans for further review. However, as the following key examples illustrate, the general trend in the Chinese regulatory environment has in our view been incrementally positive. While the Chinese government has more work to do on improving the transparency, consistency and certainty of the regulatory environment, international business and investors remain keen to grow businesses in China and support economic growth.

Key regulatory and policy developments: Moving from 2018 into 2019

Developments in China’s financial markets and financial services sector

In 2018, the new China Banking and Insurance Regulatory Commission and China Securities Regulatory Commission announced a number of measures designed to attract foreign investment into China’s financial services sector.

The new policies reflect the following key principles:

- China’s financial sector will be open and will afford equal treatment to investors offering quality financial services;
- the reform of China’s financial sector will proceed in conjunction with reforms in China’s exchange rate mechanism and further reforms to its capital account policies; and
- during the reform process, China’s focus on the management and prevention of financial risks will remain paramount (including through a focus on strict compliance with applicable laws, regulations and policies).

The GBA initiative will provide a valuable opportunity for foreign companies

Following the announcement, China’s State Administration of Foreign Exchange issued new rules aimed at addressing foreign investors’ concerns about repatriating funds associated with their securities investments out of China. Significant changes include:

- the removal of the 20% limit on the net amount of capital and profit that a Qualified Foreign Institutional Investor (**QFII**) can repatriate out of China each month;
- the removal of a lock-up period for QFIIs and RMB Qualified Foreign Institutional Investors (**RQFIIs**) – previously, no repatriation could be made during the lock-up period; and
- allowing QFIIs and RQFIIs to hedge FX risks associated with their investments in Chinese securities.

Greater Bay Area initiative

Over the last year, China progressed the Greater Bay Area (**GBA**) initiative, under which key cities in Southern China, including Hong Kong, Macau, Guangzhou, and Shenzhen will be integrated into one single, globally connected economic zone by 2035.

As one of the Chinese government's most ambitious economic policy priorities for 2019 and beyond, the GBA initiative will provide a valuable opportunity for foreign companies seeking to refresh their existing China market entry and engagement strategies. It also groups together several economic regions with which Australia has enjoyed strong trade relationships.

After much anticipation, the long-awaited Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area (the "Outline") was released on 18 February 2019. The Outline follows the signing of the Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area on 1 July 2017.

The GBA outline contemplates:

- (financial sector) presenting the GBA as an international financial hub, with established systems and regulations in line with international standards; establishing a regional centre for equity and commodity trading, expanding the scope and cross-boundary use of RMB in the GBA and launching cross-boundary RMB interbank lending, foreign exchange businesses and related derivative products;
- (innovations and technologies) creating smart cities within the GBA to encourage a culture of innovation, including the creation of start-ups and innovations in new materials, high-end medical diagnosis and treatment, genetic testing, new energy, and environmental protection. This will be supported by R&D programs and special funding for joint innovation programs within the GBA;
- (dispute resolution, governance and cooperation in legal matters) developing an international arbitration centre in the GBA, strengthening anti-corruption mechanisms, expanding integrated community service functions across the GBA and using legislative powers to accelerate the establishment of a legal system aimed at facilitating an open economy; and
- (infrastructure) improving infrastructure across key areas such as transport, information and internet communications, and energy resources.

The GBA is also seen as an important Belt & Road hub providing opportunities for international cooperation in infrastructure connectivity, as well as commerce, trade and logistics.

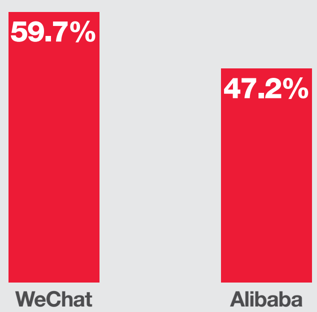
You can understand more about the Outline and its vision for the core GBA cities by reading: A new blueprint for growth — Analysis of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area.

Chinese imports and the impact of regulations and trade negotiations

In recent years, Chinese regulatory reforms for consumer products including cosmetics, infant formula, and drugs and medical devices have created key opportunities for foreign businesses to export quality products into the Chinese market.

Together with the continued rise of internet intermediaries and e-commerce channels, as well as moves from the Chinese government to increase IP protections, foreign businesses of popular consumer products have seen China emerge as a key growth market.

The most common e-commerce channels used among survey respondents to sell products and services



While the majority of respondents (38.8%) said that less than 10% of sales in China are generated through online channels, many respondents were either developing a China e-commerce strategy (29.4%) or improving their China e-commerce strategy (15.17%).

At a global level, China announced three rounds of tariff cuts across 2018, lowering import taxes on a wide variety of consumer goods and industrial products.

For foreign businesses, under the protection of the China-Australia Free Trade Agreement, tariffs on Australian exports such as wine, opals, beef and dairy as well as whisky, pharmaceuticals, vitamins and health products are expected to be reduced or eliminated in 2019.

However, while the growth opportunities for consumer products together with the lowering of tariffs present positive opportunities for businesses to enter or increase their presence in the Chinese market, the uncertain global political landscape together with increased political scrutiny on trade negotiations could give rise to unexpected policy movements on Australian exports into China.

Takeaways for 2019 and beyond

Overall, China has continued its trend of gradual economic reform with the announcement of key regulatory and policy developments.

China's continuous efforts to ease restrictions for foreign investors, increase transparency, and encourage growth and investment, including throughout the GBA, affirms the Chinese government's goals of improving the foreign investment environment and attracting investment.

However, while the volatility in the global landscape may have an impact, these broad reform initiatives present exciting opportunities for foreign businesses, particularly in certain key sectors including financial services, technology as well as infrastructure, the increased volatility in the global political landscape may also have an impact on foreign businesses over the course of 2019.

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E-commerce opportunities and challenges for foreign businesses

Challenges and opportunities for foreign businesses

E-commerce in China is and will continue to play a key role in driving growth in many Chinese industries. Many foreign businesses wishing to grow in China must have a detailed and well thought out e-commerce strategy in order to remain relevant and competitive in China.

Key challenges facing foreign businesses when conducting e-commerce business in China include recruiting and retaining human capital with relevant experience in the Chinese e-commerce market and relationships with multiple platforms, speed of change and rise of new platforms, navigating the changing regulatory landscape in China, and the lack of deep domestic social media know-how.

The top three opportunities for foreign businesses to leverage in order to effectively capitalise on digital and e-commerce trends in China are:

- Australia's domestic pool of Chinese speaking talent with professional backgrounds in the broader daigou economy and the related services and skills that support this phenomenon. This includes China-facing product incubation, promotion via social media and acting as a bridge between Australian corporate expectations and mainland China's highly competitive and frenetic pace.
- Australia's product innovation around food and wine, mother and baby, personal care and beauty products - in particular the organic and all-natural space - and the clean and green provenance story around farm to plate. Foreign businesses need to have the ability to market this story to the global Chinese shopper, including experiences such as farm gate, cellar door, vineyard, seafood market and other specialist locations. The ability to leverage these experiences through social media networks in China is critical for Australian brands to gain traction in the Chinese market. This can lead to a large network of local Chinese consumers promoting these brands via their own social media networks, reviewing sites and re-ordering the same product online delivered to their door upon their return to China.
- Fashion represents a burgeoning opportunity with a handful of iconic Australian fashion labels already active on Tmall and other Chinese e-commerce platforms. Savvy Chinese shoppers are reselling many independent and small Australian labels leveraging the popularity of Sydney and Melbourne's more sought after fashion destinations and laneways. The two major annual fashion festivals in Australia have also courted leading Chinese fashion bloggers, models and Chinese e-commerce giants in recent years and this coverage has had positive knock-on effects in China.

Observations about foreign businesses

As the largest retail market in the world, it is no surprise that China is more advanced in the e-commerce market than arguably any other market in the world. The growing millennial and middle-class consumer base with greater disposable income continues to propel lower tier cities into the 'first-class opportunity' spotlight. The e-commerce market is a valuable opportunity for foreign businesses to access significant untapped market potential as these cities mature and the appetite for Australian products, often seen to be premium, grows.

The 2019 Westpac Australia-China Business Sentiment Survey Report indicated that 30.3% of Australian businesses have a China e-commerce strategy in place, with another 29.4% planning or actively developing a stratey. In a landscape where mobile-first consumers are easily tempted by redefined customer experiences, retailers must be innovative to stay ahead of the curve. To this end, there has been a substantial uptake in the use of a variety of e-commerce channels beyond WeChat, including Alibaba, JD.com and through the daigou community.

e-commerce in China is forecast to exceed USD$140 billion by 2021

The caveat to this enormous growth and opportunity is that the Chinese e-commerce market is extremely competitive and foreign businesses must be creative and flexible to stay relevant in this constantly changing market. The fluctuating and unpredictable changes in government regulation also present a very real challenge to foreign businesses.

In addition, relations between Australia and China at a political level continue to bear heavily on Australian companies prospects flourishing in the Chinese market. Whilst Australian companies appear to be more upbeat about their prospects in China compared to companies based in the US and Europe, over half of foreign businesses operating in China perceive unfair treatment compared to domestic competitors.

Trends and changes in the e-commerce space in China

Growing cross-border e-commerce

The market size of cross-border e-commerce in China for 2016 was USD$78.5 billion and is forecast to exceed USD$140 billion by 2021.

Drivers of this growth include a trusted digital payments infrastructure, an increase in the number of Chinese travelling abroad and gaining exposure to international brands and products, and concerns relating to consumer and food safety in China. Key product categories such as baby products, health and nutrition, beauty and organic food products from foreign businesses continue to be held in high demand by the Chinese consumer.

Increasing rigorous regulatory landscape

Regulators in China are implementing an increasing number of regulatory requirements on cross-border e-commerce sales which have had a direct impact on foreign businesses operating in the Chinese market.

These regulations will require foreign businesses to comply with a stronger compliance regime in particular with respect to the use of daigou and IP protections.

An important change in the regulatory regime governing imports of foreign products through e-commerce channels is that daigou will be required to register as e-commerce operators and acquire licenses in both China and the country where they purchase goods. This means that all daigou purchases will now be subject to taxation in China.

Daigou have traditionally made up a significant proportion of imports into China of Australian goods as a result of e-commerce transactions so this new regulatory measure will impact upon the way in which foreign businesses engage the daigou as a tool for their e-commerce business in China.

Chinese customs have noted that they will take a stricter approach on undeclared parcels which have traditionally been sent by daigou. This measure is targeted at ensuring all cross border e commerce purchases are subject to Chinese taxes. However foreign businesses that have relied heavily upon daigou as part of their e-commerce strategy should be aware of the impact this measure may have on the flow of goods between Australia and China through daigou.

The new Chinese e-commerce law will also hold e-commerce platforms jointly liable for the actions of their online sellers. There will now be joint liability for sale of counterfeit and copycat merchandise online which will require foreign businesses to be more active in the way in which they sell their goods in China.

- The new law places joint liability on platform operators and merchants for selling counterfeit and copycat merchandise on their websites. Previously, only individual merchants were liable for such conduct.
- The new law applies to e-commerce platform operators, third-party merchants who sell goods and services on others' e-commerce platforms, and online vendors operating their own websites or network channels.
- All merchants selling online in China will need to register for an online selling certificate to be displayed in their online store.

Sustainable packaging

Chinese consumers received nearly 1.9 billion packages within 10 days of the Double 11 shopping festival on 11 November 2018. The excessive packaging materials have contributed to China being the leading producer of waste and this has been raised by the Chinese government as a concern.

As a result, the Chinese government is now actively promoting the development of sustainable packaging to lower the carbon footprint of the industry.

Foreign businesses should be aware of the Chinese government's approach to packaging.

What does this mean for foreign businesses?

Online channels account for less than 10% of sales for almost half of foreign businesses.

Despite the increasing regulatory challenges and complex bilateral relations, the majority of foreign businesses are optimistic about the future of Chinese e-commerce sales.

Key takeaways for foreign businesses:

- Cultivate good relationships with e-commerce platforms.
- Implement robust intellectual property protections.
- Look beyond major capital cities in China.
- A variety in product choice is valued.
- Consider how to reduce excessive amounts of packaging and plastic waste.
- Think about unique and trends opportunities in order to leverage brand Australia and increase your e-commerce sales in China.

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