

China: Country Analysis

Foreign Direct Investment Policies

The standard tax rate for foreign companies is about 25%, but this number can be lowered if certain requirements listed by the government are met. There tends to be more tax breaks for smaller companies or industries that China wants more of like the Industrial industry. Due to the tax treaty that the U.S. and China have with each other the threat of double taxation is eliminated. Also tax breaks seem to apply more to leading China owned industries. The available market in China would make the tax rates acceptable for certain companies looking to set up in China. Many of the leading industries require companies looking to do FDI to form a joint venture partnership with another Chinese company. Other industries may even require Chinese control in order to set up in the country. This would mean that the company involved in FDI would lose a lot of the freedom they would normally have and lose control over the quality of their product which in turn could hurt their reputation.

The intellectual property laws do not protect FDI companies very well either and the laws are lacking at best. This could lead to the company's ideas being stolen and sold at a cheaper rate, costing sales. It also takes awhile for the required paperwork, licensing, and permits to be passed and signed by the government giving domestic industries time to acquire a large portion of the market before FDI companies can set up completely. This is a non-transparent process that leads to non-written conditions that support domestic markets. Many believe that corruption occurs during this part since it is a deal specific process and it appears that it is used to improve domestic firms. There is a foreign investment negative list which means if a company is wanting to invest in an industry that is not on that list then they can skip the pre-approval part of the

registration process. Companies are still dissatisfied by this since it does not offer much and they want China to do more for FDI. China is a member of the WTO and is still one of the largest countries for FDI. China has made promises that it will be making FDI easier for countries in the future, but they have not done much yet. These conditions seem to put any companies who want to use FDI at a disadvantage in China, but the market size of China alone makes it a very desirable deal since it can quickly grow your market and be worth the risks and complications. If there is a market segment that has yet to be reached in China then it would be advised to go there, but if not then wait until China improves their regulations on FDI since the system puts the advantage in the hands of the domestic industries and hinders that of the foreign. (Felton, "China - United States Department of State", 2019),

Exchange Rate Determination

One Chinese yuan is equal to 0.14 U.S. dollars. China has a managed float exchange system. The currency in China is not volatile at all with less than 1% over the past month and 5 months. There is not a way to minimize the financial risk since the government controls it so tightly. The best option is to look at the country politically and look out for potential political changes that could make the exchange rate begin freely floating. Also monitor China's major trading partners and see how their currency changes since that influences China's foreign exchange market the most. This system has been in place since 2005 to keep their exports cheap. China does this by pegging their currency to the American dollar and other countries in their basket of countries that are major traders with China. They peg this to the U.S. dollar at a daily reference rate that is allowed to fluctuate at a fixed band of 1% set in 2014. Due to China's major

economic growth and their government's efforts to keep the yuan from rising in value, it has caused the yuan to become undervalued. This undervalue of the yuan is used to keep China competitive in the China and U.S. trade war. If China were to allow its currency to float freely then it would appreciate significantly. There is a high amount of macroeconomic stability since China's government makes sure nothing happens to their currency value by regulating it. China's economic stability is expected to stay stable like it was in the past and still is in the present. A firm should be aware that this type of foreign exchange system is unlikely to change unless a major political event were to happen. (Picardo, "Why China's Currency Tangos With The USD", 2019)

Culture Complications

China has a very different culture than compared to the U.S. which can make it harder for U.S. companies to be successful when engaging in FDI. China has a very high-context language which means that only about a third of their message is spoken to you and the rest is given through body language or social standing. China has an emphasis on collective culture which differs greatly from the U.S. focus on individualism where China wants what is best for the group rather than just the individual. China's culture also is set on respecting elders and people in higher positions of power without questioning their authority. All of these cultural differences can make it difficult for a U.S. company to set up in China. Also doing business can be difficult since Americans may miss some of the message due to China using a high context communication. Likewise, Chinese may get confused since Americans use a low context communication making the message too long. China is a relationship oriented culture where the

U.S. is a task oriented one. This means that Chinese businesses care more about keeping the relationships they have established even if it does not get them the most money or make them the most efficient. Chinese companies also show importance in protecting “face”, meaning that you should provide gifts, learn the language and culture, and never protest a partner’s idea directly. There are also many cultures within China that differ from one another. When learning the “standard” culture you must know that this will not apply to all and to be aware that differences exist like they do here in the U.S. China prefers to plan for long term goals instead of short leading their country to one of the highest saving rates.

There is no separation of work and home in China. Although Americans do not like to blend both their personal and work life it is not uncommon for people in China to conduct business at a casual dinner at each other’s houses. Technology is also a major difference between the countries. The U.S. likes to send emails where China sends text messages when talking about business. This could potentially confuse each other if the U.S. company does not adapt to the Chinese culture on communication. The U.S. company looking to do FDI in China should make sure that they do their research into the many different cultures and the culture where they are wanting to set up in. Also getting a good understanding of the language so that they can respectfully communicate with the local community and businesses will go a long way in conducting business. Hiring Chinese workers can help adapt your company to the Chinese culture and help the company build relationships easier. (Gao & Prime, "Facilitators and Obstacles of Intercultural Business Communication for American Companies in China: Lessons Learned from the UPS Case", 2010)

Economic Structure and Performance

China began allowing the use of privatization around the year 1997 since their state owned organizations, (SOEs), experienced a net loss in 1995. This loss gave room for the Chinese government to acknowledge the privatization of companies as a good thing to do in the eyes of communism. From 1998 to 2007 the number of SOEs was reduced by around half from 238,000 to 116,000. Most of the SOEs that were sold were the smaller ones where the major firms are still owned by the state. These new owners of the firms were mostly the old managers of the state owned ones. Although it may seem that China has lessened up on their SOEs, the reality is that the government does an extensive interview process to see if the company is even eligible for a management buy out (MBO) to make it a privatized firm. Although China does have some form of an MBO the government still plays a major role in the business and privatization process. (Chin, "Privatization and Productivity in China", 2018).

China's logistical capability is slowly increasing due to investments into China's highway system to make it more efficient. Due to its rising economic growth, however, China is struggling with clogged ports and traffic jams. The logistics is 66.2/100. China is also experiencing a rapidly increasing rate of cybercrime due to low security. This low general security makes organized crime prevalent in their country allowing for it to potentially interfere with business transactions. This increase in crime also has implications to the corruption of the government in the country. The police and officials are prime targets for such bribes. This amount of criminal behavior and bribes leads officials to corrupt practices which can influence a business greatly. The crime and security is rated 47.3/100. (Chehab, "China Country Risk Report", 2019).

The education in China is on the rise now since their economic growth has led to many students pursuing higher education in high demanding fields. China is actually the top producer of university graduates in high demand fields. This can lead to FDI companies not needing to import labor since China has a large supply of skilled labor. This has also led to an increase in the cost for unskilled labor. This in turn is diminishing the number of unskilled labor in China which is a major reason many companies came to China in the first place. This leads to China being a less attractive investment if the primary reason is cheap unskilled labor. The wage rates have also increased from around 30,000 yuan to around 80,000 yuan. The labor market is rated 53.8/100. (Chehab, "China Country Risk Report", 2019).

More than 70% of China's rivers and lakes are polluted due to its rapid economic advancement. 24% of China's top layer of water is unusable even for use in industrial settings. Water shortages are also a major issue since the rapid urbanization of China. The pollution in China's cities has gotten so bad that people have started violently protesting pollution and the forced clearing of land to make way for industries. Despite China's government knowing the risk to further economic growth they are ignoring implementing environmental regulations due to certain interest groups and the corruption in the government. With going green becoming such a strong image that consumers look for it is hard to justify FDI since your costs will already be initially above that of a local company and if the company was to try and be green then they would be under a severe disadvantage in costs to companies that used more pollutant practices. The lack of laws against environmental safety is leading to rebellions and protests which can make doing business in China potentially dangerous. (Chehab, "China Country Risk Report", 2019).

The GDP growth in China is expected to start decreasing while the GDP per capita is expected to increase by nearly double by 2028. These changes are most likely due to the fact that China's growth rate is dramatically going down as their massive population are reaching their older years and they do not have as many children being born. Their economic growth was also at an incredible rate for such a long time that eventually it will have to go down unless some major precautions are made. The leading lending rate in China is 4.35% and it has been this way since 2015 which predicts it will not be changing in the near future. (Chehab, "China Country Risk Report", 2019).

International Trade

The main countries that China trades with as far as imports and exports is Europe with 18.3% of exports going there and 16.6% of imports coming from there too. Now this is a basket of countries compared to individuals, so the highest individual countries for China's exports are Hong Kong and the U.S. with 17.4% going to Hong Kong and 16.7% going to the U.S. For imports South Korea, Japan, and the U.S. are the leading in China's imports with 9.4%, 8.3%, and 7.8% respectfully. The main exports of China are electrical machinery and equipment at 25.4% of all exports being that. Nuclear reactors, boilers, and machinery being at 17.3% and textiles being at 12.4% of all exports. China's main imports are mineral products at 24.1% and electrical machinery and equipment at 22.5%. (Chehab, "China Country Risk Report", 2019)

Tariffs are likely to increase between the U.S. and China due to the current trade war going on between the two countries. This type of tariff will be a tit-for-tat tariff to respond to each other. Due to this trade war more non-tariff barriers are expected to emerge from China.

There are many licensing requirements for an FDI firm to set up in China and it is a lengthy and favorable for domestic firm process. China does have a quota depending on what type of industry you are planning to get into as far as how many domestic workers must be included in your firm to secure domestic power for China. If the goal of the company is to sell to the U.S. from China the FDI is highly discouraged as the increase in future tariffs will make the move more costly in the long run to the organization. (Chehab, "China Country Risk Report", 2019)

Social and Political Stability

In the past social stability in China was easily managed due to their high GDP growth rate, but as of present the stability has been threatened. The GDP growth rate needs to be at 8% to maintain China's social stability, however, China has given up on this number since it appears to be unrealistic in the future due to the growth rate in China shrinking. According to Fitch solutions China's political risk index for the short term is 80.2 while long term is 66.4. This is very concerning for a business wanting to set up in China since this level of risk could lead to a worst case scenario of a total change in power. China's government is about to be challenged due to all the upcoming problems they face. China is also suffering from a rise in inequality and due to the recent reveal that China's elites are gaining a lot of their money from corrupt politics, the people are getting angry. There are also poor working conditions in China where the people are starting to protest. The best case for China is to begin a move to become a more democratic state which over the years could stabilize and begin to carry on their rapid growth, but due to their size there is no telling if this will work or not. The worst way this can go is a full military crackdown due to political unrest. No matter how it turns out there is no quick fix to China's problems and

this will likely take years to get them back on track. (Chehab, "China Country Risk Report", 2019)

Final Recommendations

A joint venture or licensing company specializing in high end industries such as technology and machines is the best chance to survive in China due to their culture needing you to have relationships to do business in their country effectively and the requirements to have domestic workers involved anyway. With the current political situation, the best option would be to wait a couple of years to see how China is going to handle its current problems. This way you do not lose your investment if things turn bad in the country. Also trade with the U.S. which is one of China's major exports is about to have an increase in tariffs and other trade barriers due to the trade war. Now is not the time for a move to China, but intensive monitoring to see how China is heading in the future is required. If China is able to pull away from these problems on top then an immediate investment would be advised since China has a fifth of the global market and still has room for more competitive brands.

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