



Licensing Challenges and Best Practices in China

January 2014

Executive Summary

- Licenses and approvals are essential to doing business in China, as in any other market, and present significant challenges for manufacturing and services providers operating there. For foreign companies invested in China, the process of expanding manufacturing operations remains particularly difficult. This report reviews companies' experiences when expanding their operations in China.
- Members of the US-China Business Council (USCBC) have continually raised the issue of administrative licensing in USCBC's annual membership survey. In USCBC's 2013 survey, members ranked administrative licensing as their third most significant concern in the China market.
- Lack of transparency in the licensing process creates some of the most prevalent challenges in China's licensing process, particularly in relation to documentation requirements, regulatory implementation, and procedural timelines.
- Requirements to disclose potentially sensitive company information in order to secure licenses – and the corresponding risk of intellectual property theft – are another notable concern. This concern was particularly strong for disclosure requirements during the course of expert panel reviews that take place at multiple stages in the licensing process.
- Throughout the licensing process, local governments frequently recommend domestic third-party firms to consult or manage different aspects of companies' domestic licensing. Such recommendations often present compliance and approval challenges and can be difficult for companies to mitigate.
- To help manage the licensing process, interview respondents suggested that companies should establish strong relationships with local government officials involved in the licensing and approval process. Respondents also recommended that companies should make clear to officials at a project's outset what information companies are – and are not – willing to disclose. To aid in this, companies may also consider creating internal decision-making structures to help manage requests for sensitive information when they arise. Other licensing best practices are detailed in the full report.

Introduction

For companies seeking to operate and expand in China, as in any market, numerous permits, approvals, and reviews are required before they can proceed. From selling products to creating new manufacturing facilities, these processes – often referred to generally as “administrative licensing” – are necessary steps to invest, expand and conduct commercial operations in China. While administrative licensing is a common process worldwide, China's extensive, complex, and at times onerous licensing system at the central, provincial, and municipal government levels often results in significant delays, added costs, and lost revenue, while also creating reluctance among some foreign companies to increase investment in China.¹

According to the US-China Business Council's (USCBC) annual member company survey, licensing remains a perennial problem in China. In USCBC's 2013 survey, members ranked administrative licensing as their third

¹ In USCBC's 2013 Membership Survey, 33 percent of respondents stated that Chinese regulations mandate different treatment for domestic enterprises in China, while 52 percent of respondents said domestic competitors were not experiencing the same licensing problems as foreign companies. “USCBC 2013 China Business Environment Survey Results: Tempered Optimism Continues amid Moderating Growth, Rising Costs, and Persistent Market Barriers.” US-China Business Council, October 2013. <http://uschina.org/sites/default/files/USCBC%E2%80%94942013Member%20Survey.pdf>

most significant concern in the China market. Prior to that, administrative licensing has ranked as the first or second greatest concern each year since 2006. That licensing has fallen in rank since 2010 suggests China's efforts to address licensing-related issues may be having some effect in improving the licensing system; however, that the issue has remained one of companies' top three concerns indicates that the situation has not improved significantly.



Licensing can include an array of approvals and processes, including product approvals, import licenses, operational licenses, and even residence permits. While application procedures, required documents, and timelines may differ somewhat from process-to-process and industry-to-industry, many of the challenges that companies face and the best practices to address these challenges and obtain the necessary licenses are similar. Thus, this report does not seek to document the problems and best practices for every licensing process that a company may face, but uses select processes and company examples to illustrate how companies might seek to overcome licensing hurdles.

To identify some of the most prevalent problems in China's licensing system, USCBC interviewed 19 member companies in August 2013 to discuss their experiences with the licensing process when expanding their manufacturing operations in China. This report is based on those interviews.

China's Administrative Licensing System

China maintains an array of procedures and requirements that companies must meet before establishing or expanding their operations, or before selling their products in the market. Most, but not all, of the rules governing this process are laid out in various legal documents pertaining to certain licensing processes.

Since 2001, the Chinese government cancelled or delegated to lower level authorities 2,400 approvals.² The government has since indicated there will be additional work to decentralize and streamline existing administrative approvals as well as to limit new administrative approvals in the future. More recently, the State Administration of Industry and Commerce announced reforms to the business registration system by eliminating some capital requirements for establishing a new company.³ Central authorities have also indicated administrative reforms will continue and most investments not related to national security, the environment, strategic resources, and public interest will no longer need to undergo government approval.^{4, 5} Though these changes have been welcomed by USCBC companies, some note that these decentralizations have primarily benefited domestic companies. Further, while these developments are important steps, depending on implementation, many significant challenges in the licensing process have yet to be addressed.

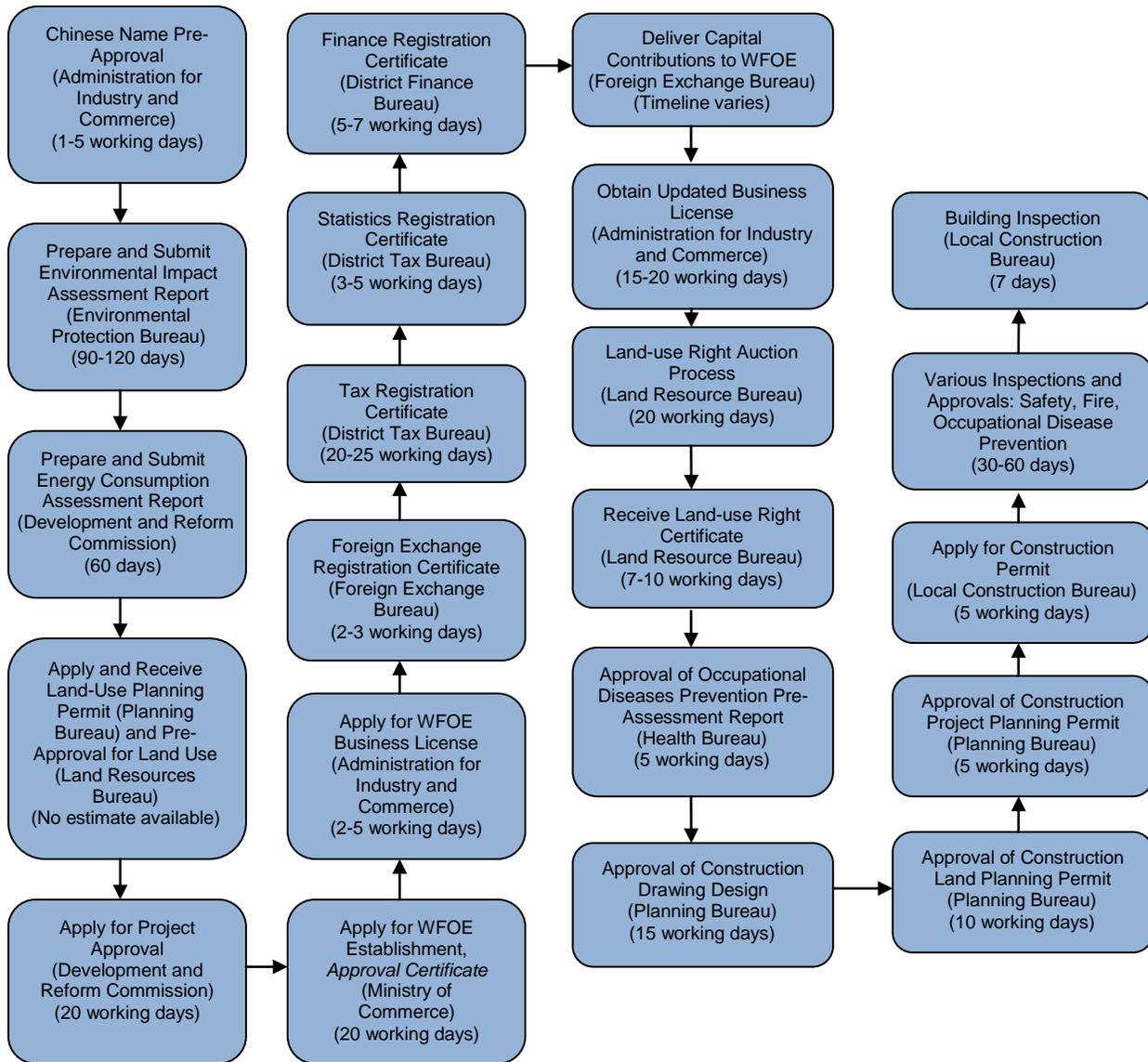
² "China Cuts Government Intervention to Push Reforms." April 27, 2013. http://usa.chinadaily.com.cn/china/2013-04/27/content_16454676.htm

³ CPC Central Committee's Decision on Several Major Issues in Comprehensively Deepening Reform. Third Plenum of the Eighteenth China Communist Party Central Committee. November 15, 2013.

⁴ "SCLAO Holds Press Conference on November 7 to Introduce Reforms on the Business Registration System." State Council Information Office. November 15, 2013. <http://www.scio.gov.cn/xwfbh/xwfbfh/xczb/index.htm>

⁵ "CPC Released the Decision on Major Issues Concerning Comprehensively Deepening Reforms on November 15." November 15, 2013. http://www.gov.cn/jrzq/2013-11/15/content_2528179.htm

As an example, companies seeking to establish new or expand existing operations in China must go through a lengthy and complex system of approvals, permitting, and government engagement that requires extensive time and resource allocation. The process requires going through multiple agencies and bureaus, depending on the size, scope, and location of the project. The outline below represents the general process and time estimate for companies to establish and construct a wholly foreign-owned (WFOE) manufacturing company in China:



Source: Sidley Austin; Timelines are estimates

While the expansion process is similar from region-to-region in China, the majority of companies interviewed for this project said they found the process runs more smoothly in China's more developed eastern provinces than in western provinces. Local officials in western China generally have less experience in dealing with licensing processes and with multinational corporations (MNCs) seeking to invest. As a consequence, companies said they prefer to invest in eastern China, where investment authorities are more experienced and generally have more sophisticated licensing and approval processes.

USCBC's interviews revealed that during the expansion process, companies frequently encounter problems in five broad areas: Transparency, expert panel reviews, disclosure requirements, third-party consultant recommendations, and licensing associated with joint ventures.

Transparency

Transparency in administrative licensing – or applicants' ability to easily apply, monitor, and determine the status of their application -- frequently contributes to procedural delays and creates uncertainty for companies engaging in the licensing process. To complicate matters, transparency varies from region to region, and among different branches and levels of government, according to company interviews.

For USCBC companies, transparency has remained a top concern, both in the context of licensing as well as more broadly in regulatory development and enforcement. In USCBC's 2013 member survey, companies ranked transparency their eighth most significant concern in the China market; transparency has remained one of USCBC companies' top 10 concerns over the past seven years.

This section will review three key ways that lack of transparency is problematic for companies engaging in the licensing process: unclear documentation requirements, inconsistencies in regulatory implementation, extended approval timelines, and insufficient procedural transparency.

Lack of Clarity in Documentation Requirements

Companies seeking to expand their manufacturing operations in China are required by central and local governments to submit various legal and planning documents. The list of required documents typically varies by region, and companies typically have to carefully review local government websites to understand which documents different regional governments require in the licensing process.

Documentation and procedures for licensing and approval processes are often made available through public sources, such as government websites. However, companies noted that the information provided on these websites is often found to be inaccurate, vague, or incomplete. For example, several companies cited cases in which local government websites list a set of standard documents that companies are required to submit. The websites also specify a general requirement that companies submit "other" documents, but frequently do not clarify what comprises "other" documents. In such cases, companies had to engage directly with local governments to understand what documentation is required in the licensing process.

Companies also raised concerns about the lack of detail in disclosure requirements. In many licensing processes, companies said there are documented requirements to disclose certain information related to the new project, but the amount of detail required in the disclosure is vague. This makes it difficult for companies to know how much information is required to avoid lengthy delays caused by insufficient applications. Additionally, vague requirements lead to different regulator interpretations of the same requirements, at times making the application process different each time companies apply.

By not listing clearly or fully the documents required to invest in a locality, company representatives are required to engage with government officials to learn what is required in the licensing process and then take the time to prepare final documents for submission. This creates delays that cost both government officials and companies valuable time and resources. These delays can ultimately reduce valuable investment, jobs, and production in the region, as they hamper companies in their attempts to launch new operations and hire local employees.

Inconsistencies in Regulatory Implementation

There are also inconsistencies in local governments' interpretation and implementation of regulations related to licensing. Even if there are clear rules in place at the national, provincial, and local levels, inconsistencies in implementing these rules within and between government agencies adds time and cost to the licensing process.

Companies described several instances in which differences in local governments' interpretation of regulations created challenges in the licensing process.

As an example of such inconsistencies, one company interviewed was required to gain approval of its documents from the Ministry of Commerce (MOFCOM) and then take the approved documents to the local Administration of Industry and Commerce (AIC) for review. When the company approached the AIC, it was told it needed to amend one of the documents. The company was hesitant to change the document, which had already been approved by MOFCOM. The company believed that any changes made to the document would need to be reviewed again by MOFCOM under the law. The AIC insisted the company would not need to send the document back through MOFCOM for a second review. After repeated conversations with the AIC and MOFCOM, MOFCOM permitted the changes to be made and confirmed that the document would not need to go through a second review. The company was later informed by the AIC that it did not need the revised document after all.

This example indicates how insufficient transparency and inconsistent interpretation between and within government agencies can foster uncertainty and ambiguity for companies operating or expanding in China. Generally, companies interviewed said they were unaware of the reasons as to why local governments interpreted policies as they did, leaving the company struggling to quickly work with officials to mitigate differences between government interpretation and company strategy.

Extended Approval Timelines and Insufficient Procedural Transparency

While central and local government regulations provide official timeframes for various steps in the licensing process, the majority of companies found that those timelines differ greatly from what occurs in practice. Several companies said that their project timelines ran anywhere from four months to one year or more past the published, public timelines. One company remarked that making a project timeline is often futile, since projections are always wrong, no matter how prepared a company is. This overall lack of certainty creates an ambiguous investment environment that can cause significant revenue loss and project delays, and one that could, ultimately, inhibit foreign investment.

In addition to these problems, several companies also described a lack of transparency in the government's review of their project-related applications. In some cases, companies that submitted all required documents to the local government for its review and approval and expected a relatively smooth licensing process, but still experienced delays. To try to mitigate these delays, some companies have resorted to developing their own methods to gain more insight into the status of an application. For example, one company that sought to find out the reason behind the delay in government review of an application dispatched an employee to wait outside the local government offices to try to locate key officials overseeing the review of their application during their breaks.

Still, another company suggested that government officials may be reluctant to disclose the reason for procedural delays because such transparency could give companies the ability to challenge those reasons. Instead, the government may be more likely to attribute delays to official vacations or misplacement of a company's application.

Companies also raised similar concerns about the process at the national level. Projects over a given investment value threshold in some industries are required to be approved by central-level authorities.⁶ Despite challenges that exist at the local level, several companies noted that local authorities often appear more willing to help companies through the licensing and investment process, as they understand the direct benefits the project will have on a given region. Comparatively, central level authorities may have less motivation to help companies move through the licensing process. Due to such factors, one company remarked that it does everything possible to avoid seeking central government approval of a project and will keep projects under certain thresholds that automatically trigger central government-mandated review.

⁶ "Foreign Investments in Restricted Industries." *China Business Review*. January 1, 2013. <http://www.chinabusinessreview.com/foreign-investment-in-restricted-industries/>

As an example of the problems that can arise from such lack of clarity, one company noted that it experienced significant delays in the licensing process when it sought to change the company from a joint venture to a wholly-foreign owned entity. In the process, the company submitted its completed application to a central-level agency for its review and approval. However, the company waited more than six months to hear back from the agency on the status of the application; the reason for the delay was not explained. In order to make progress, the company sought meetings with the agency to engage them directly and gain approval for their application. The agency agreed and met with the company. In the meeting, the agency attributed the delay in approval to personnel changes. After the meeting, the agency quickly approved the application.

The lack of clarity about approval timelines routinely affects how US companies operate in China. When regulatory systems are unpredictable, companies are unable to develop accurate timelines or budgets for their new investment. In addition, if companies are unable determine the causes behind approval delays, they are less able to prevent such delays when investing in the future. Thus, companies and government both benefit when transparency is a fundamental component in the licensing process.

Managing Insufficient Transparency

To help manage the lack of transparency, companies emphasized the importance of building relationships with local governments officials overseeing licensing processes in the region in which they are seeking to invest. Establishing relationships with officials involved in the licensing process, as well as those in investment promotion departments, helps foster rapport before investments are made and allows companies time to clarify ambiguities in documentation requirements or licensing processes. As one company noted, it will share with local officials the planned project schedule and alert officials to any expected construction or customs issues that arise. Further, companies noted that it is important to develop relationships with each agency involved in the licensing process – while ensuring compliance with the Foreign Corrupt Practices Act and Anti-Bribery Law – as many agencies are reticent to answer companies’ questions unless they are specific to their jurisdiction. Maintaining close contact with local authorities also provides channels for staff to stay apprised of new or potential regulatory changes and respond or advocate accordingly.

One company noted that sharing information about a project’s expected economic, tax, and employment contributions can help underscore the benefits the project will introduce to the community, and may help to ensure a speedier and more transparent review. Overall, companies can present a compelling narrative about the new jobs and production their investments will bring, which may appeal to local officials and communities alike.

Companies also noted that they seek to provide input on regulations released for public comment to reduce potential conflicts between regulations. Companies are usually very familiar with existing regulations governing their operations or projects, and can help provide insights into how the regulations interact with others, or where clarification may be needed. Further, companies provide comments and feedback through both formal and informal channels, including solicitations for public comment, government meetings with industry groups, and individual meetings with government agencies.

Expert Panel Reviews

Many companies interviewed expressed concern over expert panel reviews and the potential for disclosure of sensitive information during the licensing process. Depending on the size, scope, and type of project, these reviews may occur at several steps in the licensing process, such as during review of a project’s energy conservation assessment, safety assessment, occupational health assessment, project approval, and environmental impact assessment (EIA) report. The panel is typically comprised randomly of five or more experts, who must meet academic and professional qualifications set out by the government.⁷

Expert panels are usually convened to review reports submitted in the course of a particular assessment, such as an EIA report. These reports may contain detailed information on companies’ proposed project, including

⁷ *Law of the People’s Republic of China on Tenders and Bids*. Article 37. January 2000.

project economics, major unit operations, equipment lists, equipment specifics, capacity, and raw material and energy use.^{8,9} Members of expert panels are to be chosen randomly from a database of experts compiled by relevant authorities; in the case of an expert panel for review of an EIA report, the Environmental Protection Bureau would be the relevant authority. The expert panel examines the company's report and submits a written opinion based upon its review. According to interview respondents, a company will likely exchange several rounds of comments with the panel to address any concerns that the panel may have over the company's report.

Companies shared many concerns over the expert panel review process. While many of these concerns were raised in regards to the EIA, the concerns are germane to all types of expert panels reviews used in China.

Several concerns that companies raised include:

- Nomination of competitors as experts and potential conflicts of interest on expert panels,
- Companies' inability to suggest or dispute expert nominations, and
- The broad range of documents required for inclusion in the report and for consideration by the expert panel.

Problems with the Expert Panel Review Process

Companies expressed strong concerns about the government's authority to nominate Chinese competitors as experts to the review panel. Reports submitted to review panels often include detailed documentation requirements about project costs and revenue, capacity and equipment information, raw material and energy requirements, and other sensitive details about the operations. Other types of licensing processes may contain similarly sensitive company, product, or process information. For companies, this information is sensitive in itself, and providing such information to anyone outside the company – including competitors and government officials – is extremely problematic.

Foreign companies have no formal input on the composition of the expert panel, nor is there a method to dispute panelists. Furthermore, there is often very little room to negotiate what information is disclosed. Consequently companies frequently must make difficult decisions on how to address and mitigate the risks arising from experts' requests for information, or even whether to proceed altogether. For more information on managing disclosure requests, see the "Disclosure" section in this report.

Companies also noted that competitors named to the expert panel may use their position to gain access to proprietary information from companies undergoing the review. Some companies said that competitors named to the panel may request companies' trade secret information under the auspices of the review, even though the requested information may not be pertinent to the subject under consideration. Given that the scope of the panel's review can be vague, experts have broad authority to request sensitive documents from companies. In this way, expert panel reviews introduce significant liability for companies seeking to safeguard their trade secrets. Further, as there are no clear requirements to destroy sensitive information disclosed in the review process, companies face the possibility that their trade secrets will be exposed long after the review is concluded.

Companies also noted a variety of other problems that arise in the expert review process. For example, companies are often required to pay travel expenses and per diem fees for experts involved in the review. Further, companies noted there are no clear guidelines as to what these travel costs should be. One company USCBC interviewed noted there are no regulations indicating what per diem fees should amount to; rather, the company based these fees on its own "common sense" estimates.

The requirement that companies pay for travel expenses not only raises costs for companies engaging in the licensing process, but it also presents challenges with internal compliance guidelines and puts member companies at risk with regards to regulations under the Foreign Corrupt Practices Act.

⁸ *Classified Directory for Environmental Management of Construction Projects*. Ministry of Environmental Protection. September 29, 2008. http://english.sepa.gov.cn/News_service/Photo/200809/t20080926_129454.htm; see also *Law of the People's Republic of China on Environmental Impact Assessment*. October 28, 2002. http://www.china-eia.com/en/policiesregulations/1_awsregulations/4659.htm

⁹ *Law of the People's Republic of China on Environmental Impact Assessment*. Article 13. October 28, 2002. http://www.china-eia.com/en/policiesregulations/1_awsregulations/4659.htm

Companies related several anecdotes illustrating the challenges presented in the expert panel review process. After one company submitted its EIA report, the local government named a competitor to the expert review panel reviewing its report. The expert was a vice president of a domestic company in the same sector as the company that was seeking approval. The competing executive made clear that he wanted a stake in the company's new project. To try to persuade the company to agree to his demand, he began questioning different parts of the project from his position on the panel to prolong the process. The company was ultimately able to manage the expert's request, though the project timeline was delayed in the process. This example suggests companies may often need to manage expert panelists' requests, since there is no formal dispute process for individuals selected for the expert panel.

The liabilities introduced by expert panel reviews – ranging from information disclosure to compliance concerns – introduce serious risks for US companies seeking to invest in China, with implications for China's longer term attractiveness as a place to invest. These panels require companies to turn over sensitive information – which may be unrelated to the issue under review – and may expose companies' trade secrets to competitors. Further, these reviews may needlessly extend the licensing process, due to experts' unfamiliarity with the process or for other motives, costing companies both time and resources and delaying the many economic and social benefits companies' investments bring to local communities. While companies seek to comply fully with Chinese regulations and work with governments to provide necessary information, they are also committed to protecting sensitive business information. When companies determine that the risks introduced in the panel review process become too great, companies may refrain from bringing innovative technologies or operational processes to China.

Managing Expert Panel Reviews

Companies suggested that maintaining strong relationships with local governments could help influence which experts are nominated to the panel. Once panels are comprised, companies noted that identifying experts who are knowledgeable of the industry or sector and who have sound grasp of the processes or technology under review can help facilitate the review process by clarifying misunderstanding, maintaining the panel's focus on the issues under consideration, and offsetting any negative views held by other experts towards the company. For example, one company noted that it was able to recommend an expert to the panel considering its EIA, which helped counter the influence of another expert who was openly hostile to the company. Such experts can also help reduce requests for sensitive information and information that is unrelated to the process or operation under consideration, while facilitating a more timely review.

Further, companies may also be able to work with local governments to clarify misunderstandings that may arise on the expert panel. As one company noted, the expert panel reviewing its energy-consumption assessment calculated energy utilization in a way that would make the company's operations noncompliant with government energy quotas. To clarify the company was in compliance, it reached out to the local energy authority, which in turn drafted a letter to the panel stating that the company was in fact compliant with the requirements.

IP and Disclosure Issues in the Licensing Process

One of the many requirements for licensing approvals at various levels of government is that companies provide detailed product and process information. These information disclosures often put sensitive intellectual property (IP) at risk of leakage to third parties, competitors, or officials during the approval process. These concerns are not new, and have been a key issue for USCBC members over the years, including in USCBC's recommendations for strengthening trade secret protection in China.¹⁰ Given the pervasiveness of IP theft, it is understandable, although perhaps unlikely, that some interviewees viewed the entire permitting and approval processes as being specifically tailored to obtain confidential details of proprietary processes.

Companies indicated that approval processes in China are significantly less clear and objective than they are in other markets, such as the United States. This leads to the disclosure of sensitive information that is typically not

¹⁰ "Recommendations for Strengthening Trade Secret Protection in China." US-China Business Council. September 15, 2013.

required in any other location where a company operates. One company said that in its application for a safety assessment it was required to provide specific temperature and pressure information of machinery used in the production process, which it considers to be trade secrets. In every other country where the company operates, it only needs to provide a range for pressure and temperature information.

Due to the amount of data companies are required to provide in the licensing process, it can be a significant time and cost burden simply to gather the information – and even more of a problem for staff to review potential submissions to discern how to ensure compliance while also minimizing the risk of providing sensitive information. This leaves companies to make difficult decisions as they have to manage applications submission-by-submission, at a sizable cost of time and resources.

China does not maintain requirements to destroy information that may be provided to the government once the information is no longer needed in the approval process. Other entities involved in the licensing process, such as local environmental or design institutes, are also required by the government to retain a version of the information in perpetuity. Further, regulations regarding the elimination of sensitive documents are very vague, and do not stipulate directly in what cases such documents should be safely destroyed.¹¹

Managing Information Disclosure Requests

While companies may be required to provide information beyond what would be required in other markets, companies interviewed shared a number of practices they have incorporated to minimize disclosure of sensitive information while also respectful engaging with government authorities.

- **Selectively limiting decision-making authority:** One company said that it emphasized with local authorities that its China office was not permitted to disclose certain information it considers sensitive; only the company's US corporate office is permitted to make such disclosures. Emphasizing this fact early and often in the licensing process helped to manage local officials' expectations of what information the company could provide. Expressing this sentiment reinforced that the company was committed to working with the government agency, though it was restricted by internal guidance from sharing certain information. The company reported significantly reduced disclosure requirements once government officials understood that this was the company's practice.
- **Negotiating what information is made publically available:** The Chinese government is obligated to make certain information in the licensing process publically available at Chinese citizens' request. One company recommended negotiating with the government what information would be publically available from the documents it was required to submit. In negotiations, the local authorities agreed that the company could highlight small portions of the most sensitive information and the government would redact that information from public disclosures. The government was very clear, however, that only a small portion – two to three sentences per page – could be excluded.
- **Signing non-disclosure agreements with local administrative committees:** One company requests that administrative committees within local industry parks sign non-disclosure agreements (NDAs) with the company in preparation for launching new investment projects in the region. By signing NDAs with administrative committees rather than investment promotion bureaus, the NDA has a wider scope of coverage. This conveys the company's commitment to protecting its trade secrets, while helping institute protections to lessen the risk of exposure.

Third-Party Consultant Recommendations

Companies in all industries work with tax, environmental, legal, and many other third-party consultants and agents throughout the licensing process. Depending on the approval being sought, companies interviewed for this project said that local government regulators often recommend or mandate the use of specific third-party consultants. Many companies stated that they had received these types of recommendations when engaging

¹¹ *Administrative Licensing Law*. August 2003. http://www.gov.cn/flfg/2005-06/27/content_9899.htm; *Interim Measures on Project Authorization of Foreign Investment Enterprises*. October 2004. <http://www.china.com.cn/chinese/PI-c/683052.htm>

with local authorities in the licensing process. These recommendations can arise at any stage in the licensing process, including for the EIA report, certain product approvals, and to ensure paperwork complies with local government requirements.

Though companies agreed that they prefer to utilize trusted third parties over government-recommended parties, many companies felt a great deal of pressure to use government-recommended service providers. Several companies noted that if they choose not to use a government-approved entity recommended to them, they run the risk of extended lead times and strained government relations. In the course of USCBC interviews, companies raised a number of concerns associated with hiring government-recommended or mandated third parties, including:

- **Limited vendor selection:** A reoccurring problem raised by companies interviewed was that government regulators do not provide enough third parties from which the company could choose. In one company example the government recommended only one third party for the foreign company to consider, raising red flags for the company.
- **Required use of local vendors:** In some cases, a company may be strongly discouraged from or not allowed to use their preferred vendor. In one case, a local government official informed the company that their preferred supplier “lacked local experience and presence.” While not outright forbidding the company from utilizing their preferred service provider, the foreign company felt that if it did not use a government-approved vendor, the licensing process would not proceed smoothly.
- **Inadequate skills for recommended third parties:** Recommended third parties may not possess the necessary knowledge or technical skills to satisfy the standards of the foreign company. One company shared the example of an agent they employed to obtain a manufacturing license. When the company provided the agent with technical information to formulate the appropriate application documents, the agent indicated he was primarily there to ensure interaction with the government went smoothly and would have limited engagement on technical details.

One company shared that – despite its years of experience in China -- it was required by the local government to employ a recommended agent to assist in paperwork preparation. However, the company discovered that the agent acted primarily as a courier; once a company prepared its paperwork, the agent then provided it to the government. The local government refused to accept submissions from the company directly, adding additional costs for the company.

Overall, these types of recommendations create added costs and delays for companies engaging in the licensing process. Companies that feel they must hire recommended firms must budget added time and resources for due diligence investigations. Further, as several companies interviewed for this project found, local consultants may not actually be familiar with the type of licensing process in which the company is engaging. Finally, these recommendations inhibit capable international firms from contributing knowledge and skills in China’s market, and from facilitating timely licensing reviews for both Chinese and domestic companies.

Managing Third-Party Recommendations

Third-party recommendations create significant challenges for companies engaging in the licensing process. For example, many foreign companies require strict due diligence review before working with any third party with which they have not worked previously. These firms also observe a variety of practices to ensure the third party is compliant with international regulations. Risk assessments, background checks, and audits are all methods a company can use to evaluate the risk posed by partnership with a third party. Some companies expressed concern that carrying out due diligence on a government-recommended third party might offend government officials. This risk can be minimized by stressing early and often that the company is obligated by global best practices to conduct due diligence on any new third party with which it works.

While some companies felt they had to work with the third party, at least one company chose to use its preferred firm to conduct the majority of the consulting work, and then have the local entity submit the final documents to the government. For companies who did not take issue in working with local partners but wanted the government to recommend more than one entity, several companies negotiated with the authorities to share

additional local entities that could assist in the licensing process. These types of solutions helped companies appropriately respond to requests to use recommended third-party service providers while maintaining their relationships with local authorities.

Licensing Challenges in Joint Ventures

Joint ventures (JVs) – either majority- or minority-owned – add a layer of complexity to company licensing and approvals in China. Companies operating in industries – such as the automotive industry – are required to operate in JVs to sell products in China. While companies are familiar with the challenges of operating in a JV, one of the benefits companies cite is the close government connections a Chinese partner may enjoy. This relationship can prove valuable in the licensing process; companies said their Chinese partners can leverage their relationships with local government to clarify procedural issues and work directly with officials when problems arise. However, some companies noted that this relationship can also give Chinese partners significant leeway to ask their US partners for more information than is necessary in the licensing process.

Some companies noted that their Chinese partners are either unwilling to include and often resist including the foreign partner in licensing discussions with government regulators. For example, the partner may assert their relationship with government officials is sufficient to move the licensing process forward or the process is easier if the partner deals with officials directly. As a result, a JV partner may request extensive information from its foreign partner, some of which is considered sensitive, stating that it needs to share the information with the local government to move forward in the licensing process. When asked to see the requirements requiring excessive disclosure, the Chinese partner is occasionally unable to provide written evidence or refer the company to publically-available requirements. One company stated that in one instance their Chinese partner said the JV was “behind in the approval process” and that it required additional, sensitive information to move forward in resolving the licensing delays – information which the company did not consider necessary to advance in the licensing process.

While JV relationships are often unique to the partners and industry, companies will benefit from being aware of common challenges other JVs have faced prior to engaging in the licensing process with their Chinese partner. Understanding challenges shared by companies in similar arrangements may help companies negotiate strategy internally, while making them more familiar with the disclosure requirements in the licensing process. In doing this, companies will gain better understanding of the common hurdles and requirements stipulated in the regulations guiding the licensing process, and become more capable of negotiating information requests from JV partners as they arise.

Managing Disclosures in Joint Ventures

Though there is no guarantee a JV partner will protect the information supplied to them in the licensing process, companies shared practices that can be utilized to limit IP risk after information has been disclosed.

- **Contractually limit the geography where certain technology can be used:** Companies should clearly define that technology used in the production of any final product can only be sold in certain markets. China and Africa were mentioned by companies as examples. One company noted that if their agreements had not laid out these restrictions in the early stages of the relationship, their partner would likely now be a direct competitor in the developed markets key to the foreign company’s business.
- **Source some products internally:** In the China Compulsory Certification process, a company will normally provide a detailed technical documentation list that includes all components included in the final product. One way to protect this information is to split sourcing of the most technologically sensitive information between the JV and the company. The company is still required to disclose the technical information; however, by ensuring the most sensitive information is sourced from a trusted supplier the company can minimize risk of unexpected trade secret disclosure.

Conclusion

Foreign and domestic companies must negotiate a complex and opaque licensing system that often requires the disclosure of sensitive information or trade secrets, potentially to competitors. While there are steps companies can take to lessen risks in the licensing process, many of the problems addressed in this paper cannot be solved sufficiently through company best practices. Instead, the issues described in this paper should be addressed by the PRC government to create a more transparent, fair, and timely licensing process for foreign and domestic companies.

To strengthen China's operating environment and attract foreign investment, the PRC government should consider reinforcing its commitments to transparency and reducing disclosure risks introduced in the licensing process. USCBC is developing specific recommendations to this end for Chinese policymakers to consider as they seek to improve their licensing and investment regimes and strengthen foreign investment. In considering these recommendations, Chinese leadership will help improve the operating environment in China for industries across all sectors, while helping to strengthen overall investment in its market.

US companies seeking to invest or expand in China can mitigate risks and facilitate the licensing process by establishing strong relationships with local government officials, as doing so may help improve transparency and minimize disclosure requests. Further, companies should seek to make clear to officials what information they are – and are not – willing to disclose in the licensing process and create internal decision-making structures to help local branch offices manage officials' expectations. These strategies, along with those described previously, may help companies manage challenges in China's administrative licensing system.