PLMJ

JUL. 20

CHINA

NEWS

Successfully exporting and distributing products in China: Mission impossible?

The Covid 19 outbreak has impacted many areas of business around the world, including product exports and distribution.

This means we have to rethink current distribution models.

Which product export and distribution model is most effective in the Chinese market?

Is a network of contacts crucial to achieving success in distribution in this market?

There are many distribution structures available in China, and you can choose between an agency agreement, commission, franchises, brand licences or joint ventures.

It is important to analyse tax and logistics issues that could impact the business, in addition to doing a market study to determine which distribution model is the most suitable.

For example, if you intend to export cosmetics to China, it is common to use local agents to carry out the mandatory procedures of the Chinese food and pharmaceutical administration (product testing). Distributors are then provided by these local agents, with the products already tested and certified.

From a management perspective, a business owned by a foreign investor (called a FICE - Foreign-invested commercial enterprise) is generally the preferred type of vehicle for foreign companies to import and distribute their products in China. A FICE is incorporated as a public limited company and the foreign supplier is its sole shareholder.

"The export of Portuguese products to China, which had recorded a significant increase in volume in recent years, is currently suffering. This means we have to rethink current distribution models."

Since the liberalisation of the commercial sector in the People's Republic of China (PRC) in 2004, an increasing number of foreign agents and distributors have gradually established themselves there.

A foreign company can choose to set up its own company or enter into a partnership agreement with a local company or importer.

There is no doubt that foreign distributors can work directly with traditional Chinese retailers. However, this makes it necessary to use complex subcontracting networks, with no demand planning, inventory management or logistics practices, which leads to very high operating costs.

To streamline the processes of these complex distribution networks, we recommend an assessment of the supply chain, including factors such as capacity, production, and operational metrics, determined by company performance indicators.

If there are agents that "disrupt" distribution, suppliers should identify more direct and efficient routes to distribute end products.

It is important to remember that a wholesaler may have exclusive distribution in a particular district or city, but wholesale distribution remains segmented at the national level. As a result, companies wishing to distribute throughout the country need to use several channels in China.

There are also cases where some distributors are reluctant to work with distributors in other geographical areas. This makes it difficult to optimise distribution of the end product across several provinces. One solution to this obstacle may be to invest directly in the company's internal distribution capacity, creating its own distribution network instead of using local distributors or working with other suppliers in similar situations through partnership agreements.

"Working with local distributors requires foreign companies to assess how sophisticated the tools used by these distribution networks are, and what the additional time and costs associated with supply in the Chinese market are."

Many distributors in China are investment companies that buy and resell products and few of them have sophisticated planning knowledge and predictability of demand. These distributors often ignore important variables such as seasonality and product "cannibalisation", and they use weak assumptions to forecast sales and rarely compare forecasts with actual sales. Working with local distributors requires foreign companies to assess how sophisticated the tools used by these distribution networks are, and what the additional time and costs associated with supply in the Chinese market are.

The most important taxes to be taken into account by foreign companies for import and distribution purposes are corporate income tax, value added tax, and customs duties.

The General Company Law of the PRC regulates contractual relations between suppliers and distributors, and any supplier in China is free to terminate a distribution agreement without just cause and without the obligation to pay any compensation or indemnity for the effect of termination.

Companies should therefore assess this risk and choose their distribution partners very carefully.

The Chinese government has recently approved standards for some sectors of activity that define specific rules for distribution agreements. However, these rules are not yet in force because they are awaiting their regulations.

Another issue to take into account in distribution is the lack of control and inventory of products circulating within China. This could compromise the reputation and brand image of the products. Non-compete clauses in distribution agreement can reduce this risk because they are enforceable for the duration of the distribution agreement.

In most cases, responsibility for the distribution of the products is assigned to the distributor, but without establishing procedures and the objectives to be achieved.

"The Chinese government has recently approved standards for some sectors of activity that define specific rules for distribution agreements. Distribution. However, these rules are not yet in force because they are awaiting their regulations."

Companies that use product flow control charts and rely on sophisticated logistics, particularly in more rural Chinese areas, become more efficient in delivering the goods and avoiding losses and damage. The charts and inventories also help identify each agent in the supply chain and the responsibility of the parties/agents concerned.

Distributors are subject to the suppliers' pricing policy. However, under the PRC Anti-Monopoly Law, agreements fixing prices to control the market are prohibited.

Many of China's local agents and distribution channels depend on the State and have been privatised over the last decade. Large distribution channels, composed of several smaller distribution networks, combine well-established infrastructure networks and require companies to develop strong relationships with municipal governments to ensure that products circulate as planned. Exclusive territoriality agreements for a given distributor are common.

Another factor to consider when considering the distribution model is the online market, which has expanded rapidly in China and currently has over 400 million users.

Many foreign companies are expanding their business into this market through online distributors such as JiGoCity.com.

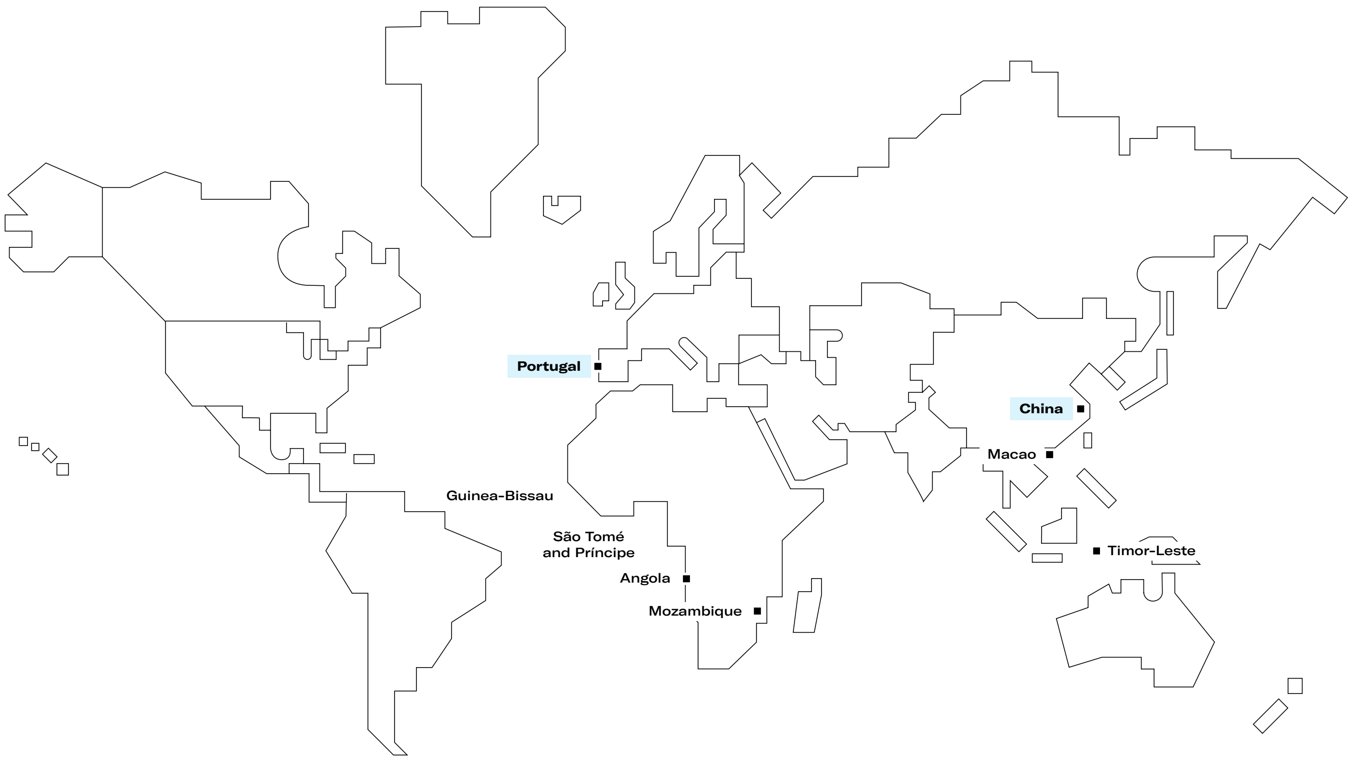
Specific issues arise in e-commerce distribution. These include restrictions on e-commerce intermediaries, territorial limitations on product distribution, and protection of intellectual property rights.

These specific conditions increasingly require licensing agreements and technology transfer agreements with local partners, which will be addressed in a separate informative note.

In conclusion:

We expect to see continued growth and expansion of sales channels and product distribution networks in China in the coming years.

Logistics networks tend to become increasingly efficient and the development of the Chinese economy will allow its supply chains to evolve. As a result, it is an increasingly attractive market for foreign companies interested in expanding their businesses. ■



Rita Assis Ferreira (rita.assisferreira@plmj.pt)