

NEWSLETTER

INTERNATIONAL

 ENGLISH VERSION

CHINA



## CHINA – MARKET OPENING AGAINST THE TREND



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## “CRITICISMS ARE REPEATEDLY RAISED BY THE EU AS WELL”

### **What are the consequences of the US-China trade dispute for European companies?**

It is obvious that the conflict does have an impact. Austrian companies in China note that the trade dispute, with its frequently changing targets and sentiments, creates uncertainty.

Among other things, uncertainty affects investment plans of Austrian companies in China. They become more hesitant, especially in the consumer goods sector, where margins are already thin. Here, relocating manufacturing sites to neighbouring South-east Asian countries is considered more frequently. But it also happens that Chinese customers substitute American goods with European products to avoid punitive tariffs.

Nobody, however, takes investment decisions lightly. Well-established value chains built over years cannot be restructured overnight. So far there are only a few Austrian companies that have withdrawn their production from China.

### **To what extent do you consider American criticism of Chinese business practices (such as compulsory joint ventures, subsidies, influence of state-owned enterprises, monetary policy) justified? Do you support the American demands?**

These are not only American demands, but criticisms repeatedly raised by the EU as well. The difference lies mainly in the choice of means.

Issues such as market access barriers for certain categories of foreign products, subsidies that distort competition, the protection of intellectual property rights or investment restrictions are regularly addressed in the dialogue the EU maintains with China. It would be wrong to say that this dialogue has not led to progress.

What is new is that the Chinese economy has now reached a level that requires trade relations to be more balanced and equal.

### **To what extent are the American measures effective?**

Things are actually moving. Although I do not see a complete U-turn, there is an increased awareness of necessary changes, in many cases a willingness to open up. With the new Foreign Investment Law, for example, China wants to show that it is open for business.

Incidentally, China needs foreign investment inflows to offset its current account, which has recently turned negative. This, too, is a result of the maturity of the country's economy, reflecting increasing consumer demand and strong growth in foreign travel.



**Dr. Martin Glatz**

is head of ADVANTAGE AUSTRIA Beijing and Commercial Counsellor at the Austrian Embassy for China, Mongolia and North Korea. In addition to its Beijing office with 20 employees, ADVANTAGE AUSTRIA maintains a presence at another six locations in China.

## How many Austrian companies are active in China? Do you still see new entrants coming to the market?

Today there are 900 subsidiaries of a total of 650 Austrian companies in China, of which just under a third are manufacturing entities.

Even though many have been in the market for some time, there are still enterprises, often medium-sized companies, who are setting up business for the first time or expanding their existing investment. In any case, the size of the market requires companies to engage with China strategically and adjust their presence accordingly.

The „New Normal“ with its focus on domestic consumption, an increased awareness of environmental protection and the need of industry for technologically advanced solutions create opportunities for businesses in sectors that did not even exist five or ten years ago.

## For which sectors does the Chinese market currently offer opportunities?

In addition to the opportunities arising from growing consumer spending and green development, I would like to mention in particular the sports and leisure industry. Especially for Austria as a winter sports nation, the Winter Olympics 2022 in Beijing offer a great opportunity not only to position its unique offer in the ski industry, but also to relate its image to a wider public. These efforts are reflected, among other things, in the rapidly increasing arrivals of Chinese tourists in Austria.

China's commitment to engage globally, as it manifests itself in the Belt and Road Initiative, creates potential for cooperation between Austrian companies and Chinese partners in third markets, particularly in infrastructure, finance and logistics. The motto „in China for China“, which has already established itself firmly aside the older “workshop of the world“-model, is now joined by a new one, „with China into the world“.

INTERVIEW

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## “OPENING IS IN CHINESE SELF-INTEREST”

### Which legal regulations have previously hindered the business activities of foreign companies in China the most?

This question would basically require a long answer, but in summary many problems are related to the fact that there is still no freedom of establishment for foreign investors in China.

In the past, the admissibility of a foreign investment was governed by the so-called Catalogue of Industries for Guiding Foreign Investment, which provided for investments permitted, restricted, or prohibited. In many areas, a foreign investment was only possible through a joint venture with a local joint venture partner.



**Sebastian Wiendieck**  
attorney-at-law and director of the legal department of Rödl & Partner in Shanghai. The German lawyer has ten years of consulting experience in China.

## What are the most important legal innovations of recent years?

Since the accession of China to the WTO, the conditions for market access have continuously improved. The aforementioned catalogue has been replaced by a negative list, listing industries and industries where foreign investment is not allowed.

With this list, the number of non-permitted investment types has been reduced to „only“ 40, most of which are generally irrelevant to German SMEs.

On January 1, 2020, the new Investment Act will also come into force, which explicitly stipulates that foreigners must be treated as Chinese people as long as investments are not on the negative list.

There is also a list of supported industries for which there is active support. This includes above all the high-tech sector, especially if the projects provide know-how transfer to China or local research and development. In these cases, there may e.g. be tax benefits via the corporate tax.

The famous joint venture obligation is abolished with the negative list. Joint ventures used to be mandatory in the automotive or railway sectors, for example. In the meantime, car manufacturers can also invest in fully owned production facilities. BMW has announced to do so. Tesla is already building its own factory in China. Generally, there is a lot of movement in this area.

On the other hand, we also see a trend towards new joint ventures on a voluntary basis. It often makes sense to partner with a Chinese company to leverage existing sales or production structures.

One driver is certainly the localization requirement. Often only a locally producing company is accepted as a supplier. The „Made in China 2025“ program is the basis for this. There are also unofficial or semi-official regulations stating that in certain industries only products made in China are purchased. It is an unwritten law that, for example, hospitals largely buy only Chinese products.

## To what extent has US pressure on China contributed to the new laws?

That is a difficult question. The Chinese ruling party would never admit to bowing to American pressure. The pressure was and is undoubtedly there, but I do not think China gave in to it. Rather, the opposite seems to be the case, as President Trump has now once gain “put on ice” the already announced further tariff increases.

The new regulation serves Chinese self-interest, such as the support of technology. It's about getting intellectual property to China. Facilitating market access is directed at this goal, not at favouring the Americans.

## **Do you expect further legal changes, possibly due to the American measures?**

Yes, there will certainly be further steps towards further opening. However, the opposite is possible if one looks at the international trends, which point more towards a deglobalization. China itself is in the process of opening up and there is a lot of catching up to do in the local production landscape.

The Silk Road project with its trade corridors stands for globalization unless it becomes a one-way street out of China. The key is that Chinese law approaches international standards. This development creates trust. What does it help if I can enter a market freely, but there is no legal certainty?

## **What is the status of intellectual property protection in China today?**

Of course, there are still copies and there will continue to be copies. The legal framework in this area is similar or already in line with international standards, but what about enforcement?

The Tier 1 and Tier 2 cities are doing well and the authorities have an interest in countering product piracy and acting accordingly. However, in case of copyright infringements, companies need to be aware that form is considered more important than content in China. Hence, being prepared is important, with the keyword being "trademark protection".

In China, the use of a foreign trademark is not per se illegal if it is not well known. Those who register their brand only when entering the market and find local brand users can have problems because the local users did not necessarily act unlawfully. On the other hand, anyone who sets his legal position in advance has good chances to defend himself.

## **How is your business in China developing? Do you see much influx of German companies, or, conversely, migration to countries like Vietnam or Thailand?**

We see that the Chinese market is still attractive and there are many new projects. For the reasons set out, we see many new joint ventures and investments in previously underdeveloped areas. There are also new projects in the service sector. These are not always huge, but there is momentum in China.

The localization trend implies greenfield projects in the investment zones. We are very optimistic for our business. Restructuring related to international trends is taking place in some sectors. While investments in the combustion sector in the automotive industry are sluggish, the trend is clearly moving towards electromobility.

Companies that produce in China and export to the US are suffering from political developments. Some of them have therefore relocated their production facilities abroad, especially to Vietnam, in order to supply the USA from there in the future.

Another obstacle is the rapid salary growth in China, which in many areas increases costs and reduces the traditional Chinese advantage. However, the degree of automation is not yet high, investments here could cushion the labour cost problem.

Internet and data security issues are complicated in China. VPN networks are barely usable for in-house communication. The secure transfer of data abroad requires a lot of advice and we see very serious developments in this area, which point to strong surveillance. The social credit system could become applicable to businesses and cause headaches.

China is a dynamic country, in a positive and negative way. You never know what will happen tomorrow and with what determinations action may be taken - sometimes things are tolerated and sometimes examples are being made.

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## RECRUITING IN CHINA: KEY LEGAL CONSIDERATIONS

**Companies recruiting employees directly in China need to understand key aspects of the country's labour and contract laws, rules, and regulations. Here we answer simple questions about the recruitment process and discuss the types of labour contracts in China.**

In principle, any company located anywhere in the world may employ a Chinese person to physically work in China.

However, the employment contract will not be regulated by relevant Chinese legislation unless it is entered into via an invested entity on the Chinese mainland, or under circumstances where the overseas company is regarded as a permanent establishment in China.

If a company is qualified to hire employees directly and decides to do so, it should be noted that employers are required to sign a written contract with their employees within one month starting from the employee's first day of work at the company.

If the employer fails to conclude a written contract with the employee after a period of more than one month but less than one year from the date of employment, the employer must pay the worker double wages for each month.

Over one year, the employer and the employee will be deemed to have concluded a non-fixed term labour contract (explained later), and the employee can be entitled to double wages for the period of more than one month but less than one year.

### ANALYSIS



**Marco Förster**

Associate, Dezan Shira & Associates, Beijing

If the employee refuses to conclude a written labour contract with the employer, the employer should terminate the employment relationship, notify the employee in writing, and pay monetary compensation to the employee in accordance with the PRC Labour Contract Law.

One exception to the above-mentioned rules is part-time work, where an oral agreement is considered sufficient, as stipulated in Article 69 of the PRC Labour Contract Law.

### **How to staff a representative office (RO) in China?**

ROs in China cannot hire staff directly. Instead, Chinese staff must be seconded from an agency that will take the title of official employer (such as dispatch agencies). Representatives working for ROs should have an employment relationship with the parent company abroad, and any disputes should be settled under the laws of that country.

This is because an RO is not a capitalized legal entity in China. An employee must have the right to claim against their employer, and an RO is not a suitable entity to file claims against.

By forcing ROs to employ staff through an agency (which itself is a capitalized legal entity in China), the interests of the employee are thereby protected.

### **When does the employment relationship start in China?**

The employment relationship is deemed to have started from the first day that the employee works at the company, not from the date of signing of the contract.

As long as the employee can prove that they have physically been working for the company for over a month prior to signing an employment contract, this will be sufficient to make a successful claim against the company.

The simplest piece of evidence proving this will be the receipt of salary. To effectively lower the future risk of labour disputes, employers should build up reliable mechanisms to ensure the prompt conclusion of labour contracts.

### **Should the labour contract be written in Chinese?**

The question of which language a labour contract should be written in is seemingly a trivial one, but it has the potential to render even the best written contracts unenforceable.

While monolingual foreign language contracts are accepted by Chinese courts, the foreign language contract must be translated by institutions that are approved by the courts, on a basis unknown to the plaintiff.

Bilingual contracts contain their own problems, principally in determining which language will be the controlling language and in ensuring uniformity in the translation. More often than not, a bilingual contract that does not specify which language is the controlling version will automatically default to Chinese as the authoritative language.

Alternatively, in the event that both languages in a bilingual contract each claim to be the controlling version, the Chinese will again be accorded primacy, even though the Contract Law provides that the contract should be interpreted according to the aim of the contract.

Foreign investors are therefore advised to have a Chinese version contract for the purpose of legal certainty.

## **What are the types of labour contracts in China?**

Depending on how the term is defined, labour contracts in China could be divided into three types:

- Fixed-term Labor Contract;
- Non-fixed Term Contract; and
- Job Contract.

### **Fixed-term labour contract**

The fixed-term contract creates an employer-employee relationship for a fixed length of time. It can be used for part-time or full-time work.

The part-time worker has five characteristics:

- The employee may not work for over four hours per day on average and 24 hours per week;
- No probation period is allowed, and either the employer or employee may end the agreement at any time;
- The employee is not entitled to severance compensation;
- The employee must be paid at least every 15 days; and
- Part-time employees need not receive a written contract.

Part-time work could be appropriate for an office cleaner, or some other role where the tasks can be completed within a relatively short period of time each day.

Fixed-term contract is the most commonly used norm of labour contract in employment relationship.

It grants employer more flexibility in termination as compared to non-fixed term contract, and provides more legal certainty to the employment relationship as compared to job contract.

### **Non-fixed term contract**

Non-fixed term contract refers to a norm of labour contract between employer and employee that has no fixed term.

Generally, there are four ways to obtain a non-fixed term contract:

- The employer and employee voluntarily sign a non-fixed term contract upon commencement of employment (not recommended);
- The employer has failed to give a written contract to a full-time employee who has been working for over one year;
- The employer wants to renew the employee's contract for a second time, and the employee does not fall under any of the categories stipulated in 'immediate termination for inappropriate behaviour of the employee' and the first two items of 'termination with 30 days' notice and compensation payment' (provided later);  
or
- The employee has worked for the same employer for ten years continuously.

The non-fixed term contract effectively guarantees the employee job security until retirement age.

As there is no longer a contractual limit to the length of employment, companies will be unable to dismiss the employee upon the expiry of the labour contract.

This means employers can only terminate the employee by mutual agreement or based on valid grounds.

## **Job contract**

A job contract is defined by the task or project the employee is to work on, not the length of time. This type of contract allows a company to hire a person to implement a specific project.

Once the project is completed, the employment relationship comes to an end. At that stage, the company needs to make a severance payment to the employee accordingly.

Job contracts are sometimes used for seasonal jobs where the scope of work can be defined very clearly. However, in most cases, defining the scope of work proves to be a challenge.

It is often hard to adequately define the completion of a project. The relevant legal framework offers no guidance on what to do when a project is left uncompleted for whatever reason, or how employees should be compensated in such a case.

This lack of clarity makes job contracts relatively more prone to disputes and even litigation.

Unlike a contract signed by a company with another company for its provision of services to complete a project, the job contract forms an employer – employee relationship.

As such, in the event of a dispute, the court will tend to protect the interests of the employee to a greater extent than those of the employer.

In addition, the employer is not allowed to set a probation period for a job contract. For these reasons, most employers avoid this type of arrangement.

## **Are there any mandatory clauses required in China's labour contracts?**

According to relevant laws, the following clauses are mandatory to be included in the labour contracts:

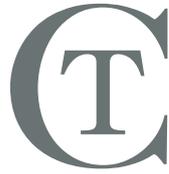
- Name of the company, address, name of the legal representative or a senior manager;
- Name of the employee together with a valid address and identification number;
- Commencement date and the term of the contract;
- Description of the job and the location where it is to be implemented;
- Salary details;
- Statement that the employer will contribute social insurance for the employee; and
- Labour protection, labour conditions and protection from occupational hazards.

Every local labour bureau will have standard labour contracts available in Chinese. However, we do not recommend using these in every case.

Each company may have specific requirements and may wish to draft labour contracts with its employees in such a way as to offer the company more protection. We therefore suggest combining a local standard template with terms you use in labour contracts for your operations abroad.

### **Recommended clauses in labour contracts**

- Depending on the specific situation, a number of additional terms to the labour contract are recommended, including:
  - Probation period;
  - Non-competition clauses;
  - Confidentiality clauses;
  - Allowances and benefits (particularly for foreign employees); and
  - Reference to the company rule-book or staff manual.
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