«Understanding the Chinese business partner's motives and incentives is key»

Lukas Zuest and Zhao Luer from the law firm VISCHER, Zurich, talk about their experience with Swiss companies searching for online and offline distribution channels in China, as well as with Chinese investments in Switzerland.

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Interview by Elisabeth Tester

How can Swiss companies tap into China's vast and highly attractive consumer market?

Luer: In order to do so, Swiss companies can set up a subsidiary in China, find a Chinese partner –in the form of a distributor, agent, or a joint venture—or sell their products on cross-border e-commerce platforms directly to Chinese consumers with support of third-party service providers. In practice, we often see a combination of these options.

What is most important when choosing a Chinese business partner?

Luer: Swiss companies need to screen potential business partners carefully, including with regard to their adherence to intellectual property rights.

Lukas: They should understand what the Chinese partner's motives and incentives are for entering a business relationship. They need to know the partner's core competencies, and the partner must have a deep understanding of the Swiss company's specific product and its potential market in China.

What are the key requirements for success in the very competitive Chinese market?

Lukas: The times when you just could choose any distributor and let him sell your products in China are gone. The markets have become extremely competitive. The partner's specific market knowledge, a clear focus, and his experience are key for being successful. Swiss companies should also consider that a marketing campaign that works in Switzerland does not necessarily work in China; it must be adjusted to the Chinese consumer's needs and sensibilities. In addition, each product needs an easy and catchy Chinese name, as Chinese consumers remember the Chinese name only.

Luer: Swiss companies must thoroughly study the market they want to enter and learn the Chinese culture. They should also monitor the respective laws and regulations, such as laws that promote foreign investments. And they should closely observe trends in the regulatory field in the different sectors.

There is cross-border and domestic e-commerce in China. Can you explain what the difference is?

Lukas: The Chinese e-commerce market basically knows two kinds of e-commerce platforms. Both are aimed at the Chinese consumer and function only in the Chinese language. Domestic e-commerce platforms, such as Tmall or JD, are local platforms where Chinese vendors sell their products to Chinese consumers. Cross-border e-commerce platforms look exactly the same and are only in the Chinese language, but the vendors are international companies from outside mainland China, including Hong Kong. Cross-border e-commerce platforms formally operate out of Hong Kong. Through this channel, foreign companies can directly sell their products to the mainland China consumer. The two most important ones are Tmall Global and Kaola; both are owned by Alibaba, and apply the B2C and B2B2C business models, respectively.

What do Swiss companies have to take into account from a legal perspective when selling their goods on a Chinese e-commerce platform?

Lukas: Cross-border e-commerce business is generally expensive. At first sight, it seems convenient not to have to set up a subsidiary in China, but the maintenance of the platform is costly and time-consuming, especially on Tmall Global. And in order to do business on these platforms, many contracts and conditions must be accepted. Depending on the foreign company's size, for B2B, some room for negotiation is possible, but not for B2C. These contracts are generally very one-sided, and the Swiss company may have to accept substantial liability risks. Companies should carefully evaluate these risks before entering into a partnership.

Luer: In addition, on the B2C cross-border platform, the Swiss company should be able to provide service, including after-sales service to the end consumer. If there is no subsidiary in China, this service must be provided by a third party.

So, a Swiss company that wants to enter the Chinese consumer market does not have to establish its own subsidiary in China?

Luer: Theoretically, no. At the beginning, they can work with local service providers that operate their cross-border e-commerce platform or with a local distributor to launch their products in China. But long-term, it is imperative to set up a subsidiary in order to provide comprehensive customer service, to be close to the customer and to closely monitor the distribution network.

Changing the topic, what is the current situation of Chinese investments in Switzerland?

Luer: Many Chinese enterprises set up their European headquarters and R&D centers in Switzerland. Europe is getting more and more important for China as a sales and development market, and Switzerland can play a unique role. Its geographic location, and the fact that many European headquarters are already situated in Switzerland, is very attractive; there is a large pool of talents with the necessary know-how to operate a regional headquarters, sales center or R&D center.

Lukas: Regarding M&A, Chinese investors find good opportunities in Switzerland. In the last few years, we have seen several waves. There was a surge of acquisitions of Swiss companies by Chinese investors in 2016; at the end of 2016, the Chinese authorities issued restrictions for foreign investments, which led to a temporary decline in M&A activities in 2017. 2018 saw a recovery, followed by a new decline in 2019, also due to the trade frictions between the U.S. and China. Despite the consequences of the Covid-19 pandemic, greenfield investment activities are expected to show strength in 2020. Chinese companies are setting up subsidiaries in Switzerland; China is again willing to operate overseas. However, the level of activity is clearly below the figures of 2016. Keep in mind that, in comparison with other countries, Chinese investment in Switzerland is still at a very low level.

Why do Chinese companies acquire Swiss companies?

Lukas: I would like to distinguish between three different phases. Until 2009, many Chinese entrepreneurs founded smaller Swiss companies in order to add «Swissness» to their product portfolio. After the international financial crisis, Chinese investors started to acquire Swiss companies across the board, from real estate to hotels to companies in financial distress. The third phase, since approximately 2015, shows more and more sophisticated Chinese investors, who also participate in and win auctions. Chinese investors both seek the technology of their acquisition target and want to exploit the target's sales potential in the Chinese market. Other Chinese companies have products they want to launch in Europe and therefore decide to acquire a Swiss company that has similar products and an existing distribution network.

What do Chinese investors have to consider in particular that other foreign investors, let's say from Europe, do not have to take into account?

Luer: After the signing of a share purchase agreement, specific actions are required before the deal can be closed, i.e. before the shares can be transferred and the purchase price can be paid. Before the closing, the Chinese investor must register the deal with the respective government authorities, e.g. at the National Development and Reform Commission or at the Ministry of Commerce. Only upon registration or approval can the transaction be completed. To provide full transparency and trust, it is important that Chinese investors address this issue early in discussions with the Swiss seller.

Finally, what is the major reason why a Chinese M&A project in Switzerland might be successful?

Luer: With regard to the closing of the deal, Chinese investors must be well prepared, and they should involve experienced, solution-oriented and pragmatic consultants. These consultants, of course, should have all the technical and professional know-how, but they should also have the relevant cultural understanding.

Lukas: And, longer-term, Chinese investors need to find a balance between accepting the local conditions and traditions and introducing their own business culture.

For more information about how to enter the Chinese market and invest in Switzerland please contact Lukas Zuest: lzuest@vischer.com.