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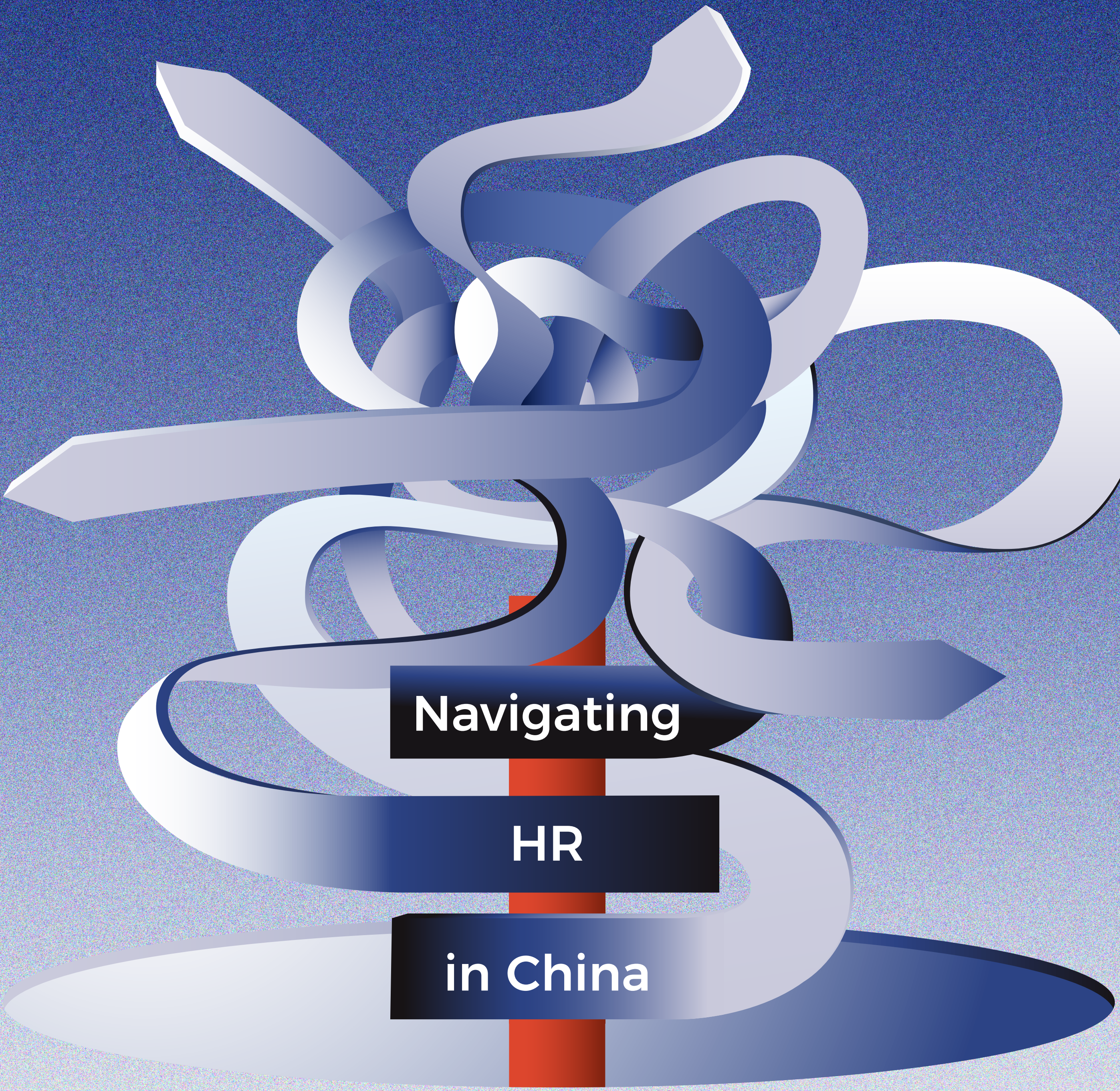

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Contents

ISSUE 82
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Chief Editor
James Skinner

Art Director
Zhang Ye

Advertising and Sponsorship Manager
Queenie Cheng
+86 (10) 6462 2066 Ext. 54
qcheng@europeanchamber.com.cn

National Member Relations Manager
Luyang Syvänen
+86 (10) 6462 2066 Ext. 37
lsyvanen@europeanchamber.com.cn

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BEIJING

Office C412,
Beijing Yansha Centre,
50 Liangmaqiao Road,
Beijing, 100125, PR China
北京市朝阳区亮马桥路五十号燕莎中心写字楼C-412室
Tel: +86 (10) 6462 2066
Fax: +86 (10) 6462 2067
euccc@europeanchamber.com.cn

TIANJIN

41F, The Executive Centre, Tianjin World Financial Centre, 2 Dagubei Lu, Heping District, Tianjin, 300020, PR China
天津市和平区大沽北路 2 号天津环球金融中心 41 层德事商务中心
Tel: +86 (22) 5830 7608
tianjin@europeanchamber.com.cn

SHENYANG

Room 1208, World Financial Center 2, No. 43, Beizhan Road 1, Shenhe District, Shenyang
沈阳市沈河区北站一路 43 号环球金融中心二期 1208 室
Tel: +86 (24) 3198 4229
Fax: +86 (24) 3198 4229
shenyang@europeanchamber.com.cn

NANJING

Room 951, World Trade Center, 2 Hanzhong Road, Gulou District, Nanjing, 210008, PR China
南京市鼓楼区汉中路 2 号世界贸易中心 951 室
Tel: +86 (25) 83627330
Fax: +86 (25) 83627331
nanjing@europeanchamber.com.cn

SOUTHWEST CHINA CHENGDU

04-A, F16, Tower 1 Central Plaza, 8 Shuncheng Avenue, Jinjiang District, Chengdu, PR China
成都市锦江区顺城大街 8 号中环广场 1 座 16 楼 04-A
Tel: +86 (28) 8527 6517
Fax: +86 (28) 8529 3447
chengdu@europeanchamber.com.cn

SOUTH CHINA GUANGZHOU

Unit 2817, 28/F, Tower A, China Shine Plaza, 9 Linhe Xi Road, Tianhe District, Guangzhou, 510613, PR China
广州市天河区林和西路 9 号耀中广场 A 座 2817 室
Tel: +86 (20) 3801 0269
Fax: +86 (20) 3801 0275
southchina@europeanchamber.com.cn

SHANGHAI

Unit 2204, Shui On Plaza, 333 Huai Hai Zhong Road, Shanghai, 200021
PR China
上海市淮海中路 333 号瑞安广场 2204 室
Tel: +86 (21) 6385 2023
Fax: +86 (21) 6385 2381
shanghai@europeanchamber.com.cn

SOUTHWEST CHINA CHONGQING

105, A2 Block, SinoSwiss Technopark, Jinzhou Avenue, Yubei District, Chongqing, 401147, PR China
中国重庆市渝北区金州大道平和路 5 号，中瑞产业园 A2 栋 105
Tel: +86 (23) 63085669
chongqing@europeanchamber.com.cn

SOUTH CHINA SHENZHEN

Rm 308, 3/F Chinese Overseas Scholars Venture Bld, South District, Shenzhen Hi-tech Industry Park, Shenzhen, 518057, PR China
深圳高新区南区留学生创业大厦 3 楼 308 室
Tel: +86 (755) 8632 9042
Fax: +86 (755) 8632 9785
southchina@europeanchamber.com.cn

President's Foreword

Staff localisation: a success story leading to new challenges

Jens Eskelund

President

European Union Chamber of Commerce in China

One of the great successes of European companies in China has been the ability to identify and develop Chinese nationals to take on senior leadership positions. This speaks to the quality of talent available in China, but also the realisation that the ability to attract the best people requires companies to offer promising career development opportunities.

However, while many European companies have successfully localised positions, this has brought new challenges to their operations. The European Chamber's *Business Confidence Survey 2024* (BCS 2024) found that 41 per cent of respondents experienced a growing divide between their headquarters (HQs) and China operations in the past two years, up from just 20 per cent in 2022.[1] Companies report that this has resulted in slower decision-making processes, with HQs and China offices struggling to align on important issues. Foreign nationals on the ground in China have typically been seen as playing a major role in bridging this gap, often arriving in China with prior experience at HQs, and a deep understanding of the corporate culture.

The dilemma companies now face is how to balance the benefits of local workers with a better understanding of China's business environment, against the advantages that foreign employees can bring to the table. Increasingly, it is becoming clear that the best solution is to foster a mix of both Chinese and foreign nationals along the talent pipeline — from entry-level to middle management and all the way to senior management positions.

For this to be possible, China needs to be seen as a long-term career development prospect for foreign nationals. However, the BCS 2024 found that nearly 40 per cent of respondents encounter challenges attracting or retaining international talent, with factors such as reluctance to relocate, high salary expectations and the lack of quality and affordable children's education the main concerns.[2] Three years of travel restrictions during the Covid-19 pandemic further diminished China's appeal.

Chinese authorities have attempted to correct this by making it easier for foreign travellers to visit China through the introduction, and subsequent expansion of, a visa-free policy for the citizens of several countries, along with other conveniences for visitors. While this welcome step has had a positive impact on business travel, it has so far done little to increase the number of foreign nationals working at European companies in China.

The extension of the individual income tax exemption for foreign nationals announced in late 2023 is one example of a policy that has had a real impact. Yet this is merely a continuation of the status quo rather than something new.

In order to attract foreign nationals in the numbers that it used to, China will need to undertake significant policy reforms. To help identify the key areas where improvements are urgently needed, the Chamber's Human Resources Working Group has detailed its key recommendations in the *European Business in China Position Paper 2024/2025*. If implemented, these could substantially improve European businesses' ability to attract and retain the right balance of both domestic and foreign employees.[3]

1 *European Business in China Business Confidence Survey 2024*, European Union Chamber of Commerce in China, 10th May 2024, viewed 11th September 2024, p. 39, <https://www.europeanchamber.com.cn/en/publications–business–confidence–survey>

2 Ibid. p. 58

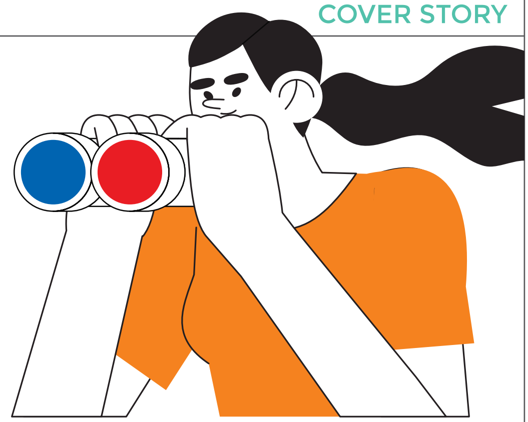
3 *European Business in China Position Paper 2024/2025*, European Union Chamber of Commerce in China, 11th September 2024, viewed 12th September 2024, pp. 85–90, <https://www.europeanchamber.com.cn/en/publicationsarchive/1269/European_Business_in_China_Position_Paper_2024_2025>

HR IN CHINA

The common pitfalls and how to avoid them

Over the past decade there has been an increase in economic volatility and geopolitical tensions. In response, many countries, including European Union (EU) Member States and China, have introduced new laws and compliance measures to adapt to changing times. These factors have increased the governance burden for EU enterprises investing in China. Among these challenges, the most sensitive and crucial are related to the hiring and management of workers. **Liu Yufang** and **Dai Ying** of **Beijing Jotai Law Firm** set out the things companies need to do to avoid some of the common pitfalls.

Labour laws, characterised by strong administrative oversight and regional attributes, vary greatly between the EU and China due to significant social and cultural differences. Grounded in the framework of Chinese labour law,[1] this article examines a number of issues commonly encountered by EU enterprises in China in their human resource (HR) management. It offers targeted compliance suggestions aimed at benefitting their operations.



"Labour laws, characterised by strong administrative oversight and regional attributes, vary greatly between the EU and China due to significant social and cultural differences."

Avoiding dual employment relationships

EU companies often need to dispatch employees (especially senior managers and technical personnel) to work at their subsidiaries or joint ventures in China.

According to the *Regulations on the Administration of Foreigners' Employment in China*,[2] foreign nationals working in China must obtain a work permit and sign an employment contract with a local company. Given that dispatched employees are managed by the parent company located in the EU but also hold a Chinese employment permit, this situation can easily lead to disputes concerning the dual employment relationship.

A 2022 judgement detailed the case of a Malaysian citizen who had signed an employment agreement with an international group registered in Singapore and was then dispatched to work at the group's subsidiaries, initially in Shanghai and then in Chongqing.[3] The two subsidiaries successively obtained an employment permit for the employee, and the Shanghai subsidiary signed an employment contract with him. Later, the foreign national initiated litigation against the Chongqing subsidiary over matters related to the recognition of employment relationships. A local court determined that the foreign national had had an employment relationship with both subsidiaries at different times. The judgement was reached based on the employment permit and the signing of the employment contract.

It is worth noting that for EU companies investing in China, once an employment relationship is recognised between the dispatched or seconded employee and the subsidiary or joint venture, the latter will bear liabilities such as making retroactive social insurance contributions, paying compensation to the employee for terminating an employment contract, or even penalties for illegally terminating an employment contract. Failure to pay social insurance for an employee may also result in administrative penalties.

Compliance Suggestions:

- Through the design of dispatch agreements and employment contracts, clearly define which entity establishes the employment relationship with the foreign national employee.
- If it is not desired for the employee to establish an employment relationship with the subsidiary or joint venture in China, then the China-based entity should avoid signing employment contracts. Instead, the dispatch agreement should explicitly state the mutual intention to establish an employment relationship between the employee and the EU parent company.
- If the employee's stay in China is limited, it is advisable to use a business visa rather than an employment permit.

Balancing data protection with HR management

It cannot be denied that there is a tension between the employer's right to manage and the employee's

[1] The framework of Chinese labour law integrates private and public law, adhering to a governance model of 'self–regulation under state control'. The labour law system is complex and is built upon the foundation of labour law and employment contract law, complemented by administrative regulations, normative documents from central and local governments, and judicial interpretations, etc.

[2] *Rules for the Administration of Employment of Foreigners in China*, State Council, 2nd August 2018, viewed 18th September 2024, <http://english.www.gov.cn/services/work_in_china/2018/08/02/content_281476245886934.htm>

[3] (2022) Chongqing 05 Civil Final Appeal 2464, China Judgements Online (registration required), 2022, viewed 18th September 2024, <https://wenshu.court.gov.cn/website/wenshu/181217BMTKHNT2W0/index.html?pageId=f16d78ac367d1b0eaff723a6aada0dee&s21=(2022)%E6%B8%9D05%E6%B0%91%E7%BB%882464%E5%8F%B7>

right to privacy and personal data protection. For example, some Chinese companies provide employees with smart cushions or wristbands to enable HR departments to monitor whether employees exceed their break times.

Although the law stipulates that companies may process personal information without an individual's consent if necessary for HR management or the establishment and fulfilment of employment contracts,[4] it remains challenging in practice for companies to strike a balance between their operational needs and an employee's privacy. Getting this balance wrong can lead to labour disputes.

A recent case that drew media attention involved an employee who used an umbrella to cover her desk for 18 days, citing concerns about the exposure of her privacy by surveillance cameras installed over her workspace in Shenzhen. After being fired, she took the company to court for illegal termination of her contract.[5] While the court ultimately ruled that the termination of the contract was lawful, this case illustrates the challenge posed by personal data protection laws to HR management.

Another major challenge is the cross-border transmission of employees' personal data, particularly as large multinational corporations (MNCs) often use a globally unified HR management system and internal directory for their operations, including for sharing employees' names, avatars, phone numbers, email addresses and other types of personal data, some of which may be classified as 'sensitive' under Chinese law.

Prior to 22nd March 2024, when the Cyberspace Administration of China issued the *Regulations on Promoting and Regulating Cross-border Data Flows* (*Regulations*),[6] the criteria for transferring an employee's personal information abroad had been a persistent concern for MNCs. However, according to Article 5 of the *Regulations*,[7] companies are exempt from filing for an Outbound Data Security Assessment, entering into a standard contract for Outbound Personal Information, and obtaining certification for Personal Information Protection, if they implement cross-border HR management in accordance with the legally formulated employment rules of the company and collectively bargained contracts. The exemption does not include 'important data'.[8]

Compliance suggestions:

- The HR management rules inside a company should be aligned with the company's collection and protection policies for personal data and reviewed for any conflicts with laws and regulations.
- When collecting sensitive personal information from employees, the 'inform-consent' procedure should be followed, and written records should be properly maintained for a reasonable period as required by law and the internal rules of the company.
- If there is uncertainty about the categorisation of 'important data' being transmitted overseas, it is advisable to consult with local regulatory authorities (such as the local cyberspace administration) to determine whether the information falls within the scope of the exemption provided by the *Regulations*.

Protections for certain groups of employees

In China, labour protections for pregnant and breastfeeding employees, employees on medical or maternity leave, employees aged from 16 to 18, and those who have suffered work-related injuries are governed by mandatory legal provisions that contractual terms in the employment contract cannot override. The implementation of these provisions varies by region, and such regulations are typically implemented according to local labour norms which can cause compliance difficulties for enterprises when managing human resources across different Chinese regions.

For instance, in Beijing and Shanghai, female employees are entitled to 158 days of maternity leave; in the province of Heilongjiang, the duration is 180 days; whereas in the province of Qinghai, it extends to 188 days. Additionally, a portion of the salary during maternity leave must be borne by the employer rather than being fully covered by the maternity fund. In Beijing, for example, the maternity fund covers payments for only 128 days, with the remaining 30 days of benefits paid by the employer according to the employee's earnings prior to the start of maternity leave.[10]

Regarding employees on medical leave, employers are required by law to provide a period of medical leave. Following the end of this period, terminating an employee solely based on illness is permissible only if the employee is unable to continue their previous duties or take an alternative position offered by the employer. Otherwise, a termination in these circumstances would be

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[4] On 20th August 2021, China promulgated its first Personal Information Protection Law, forming the 'three pillars' of information protection along with the Data Security Law and the Cybersecurity Law, which include enhanced protection of natural persons' information, including that of employees.

[5] Luo, C, *Female employees were fired after they used umbrellas to shield themselves from security cameras at work due to privacy concerns — is this unjust?*, Legal Daily, 26th May 2021, viewed 14th September 2024, <https://mp.weixin.qq.com/s/5GEqmlEWs1nwNXcVg1CQ–w>

[6] *Regulations on Promoting and Regulating Cross–border Data Flows*, Cyberspace Administration of China, 22nd March 2024, viewed 18th September 2024, <https://www.cac.gov.cn/2024–03/22/c_1712776611775634.htm>

[7] Data handlers sending personal information overseas are exempt from filing for an Outbound Data Security Assessment, entering into a standard contract for Outbound Personal Information, or obtaining certification for Personal Information Protection, if such transmission implements cross–border human resource management in accordance with legally formulated labour rules and regulations and collectively bargained contracts, where it is indeed necessary to provide employees' personal information overseas. See Article 5: *Ibid*.

[8] A definition of important data is found in Article 19 of the *Measures for the Security Assessment of Data Outbound Transfers* (*Measures*), issued by the Cyberspace Administration of China in September 2022. According to the *Measures*, important data refers to data that, if tampered with, destroyed, leaked, or illegally obtained or utilised, could pose a threat to national security, economic operations, social stability, or public health and safety.

[9] For example, according to the Labour Contract Law, enterprises are entitled to retain the information of former employees for two years. As for the information of current employees, it depends on the company's rules and the necessity of retaining such information, which requires a case–by–case analysis.

[10] These provisions can be found in various population and family planning regulations, such as those of Beijing, Shanghai and Heilongjiang.

considered illegal. In a case released by the Shandong Higher People's Court,[11] an employee suffering from cancer applied for additional leave after the period of medical leave had ended. The employer insisted on sending a return-to-work notice demanding the employee resume his original position. After it became clear that the employee was unable to return to work, the employer terminated the employment contract. The court ruled that the termination was illegal and ordered the continuation of the employment contract.

Compliance Suggestions:

- Companies are advised to fully understand national and local laws and policies applicable to their location or operation areas. When setting rules for working hours, rest and holidays, they should strictly adhere to the special protections mandated by law for female employees, injured workers and sick employees, ensuring they receive the minimum legal entitlements.

- Companies should incorporate these policies into their internal regulations to ensure the legal entitlements of female employees, sick employees and those who have suffered work-related injuries are protected.

Cultural differences in anti-harassment obligations

In 2020, an employer's duty to prevent sexual harassment was incorporated into China's Civil Code. Previously, this obligation was scattered among various public policies and industrial rules.[12] Currently, multiple laws and regulations, including the Civil Code, the Law on the Protection of Women's Rights and Interests and the Anti-domestic Violence Law, along with local policies, regulate the responsibilities of employers to prevent and tackle harassment. Failure to do so could result in civil liabilities and administrative penalties.

Given the significant differences in culture, values and work practices between China and Europe, EU companies operating in China need to understand local legal requirements and consider the cultural characteristics of the region. Otherwise, the occurrence of a 'sensitive incident' could easily trigger a crisis, and improper handling could cause significant damage to a company's reputation.

In 2021, a sexual assault allegation involving a female employee of Alibaba Group garnered tremendous public attention in China.[13] One of the most criticised aspects of the incident was the claim by the victim that she was pressured to drink excessively during a meal with clients, something that is not uncommon in Chinese workplaces. Following this incident, several Chinese internet giants, including Alibaba, announced they would change their corporate cultures to ensure there were no further such incidents. Alibaba pledged to expedite the formulation of guidelines designed to prevent sexual harassment, with the company also dismissing and penalising several senior executives.

Compliance Suggestions:

- Companies should establish anti-harassment policies suited to tackling workplace issues common in China, set up dedicated handling bodies, ensure smooth complaint-reporting channels, and conduct anti-harassment education and awareness campaigns for employees. By doing so, businesses can reduce the likelihood of workplace harassment incidents.

- Companies should promptly investigate and address complaints of harassment, offering support and assistance to affected employees while maintaining confidentiality regarding the whistleblower and the victimised employee.

Conclusion

In summary, understanding Chinese labour laws and establishing an HR compliance system that fits within the local legal framework is a key element of successful operations for any EU company planning to invest in China, or that is already deeply engaged in the Chinese market.

EU companies need to continuously review and adjust their HR management policies, and closely monitor the latest developments in Chinese judicial practices regarding labour laws. It is recommended to conduct regular internal audits of HR compliance, examine the implementation status of relevant systems, and seek the involvement of external professional organisations when necessary, thereby adapting to new norms and legal requirements.

Liu Yufang is a lawyer specialising in Chinese labour law at Beijing Jotai Law Firm. **Dai Ying** is a partner at the firm and specialises in corporate affairs and investment.

Beijing Jotai Law Firm is committed to providing smart solutions for its clients. Its founder has appeared in the rankings of the ALB and the Chambers. The Cross-border Legal Service Team, comprising lawyers working in French, English and Chinese, is proficient in international investment and trade (particularly EU-China deals), corporate affairs and dispute resolution.

[11] Huang, J, and Zhang, B, *If an Employee Fails to Show up for Work After the Expiration of the Medical Treatment Period, Can the Employer Terminate the Labour Contract on the Grounds of Absenteeism?*, Shandong High Law, 22nd April 2023, viewed 18th September 2024, <https://mp.weixin.qq.com/s/aIWHq6xHkkCHIPwGsQqdKQ>

[12] The public policies include the *Outline for the Development of Chinese Women* issued by the State Council and the provincial *Implementing Measures of Special Regulations on the Labour Protections of Female Workers*, while certain industry agreements, such as the Social Responsibility Management System established by the China National Textile and Apparel Association, also stipulate the obligation.

[13] See: *Jinan Public Security Report on 'Sexual Assault Case of Alibaba Employee': No Evidence of Rape*, China News, 14th August 2021, viewed 18th September 2024, <https://www.sd.chinanews.com.cn/2/2021/0814/79969.html>

Managing the big players

Who should head a multinational in China?

Many multinational companies operating in China are going through a tough time. The limited number of experienced foreign nationals willing to work in the country, combined with pressures to localise, is putting foreign firms at a disadvantage as they try to succeed in a much tougher economic climate. **Gabor Holch** asks what steps multinationals can take to find the right people.

Casual observers on their first post-pandemic visit to a major Chinese city might get the impression that things are back to normal. Locals avidly consume global car, electronic, fashion, cosmetics, food and beverage brands. The neon logos of multinationals still illuminate the buildings that host their China offices. Restaurants continue to offer international culinary choices. Chinese cities promote international trade and technology fairs.

But the business climate surrounding those reassuring urban hubs has changed dramatically and irreversibly in recent years. Starting with the big picture, the macroeconomic and political context of China-based multinationals is unrecognisable for anyone who remembers how things were a decade ago. The nation's trade wars, economic struggles, and firmer commitment to ideology have put a question mark on the feasibility of the China strategies of foreign firms. China's lengthy enforcement of its 'zero-Covid' policy undermined the country's predictability – previously one of its most attractive features.

China's post-pandemic recovery both fell behind expectations and coincided with economic uncertainty, growing political interference in business and surging opportunities elsewhere. Blinded to China's potential by years of inaccessibility for business travellers and poor digital access from abroad, many European headquarters opted for a confusing dual strategy. On one hand, they followed demands by China-based executives to localise entities, business models and workforces. On the other, they quietly started 'de-risking', shifting resources away from China including investment, fixed assets, intellectual property and people.

These dramatic changes hit foreign business where it hurt the most. They uprooted two decades of efforts to smoothly integrate China into global networks of investment, know-how, production, distribution and services. Politics widened the gulf between China and its top trading partners in defining sectors such as green energy and artificial intelligence. Importantly, while European firms started the 2000s with ambitions to nurture a generation of globally interchangeable Chinese and international managers, two decades of management localisation efforts failed to deliver.

European Union (EU)-China commercial relations are admittedly at a low point, with delayed reforms causing 'promise fatigue' according to one recent publication.[1] But in the spirit of *wei ji*—the Mandarin for 'crisis', suggesting both danger and opportunity—European firms should ditch any hope for a return to normal and face new realities. While individual executives at EU firms can hardly influence global investment trends or foreign policy, they can play decisive roles in finding, hiring and developing future leaders who will represent European firms in China.

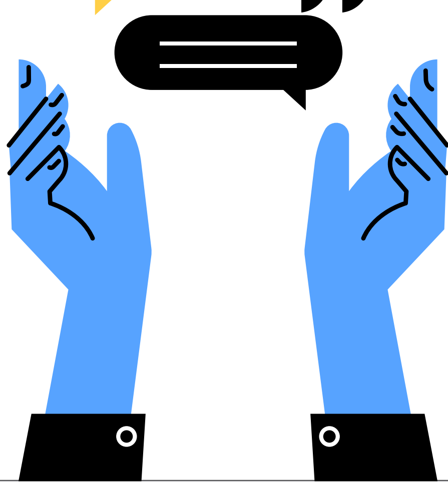
In other words, since most experienced foreign national managers left and new inflows have not resumed, now is the time for European firms to forge the leadership vision of their China branches for the next decade or two.

Why China?

Simon Sinek's TED talk on starting with 'why' stated something obvious: meaningful action comes from internal motivation.[2] If we ask why talented managers (foreign national or local) wanted to succeed at multinationals in China, all reliable sources point to the same primary reason: they wanted to boost their careers. Yes, some came out of curiosity about China's technological development or culture, but most needed the ten-fold increase in responsibility, visibility and impact that only China could provide.

Yet as its economy cools and localisation prevails, China is no longer the same career booster. Ambitious candidates often prefer emerging markets with rising investment figures.[3] That also implies that previously secondary motivations will take the lead. Managers with backgrounds in sectors such as electric vehicles, 5G technology or mobile payments yearn to be close to the cutting edge of their fields. Those with Mandarin fluency or family ties in the country can find their purpose in China, while colleagues looking to continue building their careers move on to new markets.

"As its economy cools and localisation prevails, China is no longer the same career booster."



Career goals

Career objectives are often confused with corporate goals, even by the newly appointed executives themselves. Transitional times like ours reveal the difference. The pressure on foreign firms in China has made some foreign nationals realise that beyond the long-gone double-digit growth, there is nothing keeping them in the country. Others are grateful for the opportunity to stay even if results are unimpressive.

It might seem obvious which type of candidate is more beneficial for a firm, but human resources (HR) professionals must be careful. Strongly rooted managers with limited interest in global outreach have inadvertently distanced many China branches from their European headquarters and worldwide offices. Now they struggle for data, resources and direction. Whether the chosen leaders are local or foreign, committed or casual about China, their role must be to bridge local operations with global goals, resources and markets.

Strategy

The changing balance between emerging Asian economies and a riskier China is confusing for rooted executives. 'De-risking' deprives them

1 *European Business in China Position Paper 2024/2025*, European Union Chamber of Commerce, 11th September 2024, viewed 23rd September 2024, p. 19, <https://www.europeanchamber.com.cn/en/publications–archive/1269/European_Business_in_China_Position_Paper_2024_2025>

2 How Great Leaders Inspire Action, YouTube, uploaded by TED, 5th May 2010, viewed 23rd September 2024, <https://youtu.be/qp0HIF3SfI4?si=Z–aB09DJLkl_oFV7>

3 See Figure One: *European Business in China Position Paper 2024/2025*, European Union Chamber of Commerce, 11th September 2024, viewed 23rd September 2024, p. 9, <https://www.europeanchamber.com.cn/en/publications–archive/1269/European_Business_in_China_Position_Paper_2024_2025>

of prestige, connections, resources and opportunities. China is no longer the undisputed top market for most global firms, and strategies that ignore that fact backfire. 'China for China' was an understandable risk mitigation response to Beijing's self-reliance policies, but it undermined the competitive advantage of multinationals over local firms. Many 'old China hands' seem out of ideas for this new era.

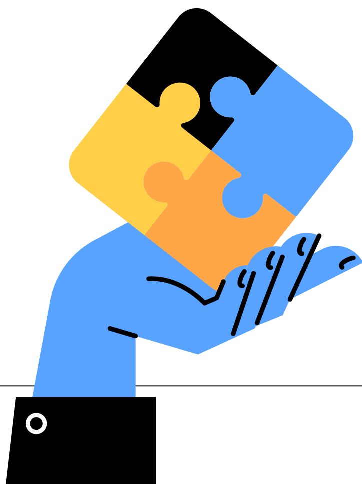
De-risking from China by European firms results in unproductive debates on which side needs the other most, and who owns the future. Whether local or foreign, leaders of China branches must align their corporate headquarters, local Chinese realities and global networks with diverse stakeholders in between. That is where multinationals enjoy an advantage over competitors from an increasingly self-reliant China: long-established supply networks of multilingual workers, innovative ideas, worldwide resources and diverse markets.

Finding the right candidates

Because China's reality changes over time, the ideal candidates are often not the obvious ones. For decades, headquarters rewarded the top-down implementation of imported plans in special economic zones carved out of China's mainstream economy by government bureaus. Today's localised China branches are integrated into indigenous systems of compliance, resources, economic trends and even competition. Changes erode the experience of seasoned leaders, while flexible young managers still lack the required routine and insight.

This shrinks leadership succession talent pools, but European firms cannot appoint managers solely based on skills or experience. Instead, they need candidates (young or senior, foreign or local) with the necessary mix of personal characteristics: the ability to stay focussed on goals, learn fast and act flexibly, all while delivering in a compliant manner and operating according to the requirements of headquarters. Importantly, leaders must be part networker and politician: rare for technically trained managers but essential in today's China. HR teams must use interviews and assessment tools to identify suitable candidate traits, as even experienced professionals might prove temperamentally unfit for China after deployment — a costly mistake for firms.

> "Importantly, leaders must be part networker and politician: rare for technically trained managers but essential in today's China."



Leaders need diverse teams

The list of necessary traits for leaders of China operations presents a challenge. While some recruiters may hit the jackpot with people who check all the boxes, most will have to make tough choices. Should they choose the candidate with the stellar financial record or the fluent Mandarin? The technology trends expert or the well-connected veteran? Local experience or a passport that allows global travel? When no single candidate fulfils seemingly essential criteria, teams provide the solution.

The alignment of headquarters' expectations, local circumstances and worldwide resources calls for diverse teams with complementary capabilities. A China branch's boss can be a local veteran or, like most foreign managers, on a two-to-three-year assignment, an industry expert or a rising star; their immediate team must balance their blind spots. Seasoned leaders must collaborate with young colleagues comfortable with new technology. Proven local executives need foreign nationals who can travel visa-free at short notice. Rooted China residents need insight from remote team members working in different countries.

In short, despite all the pressure to do the opposite, foreign firms in China need leaders who can help them stay truly multinational.

Gabor Holch coaches and advises multinational executives on upgrading their skills from competent managers to corporate leaders with global mindsets. China-based since 2002 and working globally, Holch is a Certified Management Consultant (CMC) in English and Mandarin and licensed in major assessment tools. His book, Dragon Suit: The golden age of expatriate executives in China, was published in 2023.

EUROPEAN CHAMBER'S

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Senior Membership and Events Manager
Shanghai Chapter

Helika Juergenson

5 years
Project Manager at China IP SME Helpdesk
Beijing Chapter

Sally Huang

10 years
General Manager
Southwest China Chapter

European Chamber
中国欧盟商会

Mastering HR compliance in China

Essential insights for European businesses

Every European company operating in China hopes to have a successful and profitable business, yet many overlook the vital role of human resource compliance. In this article, **Martin Zhou** and **Dylan Wu** of **Linklaters Zhao Sheng** explore several key areas of Chinese employment law that businesses need to be aware of.

Robust human resources (HR) compliance not only helps mitigate legal risks, foster a positive workplace culture, and enhance employee morale and retention, but also safeguard a company's reputation and operational stability in the competitive China market. This article covers frequently asked questions and emerging challenges in Chinese employment law to help your business thrive.

Anti-discrimination

As a general principle scattered across various pieces of legislation, employers must provide equal employment opportunities to all employees and applicants without regard to nationality, race, religion, gender or any other distinct characteristic. Employment contracts cannot include restrictions on marriage or pregnancy for female employees. Additionally, discrimination against individuals with infectious diseases is prohibited, although those infected cannot work in specific high-risk occupations.

Furthermore, gender discrimination against female candidates during recruitment is also illegal. Employers cannot ask female candidates about their marital status or circumstances relating to childbirth or children during job interviews, and pregnancy tests are prohibited in pre-employment medical checks.[1]

Unlike the European Union's (EU's) Artificial Intelligence (AI) Act, China does not have a law restricting the use of AI in recruitment and HR

[1] In 2013, a woman in China sued a major education and training company, alleging that its job advertisement was discriminatory as it specified the position was open to "males only". This case, which ended in a settlement, was hailed as China's first gender discrimination lawsuit.

Gender discrimination cases have continued since then. In March 2024, the Suzhou Intermediate People's Court published a collection of labour dispute cases heard between 2018 and 2023, all involving female employees claiming their rights had been violated. In one notable case, a female employee was terminated during her probationary period after becoming pregnant. Her employer cited her inability to "travel for business" and being "not competent for high–intensity work" as reasons for her dismissal. The court ultimately ruled in her favour, supporting her claim for reinstatement.

management. However, employers must still comply with anti-discrimination requirements when using AI tools.

Protection for female employees

In addition to the anti-discrimination requirements mentioned above, the law has established certain specific safeguards for female employees. For instance, employers are not permitted to reduce their salaries and benefits, restrict promotions, stop them from obtaining professional and technical titles or dismiss them due to marriage, pregnancy, maternity leave or breastfeeding. If a female employee's contract expires while she is pregnant, on maternity leave, or within the breastfeeding period (up to a child's first birthday), the contract must be extended until these circumstances end.

Workplace sexual harassment remains a hot-button issue in China, much like in Western countries, arousing public anger from time to time. To mitigate the risk of incidents in the workplace, the law places a variety of requirements on businesses, including formulating rules and policies against sexual harassment, carrying out education and training on prevention and stopping sexual harassment, and setting up formal complaint mechanisms for employees.[2]

Data protection

Employers have the right to obtain from an employee the basic information which is directly relevant to the employment contract and must keep employees' personal information confidential.

The Personal Information Protection Law, which took effect on 1st November 2021, has enhanced the protection of personal information. Obtaining

“The Personal Information Protection Law, which took effect on 1st November 2021, has enhanced the protection of personal information.”

consent remains central to processing employees' personal information legally, while additional consent from individuals is required under certain circumstances, including for processing sensitive personal information.

Intra-group transfers of employee data is a common data export scenario for multinational corporations, which typically leverage global systems to manage employee data. EU businesses may seek to explore the HR management exemption under existing data protection legislation to export data. To satisfy the exemption, the onshore companies must implement relevant labour rules or collective agreements legally and demonstrate a 'genuine need' to export the employee data.

As part of best market practice, employers implement privacy notices or policies to inform employees about how their personal information will be collected and processed as well as their rights.

Labour unions

In China, labour unions help keep businesses stable and promote their healthy development. Unlike in many Western countries, they rarely oppose management's goals or decisions. Employees have the right to form a union and are encouraged to do so, though by law an employer is not obligated to create one.

Employees are free to become members of labour unions. Once a labour union is set up, the employing entity is required to allocate funds to the union, while union members are required to pay membership fees.[3]

Salaries

Generally, an employer cannot unilaterally change the terms of employment, including an employee's remuneration. By law, any salary amendment must be in writing and signed by both parties. In practice, an employee is unlikely to challenge a salary increase, while a reduction is more contentious. The most prudent approach is to obtain the employee's consent to any pay cut.

An employment contract may include provisions allowing for pre-consent to salary changes. These provisions can be challenged and are subject to review

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2 In 2022, the Supreme People's Court released a set of cases for lower courts' reference. One case indicates that the Supreme People's Court supported an employer's termination of employment of a senior manager who had failed to properly address sexual harassment in the workspace. It commented that managerial personnel must take reasonable measures to address employee complaints of sexual harassment. If they fail to do so, condone harassment, or interfere with investigations, the employer can terminate their employment for not fulfilling job responsibilities and violating regulations. Claims by managerial personnel that such terminations are unlawful will not be supported by any court.

3 The employing entity is required to allocate an amount equal to 2 per cent of the total wages of all employees to the union fund. In contrast, employees who are members of the union are required to pay their membership fees, which should be 0.5 per cent of their respective monthly salary.

by labour arbitration tribunals and courts on a case-by-case basis.

Some courts hold that businesses facing economic challenges, such as those caused by Covid-19, may reduce employees' salaries if a collective consultation is conducted. However, caution is advised, as reductions are not justified without an imminent need to lower costs. While collective consultation is necessary, this approach to salary adjustment is not universally recognised and remains to be tested.

Termination of employment

China's employment law is employee-friendly regarding termination. Employers cannot terminate contracts at will and must rely on grounds specified in China's Employment Contract Law.[4] Employees are entitled to statutory severance in certain scenarios, such as performance issues or mass layoffs, but not in others (such as serious breaches of internal policies). Statutory severance is generally calculated as one month's average salary for each year of service.

Termination grounds affect procedural requirements, timelines and costs. Without basing the case on statutory grounds and meeting the relevant statutory requirements, terminations are likely to be deemed wrongful, potentially leading to double severance payments or employment reinstatement (the latter being worse for employers). In labour dispute cases relating to an employer's unilateral termination of employment, the employer bears the burden of proof to justify the termination.

Given the risks of wrongful termination, employers often pursue mutual agreements, offering severance packages higher than the statutory amount to incentivise employees to release potential claims.

Businesses are recommended to exercise caution when implementing unilateral termination against their employees. European businesses operating in China should ensure the following safeguards are in place:

- Maintain robust management systems (such as performance management monitoring and internal disciplinary investigation mechanisms), which could help document and address issues systematically.
- Be mindful of regulatory and legal requirements (if any) during in-house investigations (as appropriate) and consult specialist teams at an early stage.
- Review relevant legal requirements from both substantive and procedural perspectives before creating an action plan.
- Collect, secure and review all relevant evidence before making a decision on termination, and ensure that evidence will be admissible in a labour arbitration tribunal or court hearing.
- Explore alternative solutions such as mutual separation agreements or encouraging the employee to resign voluntarily, which will be more amicable and less legally contentious than unilateral termination.
- Consult with in-house or external legal counsel and seek legal advice before making a decision.

Increase in retirement age

Notably, on 13th September 2024, the Standing Committee of the National People's Congress announced its decision to gradually increase the statutory retirement age for employees in China, effective from 1st January 2025. Over 15 years (January 2025 to December 2039), the statutory retirement age will gradually increase from 60 to 63 years for male employees and from 50/55 to 55/58 years for female employees, depending on their role. Employers are advised to bear in mind this legal development and carefully assess each termination case where the age of the employee in question may have an impact. Eb

Martin Zhou is the Head of Employment & Incentive practice (Mainland China) at **Linklaters Zhao Sheng**. Dylan Wu is a Managing Associate at the joint operation. **Linklaters Zhao Sheng** combines premier China law and full-service capabilities with Linklaters' international expertise. Its Employment and Incentives team ensures clients are best placed to react to evolving business needs. The joint operation covers the full range of employment and incentives issues including recruitment and employment, remuneration and incentives, transfer of employment and HR integration, layoffs and redundancies, workplace misconduct, investigations, restrictive covenants, labour dispute resolution and data privacy.

[4] The Employment Contract Law provides a variety of grounds for employers to unilaterally terminate employees. Termination with cause includes serious violations of internal rules, dereliction of duty or embezzlement causing severe losses to an employer, or incompetence. Additionally, the law allows redundancy of a large number of employees (more than 20 or over 10 per cent of the workforce) at once.

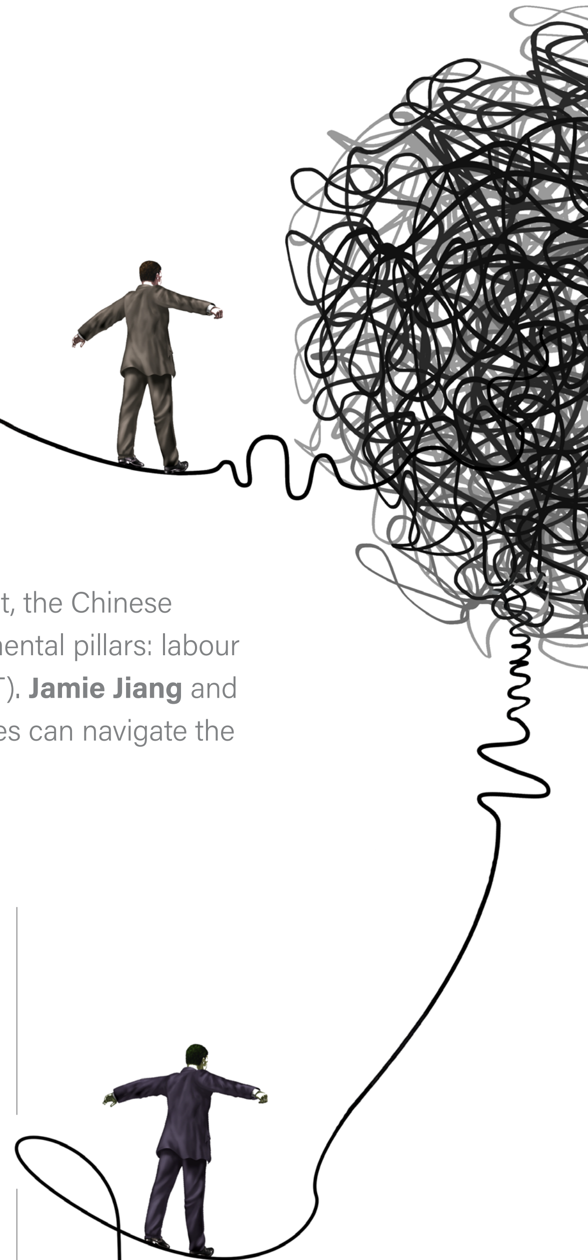
European Chamber
CARBON NEUTRALITY ACTION
WORKING WITH CHINA TOWARDS 2060

Join our working groups to make your contribution

- Advocating for EU-China cooperation on decarbonisation
- Facilitating coordinated efforts among the Chamber's membership
- Working with China to achieve its 2060 carbon neutrality goal

Navigating the ‘trinity concept’

Labour contracts, social security and income tax



When it comes to company compliance with employee management, the Chinese authorities utilise the ‘trinity concept’ which comprises three fundamental pillars: labour contracts, social security contributions and individual income tax (IIT). **Jamie Jiang** and **Cherry Tao** of **Dezan Shira and Associates** explain how companies can navigate the various laws and regulations to ensure compliance.

With the implementation of the *Administrative Supervision Measures for Social Insurance Funds* (*Measures*)[1] on 18th March 2022, regulators in China's major first-tier cities, such as Beijing and Shanghai, have intensified their focus on ensuring the alignment of employees' labour contracts, social security contributions and the withholding of IIT.

This means that the location of employment specified in the labour contract, the city where the employee is enrolled in China's social security system and the city where IIT is filed must be consistent. The alignment of contracts, social security and taxes is known as the ‘trinity management method’, and it is something that has become a significant concern for companies operating in China.

In this article, we explore the practical implementation of this policy, discuss the potential implications of non-compliance and examine the professional solutions available.

Over the past few years, the following four characteristics have been observed in the implementation of this policy.

Local jurisdiction, universal coverage

The trinity management method is implemented by local labour authorities across China. It is a common practice in all regions to conduct targeted interviews with companies and issue orders for the timely rectification of any violations. These interviews are not limited to specific types of companies, with both state-owned enterprises (SOEs) and private enterprises affected. Notably, leading companies across various industries have been the initial target for such interviews.

1 *Administrative Supervision Measures for Social Insurance Funds*, Ministry of Human Resources and Social Security, 18th March 2022, viewed 19th September 2024, <https://www.mohrss.gov.cn/xxgk2020/gzk/gz/202202/t20220221_436454.html>

> **"According to Article 88, the relevant department can impose fines ranging from two to five times the defrauded amount."**

No formal notice

Despite China's labour laws requiring an employee to work, pay taxes and enrol in social security in the same city, no official document has been released that officially lays out the trinity management method. Instead, local authorities tend to notify businesses in relatively unofficial ways. For instance, in Beijing, notifications from the municipal social security centre were shared through various districts or counties' official WeChat accounts, reminding companies of the need to ensure employees work and pay social security and IIT in the same city. Similarly, in Hangzhou, instructions related to the trinity requirement are commonly disseminated through sessions or seminars attended by business representatives.

Enhanced supervision

With government services increasingly digitalised, local labour and social security bureaus, as well as tax authorities, have better tools and data to ensure consistency in the reimbursement clauses in labour contracts, social security contributions and IIT payments. Using different base amounts for social security payments and IIT withholdings has become more challenging and risky.

For example, when claiming work-related injury benefits or medical insurance, certain checks are completed. In cities like Shanghai, the base salaries specified in labour contracts, social security contributions and IIT payments are reviewed when examining an employee's application materials for a residence permit. Additionally, in cities like Beijing, the employer's name on the labour contract and the name of the company paying social security contributions are reviewed to ensure they match when determining the eligibility of relevant employees' children for some public schools.

What additional legal consequences are there for violating employee management norms?

In addition to reviews and corrections mandated by relevant authorities, Article 32 of the *Measures* stipulates that if a person fabricates their eligibility for social insurance participation by providing false personal information or incorrect employment details using forged, altered or embezzled identity certificates, presenting false certification materials, or employing other fraudulent means to illegally obtain social insurance benefits, they will be dealt with under Article 88 of the Social Insurance Law.[2]

According to Article 88, the relevant social insurance administrative department can order the repayment of fraudulently obtained social insurance benefits and impose fines ranging from two to five times the defrauded amount. This is the first time that the Ministry of Human Resources and Social Security has explicitly stated in an official document that "fabricating labour relations" and "fabricating social security eligibility" in order to join social security schemes will be regarded as illegal acts.

How is China's trinity management method different from other major economies?

China's trinity management approach is different from that of some other major economies.

In the United States, the location where an employment contract is signed, where social insurance is paid and where taxes are filed can differ. An

[2] See Article 88: *Social Insurance Law*, Ministry of Human Resources and Social Security, 29th December 2018, viewed 19th September 2024, <https://www.mohrss.gov.cn/xxgk2020/fdzdgknr/zcfg/fl/202011/t20201102_394629.html>

employment contract can be signed in one state while the employee works in another. This situation is common in interstate employment. Social insurance is typically paid in the state where the employee actually works. The tax filing location usually depends on the employee's place of residence and work. Employees may need to file taxes in both their state of residence and their state of employment, depending on the regulations of the state where they live and work.

In Germany and France, a company can also pay taxes and social insurance contributions for employees working in a different city to where the company is registered. Social insurance contributions are based on the employee's place of work. The employer is responsible for deducting contributions from the employee's salary and paying them to the relevant authorities, regardless of the company's registered location. Income tax is also deducted from the employee's salary by the employer and paid to the tax office in the region where the employee is registered as a resident. This means that even if a company is registered in one city, it can handle tax payments for employees working in other cities. This flexibility allows companies to have employees working remotely or in different locations without needing to establish a separate legal entity in each city.

Why do foreign companies find it difficult to comply with trinity management?

If a foreign investor plans to establish a company and hire employees in just one city, there will likely be no major issues with trinity management compliance. However, in practice, foreign investors often set up in one city but want to maintain operations in multiple cities across China, necessitating having local employees in those cities. In such cases, complying with trinity management can be challenging.

Local employees often prefer to enjoy social security and other benefits in the city where they live. However, foreign-invested enterprises cannot create social security accounts or pay IIT in cities where they have no branches.

While a company can meet the rules by setting up branches or subsidiaries in each city, this approach is often too costly for small and medium-sized businesses, especially those in the early stages of development. This is particularly true when the number of local employees is very small.

Even if a company is willing to bear the cost of setting up local branches, it takes time. The company still needs to make corresponding arrangements for the transitional period.

Additionally, managing labour contracts, social insurance, and IIT payments across multiple cities in China is complex. China's labour regulations are handled at the local level and can vary significantly from city to city. This presents a significant challenge for foreign companies that are new to China or have a comparatively small human resources (HR) team.

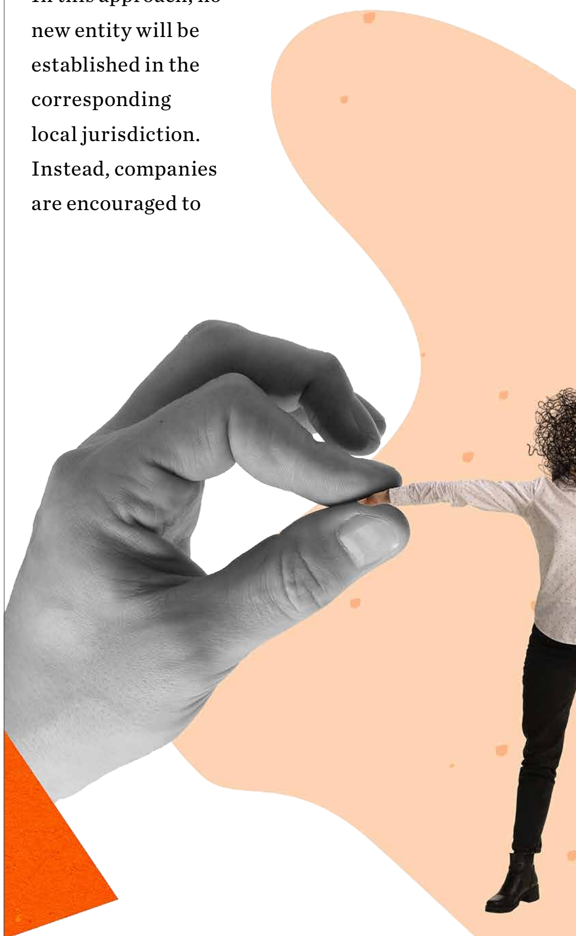
How can businesses ensure compliance with the trinity management method?

Based on the above, it is evident that an increasing number of cities are imposing stricter scrutiny on the alignment of labour contracts, social security payments and IIT withholdings. The proper implementation of the trinity management method is now closely linked to eligibility for various benefits. Relevant authorities have developed more technical methods to enforce compliance, resulting in intensified legal consequences for violations. It is of utmost importance for companies and HR departments to prioritise and actively plan for compliance in this aspect.

For businesses that do not have a physical entity registered in corresponding local jurisdictions to handle local employees' social security and IIT payments, we have identified three possible solutions.

Solution 1: Mutual agreement with employee to re-sign their labour contracts

In this approach, no new entity will be established in the corresponding local jurisdiction. Instead, companies are encouraged to



negotiate with relevant employees to amend their labour contracts. A new labour contract will be signed between a company's headquarters and the employee, with headquarters responsible for managing the employee's social security and IIT at its location. The primary advantage of this solution is that it incurs minimal additional costs for the business. However, it may be challenging to convince employees to accept this arrangement, as they might be seeking access to specific social benefits available by complying with the trinity management method.

Solution 2: Setting up new entities in various local jurisdictions

In this approach, companies will need to register new entities in the jurisdictions where their employees are operating on the ground. These new entities will then be responsible for managing employees' social security and IIT payments. This solution prioritises employees' demands to participate in social security and pay IIT locally. However, setting up new local entities is likely to substantially increase overall compliance costs for businesses.

Solution 3: Using professional HR services

In addition to the previous solutions, there is another approach that allows businesses to have employees enrolled in social security schemes and pay taxes in jurisdictions other than where the business is registered: companies can make use of professional HR services such as professional employer organisations (PEOs).

Under this solution, businesses enter into an agreement with a PEO that has branches in the cities where their employees are located. The PEO will manage employees' labour contracts, social security contributions and payroll through their local branches. This centralised management offers a streamlined and efficient solution that simplifies HR management, ensures compliance, saves costs, reduces legal risk and ensures scalability and flexibility.

For instance, if a foreign investor establishes a company in Shanghai but needs to base some employees in Beijing, the investor can utilise a one-year PEO service. Employees would sign labour contracts with a PEO operating in Beijing, ensuring that social security, IIT and payroll are managed locally. Once the business concludes, the employment relationship with the PEO can be terminated. Alternatively, if the investor decides to establish a physical presence in Beijing, labour contracts can be re-signed between the local entity and the employees.

In essence, using PEO services allows companies to test the market at minimal cost. If successful, the company can establish a local entity and continue independently; if not, the complexities of setting up and deregistering a company have been avoided.

Summary

The trinity management approach to labour contracts, social security contributions and IIT is an increasingly prominent trend across China, particularly in first-tier cities. In this new context, businesses can no longer sign labour contracts with their employees while managing their social security contributions and IIT payments through separate local entities. Companies are advised to carefully study the new requirements and explore suitable solutions promptly to avoid increased scrutiny from relevant authorities.

This article has been expanded from a previous article published by Dezan Shira and Associates.

Cherry Tao is assistant manager on the Human Resources Administration and Payroll Services team at Dezan Shira & Associates' Dalian office.

Jamie Jiang is a senior associate on the Human Resources Administration and Payroll Services team at Dezan Shira & Associates' Dalian office.

Dezan Shira & Associates assists foreign investors in China and has done so since 1992 through offices in Beijing, Tianjin, Dalian, Qingdao, Shanghai, Hangzhou, Ningbo, Suzhou, Guangzhou, Dongguan, Zhongshan, Shenzhen and Hong Kong.

The company has offices in Vietnam, Indonesia, Singapore, the United States, Germany, Italy, India and Dubai (UAE), as well as partner firms assisting foreign investors in the Philippines, Malaysia, Thailand and Bangladesh.

1ST JULY
BEIJING

European Chamber meets DG ENER Director General Juul-Joergensen

Representatives from the Chamber with Director General for DG ENER Ditte Juul-Joergensen
Photo: European Chamber

On 1st July, European Chamber representatives from the Energy and Environment working groups, and Carbon Market Sub-working Group, were led by States' Representative Gianni di Giovanni to meet with Director General of the Directorate-General for Energy (DG ENER) Ditte Juul-Joergensen.

Topics discussed during the meeting included China's path to carbon neutrality, and Chamber members' experiences with decarbonising their China operations. The Chamber delegation also outlined the need for increased access to green electricity and the harmonisation of different Green Electricity Certificate frameworks between the European Union and China if China is to achieve its 30/60 carbon goals.

17TH JULY
BEIJING

MOFCOM roundtable on trade-ins of consumer goods

European Chamber representatives at the MOFCOM roundtable
Photo: European Chamber

On 17th July, European Chamber Secretary General Adam Dunnett participated in a roundtable organised by the Ministry of Commerce (MOFCOM), on China's *Action Plan to Promote Large-scale Equipment Renewals and Trade-ins of Consumer Goods*. The meeting was chaired by Vice Minister of Commerce Ling Ji.

At the event, Dunnett noted that Chamber members are concerned that, in practice, they will not be permitted to participate fairly in the initiative. He also emphasised the need for the development of related manufacturing standards and increased consumer awareness of the need for upgrades of outdated, energy-intensive equipment in China. Ling stated that China will continue to open up its market, optimise its business environment, and support domestic and foreign enterprises to equally participate in the scheme.

27TH AUGUST
SOUTH CHINA

Vice President Zenkel speaks at China-Europe energy forum in Guangzhou

Attendees pictured at the third China-Europe Energy Technology Innovation Cooperation Forum
Photo: European Chamber

On 27th and 28th August, the third China-Europe Energy Technology Innovation Cooperation Forum, organised by the European Chamber, China Electric Power Planning & Engineering Institute and China Southern Power Grid, was held in Guangzhou.

During the session, Chamber Vice President Klaus Zenkel pointed out the unique advantages of China and Europe in energy technologies, which are set to redefine global energy landscapes and drive sustainable development: China has emerged as a powerhouse in renewable energy, particularly in solar and wind, while Europe is renowned for its advanced energy infrastructure and commitment to sustainability. Zenkel emphasised the need for continued dialogue to overcome political and economic differences.

7TH AUGUST
SHANGHAI

Exclusive roundtable with Shanghai vice mayor

Vice President and Shanghai Chapter Chair Carlo D'Andrea speaking at a roundtable on China's large-scale equipment renewal and consumer goods trade-in policy
Photo: European Chamber

On 7th August, the European Chamber participated in a roundtable on the *Action Plan to Promote Large-scale Equipment Renewals and Trade-ins of Consumer Goods*, organised by the Shanghai Municipal Commission of Commerce and attended by Shanghai Vice Mayor Hua Yuan.

European Chamber Vice President and Shanghai Chapter Chair Carlo D'Andrea attended along with four Chamber Advisory Council members and six working group chairs. D'Andrea emphasised that efforts should be made to improve technical standards related to traded-in products and equipment, and to prioritise the use of recycled and low-carbon materials when implementing the scheme. Hua stressed the importance of ensuring all companies receive equal treatment under the policy.

9TH AUGUST
NANJING

Roundtable discussion with Nanjing Bureau of Ecology and Environment

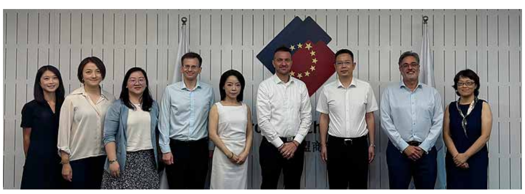
A delegation from the European Chamber's Nanjing Chapter attends a meeting at the Nanjing Bureau of Ecology and Environment
Photo: European Chamber

On 9th August, Shan Jianhua, vice chair of the European Chamber's Nanjing Chapter, led a delegation to the Nanjing Bureau of Ecology and Environment to discuss European businesses' concerns related to environment, health and social inspections conducted by Chinese officials in the region. The delegation was welcomed by Zhou Ninghui, the bureau's deputy director general.

Discussions between the two sides focussed on enhancing communication between the Chinese Government and European firms, including with their headquarters. Future collaborations were planned to introduce advanced monitoring systems for operational efficiency and compliance.

21ST AUGUST
SHANGHAI

Exclusive meeting with deputy special commissioner of Shanghai MOFCOM



The European Chamber delegation pictured with He Shaojun, deputy special commissioner of Shanghai MOFCOM
Photo: European Chamber

On 21st August, the European Chamber hosted a meeting with Deputy Special Commissioner of the Shanghai Ministry of Commerce (MOFCOM) He Shaojun. European Chamber Vice President and Shanghai Chapter Chair Carlo D'Andrea and Chamber Vice President Bruno Weill led the delegation.

D'Andrea outlined the need for China to improve its intellectual property rights regime, lower operational and living costs for foreign nationals in Shanghai, simplify its visa application process and increase market access for foreign companies. He Shaojun thanked the Chamber for raising issues faced by the European business community in China and said that he would provide feedback to the relevant Shanghai government departments.

European Business in China

POSITION PAPER 2024/2025

More action needed, not more action plans

While doing business in China has always required a high degree of flexibility in order to adapt to the rapidly changing environment, companies previously viewed the complex challenges they encountered as the 'growing pains' of an emerging market. There was a common perception that the difficulties faced were worth bearing in exchange for access to a large and dynamic market, world-leading manufacturing clusters and comparatively cheap labour. With the risks of doing business mounting and the rewards seemingly decreasing, many investors are now confronted with the reality that their approach may require a substantial strategic rethink.

The central concern for European Chamber members is China's economic slowdown. However, several other factors are dragging on business confidence, including perennial market access and regulatory barriers; a highly politicised business environment; lacklustre domestic consumption; overcapacity; the persistence of ambiguous rules and regulations; and the government's continued focus on national security and developing a high degree of self-reliance.

A sentiment is emerging at company headquarters (HQs) and among shareholders that the returns on China investments are no longer commensurate with the risks faced. Profit margins in the country are equal to or below the global average for approximately two thirds of European Chamber members, and pessimism about future profitability is at an all-time high. With many other markets now offering greater predictability and legal certainty along with at least the same returns on investment, continuing to invest at previous levels in China is simply becoming harder to justify.

There are indications that foreign-invested enterprises (FIEs) have already begun adjusting their investment strategies. Foreign direct investment (FDI) into China decreased by 29.1 per cent year-on-year during the first half of 2024. Furthermore, the volume of investments made by European Union (EU) and American firms is now roughly half that of a decade ago, with smaller multinational companies and small and medium-sized enterprises in particular opting to invest elsewhere.

In past years, this shortfall would have at least been partly offset by reinvestments – businesses using profits earned in China as opposed to capital injections from their HQs to fund projects. However, this metric is also trending downwards, as is the number of businesses that plan to expand their China operations.

In tandem, the nature of the FDI that the country is still able to attract is changing, as focus shifts from cost and efficiency considerations, to building resilience and ensuring the continuity of company operations. New investments are increasingly defensive, geared towards creating China-specific value chains, separate IT and data storage systems, localising business functions, and enhancing compliance capacity, rather than beefing up China research and development or capturing market share. These kinds of investments will neither create new jobs nor drive innovation.

Similar defensive trends can be seen when it comes to diversification of supply chains. European Chamber members have begun both offshoring and onshoring, often at additional cost and loss of efficiency, as they seek to mitigate risks.

These changes are by no means a sign that European companies are running for the exit, but they do represent a strategic shift towards siloing China operations from the rest of the world. While this creation of autonomous, and sometimes divergent, systems may provide greater operational resilience, it will likely set the EU and China on course for a future of reduced engagement resulting in missed opportunities.

Photo: European Chamber

29.1
per cent
year-on-year decrease in FDI into China was observed during the first half of 2024.

2/3
Approximately two thirds of European Chamber members report profit margins in the country that are equal to or below the global average.

1,024
detailed and constructive recommendations contained in the Chamber's latest Position Paper.

Reform plans need to be backed by meaningful implementation

At the start of the new millennium, reform plans announced by the Chinese Government were seen by foreign companies as credible, following years of concrete improvements to the business environment in the periods immediately preceding and following the country's World Trade Organization accession. Now, after more than a decade of largely unfulfilled pledges, doubts over China's commitment to reform are increasing.

It is against this backdrop that the State Council's 13th August 2023 *Opinions on Further Optimising the*

Foreign Investment Environment and Increasing the Attraction of Foreign Investment (*Opinions*)[1] was initially hailed as a potential turning point. While not a silver bullet for the headwinds China's economy is facing, the European Chamber believed that full implementation of the *Opinions* would help prevent a further deterioration in business confidence and provide a solid foundation to build on.

One year on from the document's publication, momentum has been lost.

To quantify this, the European Chamber asked the members of its 50 working groups, sub-working groups and fora, as well as its seven local chapters, to provide feedback on the progress they have seen on the measures so far.

This 'reality check' makes for sober reading. While the *Opinions* contain several big-ticket items that could really move the needle, limited implementation has taken place. With a few exceptions, the areas in which progress has been made have been those that will have little material impact on business, or which are too narrow in scope to meaningfully address the challenges faced by foreign companies.

The key takeaways of the *Position Paper's* analysis are summarised below, organised across six thematic areas:

- **Market access and procurement:** Actual progress made has so far largely been incremental and restricted to initiatives of limited sectoral and geographical scope, while foreign companies continue to face discrimination in China's procurement market.
- **Human resources (HR) and business travel:** Early breakthroughs were seen through the extension of China's preferential individual income tax policy for foreign nationals and via the waiving of visa requirements for citizens from several EU Member States. However, such developments represent low-hanging fruit and have yet to be followed by additional action that addresses the main HR-related concerns of European companies.
- **Digital and cyber:** Some initial momentum has been built in this area following the revision of China's regulations for cross-border data transfer. At the same time, there remains the need for upcoming rules to not be defined in an expansive manner,[2] as well as for industry-specific regulations to be better aligned with China's revised *Provisions on Promoting and Regulating Cross-border Data Flows*.[3]
- **Access to green energy:** Incremental progress has been made, but more needs to be done if FIEs are to meet their global corporate decarbonisation goals, which for many is needed to legitimise their continued presence in the China market.
- **Intellectual property rights (IPR):** Practical challenges continue to undermine the enforcement of IPR in China, while little progress has been made on sectoral-level challenges.
- **Investment promotion and facilitation:** Concerted efforts have been made to increase government-industry dialogues. However, in many instances, such dialogues have not produced results. There are several points in the *Opinions* related to the provision of support and incentives for investment in China, but their impact has been largely underwhelming, in part due to the related text lacking ambition and specificity.

The 2024 Third Plenum: Little to suggest a course correction is imminent

With limited progress made on the *Opinions*, the foreign business community had been looking to the Third Plenum of the Central Committee of the Chinese Communist Party for signals that their concerns would be addressed, in particular policies aimed at boosting domestic demand, a renewed focus on reform and opening up, and greater weight being given to market forces.

However, there was little indication provided at the session that a course correction will be forthcoming.

The Third Plenum *Decision* continues to promote investment in manufacturing as a key driver of China's economic development, albeit under the moniker 'new quality productive forces,' all while providing little concrete detail on how domestic consumption will be stimulated.

Second, while the document states that that the market should play "the decisive role in resource allocation", it also calls for state-owned enterprises (SOEs) and state capital to "get stronger, do better and grow bigger." At the time of writing little indication has been provided on how the authorities will square this circle.

Third, the *Decision* places an increased emphasis on national security, with a

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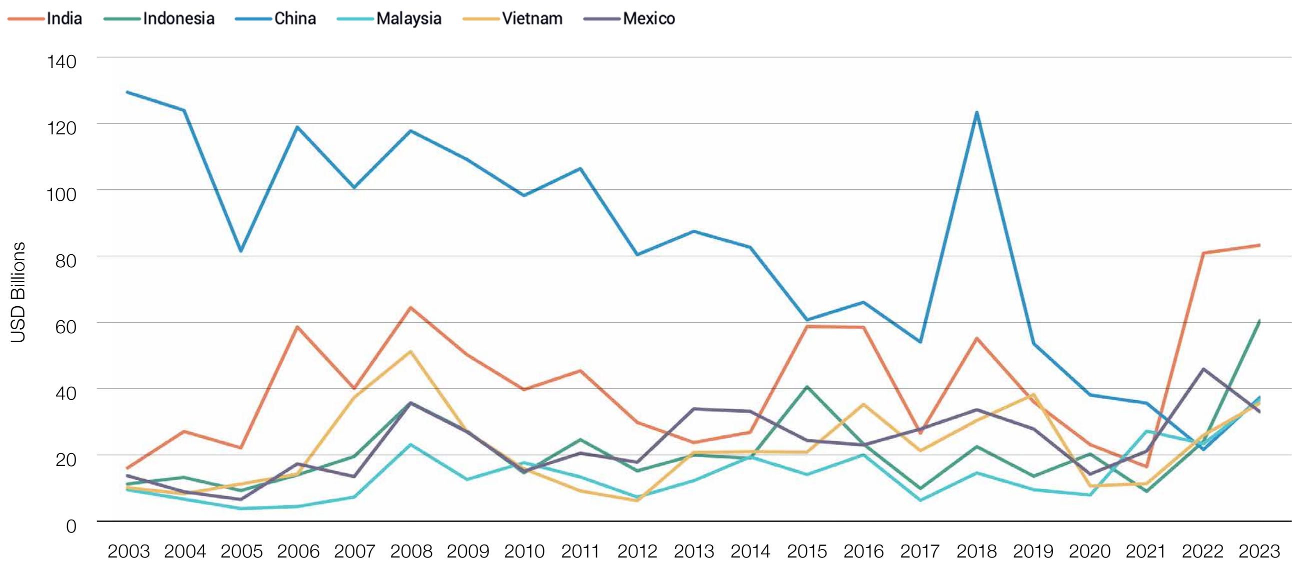
1 *Opinions on Further Optimising the Foreign Investment Environment and Increasing the Attraction of Foreign Investment*, State Council, 13th August 2023, viewed 13th September 2024, <https://www.gov.cn/zhengce/content/202308/content_6898048.htm>

2 Examples include upcoming rules for what constitutes 'important data' and 'sensitive personal information'.

3 *Provisions on Promoting and Regulating Cross–border Data Flows*, Cyberspace Administration of China, 22nd March 2024, viewed 14th October 2024, <https://www.cac.gov.cn/2024–03/22/c_1712776611775634.htm>

FIGURE 1. VALUE OF ANNOUNCED GREENFIELD FDI PROJECTS, 2003–2023



Source: UNCTAD world investment report

whole chapter dedicated to the subject. While all state actors must do what is necessary to ensure economic security, the concern among FIEs is that China's prioritisation of security could lead to policies that go beyond legitimate concerns and create insurmountable business risks. European companies are already struggling to understand their compliance obligations under a slew of recent security-related legislation.

The costs of failing to act

The main cost of failing to address business concerns more comprehensively, is that the negative trends witnessed over the past few years can be expected to continue.

At the **business level**, this would equate to a further loss of investment for China, the continued siloing of supply chains and company operations, and the current fissure between HQs and their China operations expanding to become a chasm.

Beijing would also be opening the door wider for other regions to court investment at its expense. The graph above—which shows annual greenfield FDI flows into China, Indonesia, Malaysia, Vietnam, India and Mexico between 2003 and 2023—illustrates that this dynamic is already in play, and that it intensified from 2018 onwards.

At the **intergovernmental level**, failure to implement meaningful economic reforms will likely result in an increase in EU-China tensions. The EU has already begun taking a more assertive stance towards China on key areas of concern to European business in China. Moreover, it now has the legal muscle to exert real pressure, having introduced in recent years a set of tools aimed at protecting the integrity of its Single Market, and ensuring reciprocal market access and a level playing field for European companies operating in third markets.

Tensions could be dialled down if the Chinese authorities were to fully implement the measures detailed in the *Opinions*. While this would not be a panacea, it could turn the tide and begin the process of rebuilding investor confidence in the China market.

If China is to re-establish itself as the preferred destination for foreign investment, then significant additional steps will also be needed to improve the business environment. To this end, the Chamber's latest *Position Paper* puts forward 1,024 detailed and constructive recommendations to the Chinese authorities on how this can be achieved.

Robbie Jarvis is a Policy and Communications Manager at the European Chamber and lead pen of this year's *Position Paper*.

To download the *European Business in China Position Paper 2024/2025* free of charge, please scan the QR code.

China's new Company Law

What foreign firms need to know about capital contribution

Following approval by the Standing Committee of the National People's Congress on 29th December 2023, China's revised Company Law took effect on 1st July 2024.[1] It represents the most comprehensive and substantial amendment to the Company Law since its enactment in 1993, over 30 years ago. In this article, **Carlo Diego D'Andrea** and **Aris Xie** of **D'Andrea & Partners Legal Counsel** explain how new capital contribution rules in the revised Company Law will impact foreign companies.

Adjustments to the maximum period for subscribed capital contributions by shareholders

The first major change to the law is the requirement that the registered capital of a company must be paid within a specified term, with the consequences of failing to fulfil this obligation by the specified date having also been strengthened. For limited liability companies, Article 47 explicitly establishes a five-year time limit for capital injection, stating, "Within five years from the date of incorporation, all shareholders shall fully contribute their subscribed capital in accordance with the provisions of the company's articles of association".

For companies established and registered before the implementation of the revised Company Law on 1st July 2024, if their capital contributions exceed the five-year time limit, they are required under the law to "gradually adjust" their capital contributions within five years of the establishment of the company. Additional implementing regulations from China's authorities have been released to provide further guidance on how gradual adjustment will be applied.

Accordingly, the State Council promulgated the *Provisions of the State Council on Implementing the Registered Capital Registration Management System*

[1] *Company Law of the People's Republic of China,* National People's Congress, 29th December 2023, viewed 18th October 2024, <http://www.npc.gov.cn/npc/c2/c30834/202312/t20231229_433999.html>

under the Company Law (*Management Provisions*).[2] In conjunction with the *Management Provisions*, adjustment systems are provided for companies in different situations.

For limited liability companies registered on or before 30th June 2024, and the remaining period for subscribed capital contributions exceeds five years from 1st July 2027, the *Management Provisions* provide a three-year transition period, requiring the remaining period for subscribed capital contributions to be adjusted by 20th June 2027 to 'within five years'. Any adjustment must be recorded in the company's articles of association.

Strengthening shareholders' capital contribution obligations

Along with the time limit for the contribution of registered capital, the revised Company Law generally strengthens the regulation and liability requirements for shareholders' improper or insufficient contributions.

The law explicitly states that shareholders who fail to contribute their capital in full and on time shall be held liable for compensating the losses incurred by a company. Directors have an obligation to verify contributions and issue collection notices on behalf of a company. If a director fails to fulfil this obligation in a timely manner, resulting in losses for a company, they shall bear the liability for compensation. Shareholders who receive notifications from the directors but still fail to fulfil their contribution obligations within the prescribed period may, by resolution of the board of directors, face a notice of loss of rights. This implies that the shareholder loses the rights to their unpaid contributed shares.

In addition, if a company is unable to pay its debts as they become due, the company or its creditors, whose debts are due, are entitled to demand that shareholders who have subscribed to but not yet fully paid their capital contributions (because the payment term has not expired) make those payments in advance of the term.

Improvement of equity transfer rules

The revised Company Law has enhanced the right of consent for other shareholders regarding the transfer of equity and, for the first time, clearly stipulates the sharing of responsibilities between the transferor and transferee in the event of an equity transfer. Specifically, Article 84 of the Company Law removes the requirement for shareholders of a limited company to obtain the consent of other shareholders for the transfer of equity, replacing it with a requirement to provide notification. If the other shareholders fail to respond to the notification, it will be deemed as waiving their right of first refusal.

Conclusion

This comprehensive revision of the Company Law adjusts the existing corporate governance structure from multiple perspectives, which will significantly impact the operations of foreign-invested enterprises in China and influence their future investment decisions. Specifically, it will affect the optimisation of the current corporate governance structure, the adjustment of registered capital and the subsequent operation of companies. It is essential to pay attention to subsequent regulations and rules issued by regulatory authorities and consider the actual situation of a company's operations in China to assess the aspects that need to be adjusted. Navigating the updated capital contribution rules and foreign investment landscape, as well as adhering to best practices, remains crucial for successful operations in China. By staying informed and seeking professional advice, foreign-invested companies can leverage these changes to their advantage and thrive in the dynamic Chinese market.

Carlo Diego D'Andrea is managing partner at D'Andrea & Partners Legal Counsel. **Aris Xie** is a counsel at the firm.

D'Andrea & Partners Legal Counsel is a leading international law firm, with European headquarters situated in Milan, Italy, and its Asia-Pacific headquarters based in Shanghai, China. The firm has a strong presence across major cities in China. The firm is one of the very few international law firms in China duly authorised by the Ministry of Justice to operate as a Representative Office of a foreign law firm in China.

[2] *Provisions of the State Council on Implementing the Registered Capital Registration Management System under the Company Law,* State Council, effective on 1st July, 2024, viewed 18th October 2024, <https://www.gov.cn/zhengce/zhengceku/202407/content_6960377.htm >

Media Watch

President Eskelund interviewed on foreign companies' China challenges

With the Third Plenum held in July, there was considerable media interest in the European Chamber's views on how statements made at the Plenum were likely to impact the outlook for foreign direct investment into China. Chamber President Jens Eskelund reiterated the Chamber's long-standing position that China needs to take measures to restore the predictability, reliability and efficiency of its market if investor confidence is to be restored to pre-pandemic levels.

Chamber comments on China's first-half GDP figures

On 15th July, China's National Bureau of Statistics announced that the country's gross domestic product (GDP) had expanded by five per cent during the first half of 2024. Chamber President Jens Eskelund was interviewed by the *People's Daily* on the announcement. He highlighted that the total value of China's exports had increased 6.9 per cent over the same timeframe, adding that China is focussing on the development of high-tech industries as new drivers of growth.


"为世界经济发展注入更多动力"
人民日报 2024-07-17 00:00

People's Daily headline on China's GDP figures
Media: *People's Daily*
Date: 17th July 2024

President Jens Eskelund speaks live to *CNBC* on the challenges faced by European companies in China
Media: *CNBC*
Date: 15th July 2024


既是大市场也是新赛道 外资眼中的中国新机遇
央视新闻客户端 2024-08-10 20:24:02 17.5万

CCTV article on businesses' reactions to the consumer goods action plan
Media: *CCTV*
Date: 10th August 2024

Chamber view sought on consumer goods action plan

On 13th March, the State Council released the *Action Plan to Promote Large-scale Equipment Renewals and Trade-ins of Consumer Goods* (*Action Plan*). On 17th July, Vice Commerce Minister Ling Ji said at a roundtable meeting for foreign-invested enterprises that the campaign will effectively expand domestic demand, stimulate investment, upgrade consumption and provide market opportunities for all types of businesses operating in China, including foreign-invested enterprises.

Speaking to *CCTV* about the *Action Plan*, Chamber President Jens Eskelund noted that the Chamber will be monitoring the implementation of the plan to see if its members are able to benefit from the scheme in practice.

China Shows Few Signs of Tilting Economy Toward Consumers in New Plan

The Communist Party rebuffed calls from economists to shift away from investment-led growth and toward consumer spending.

A *New York Times* article on Chinese policymakers emphasis on investment-led growth
Media: *NYT*
Date: 19th July 2024

Macro Matters

Chinese officials expect bumpy ride for economy after policy meeting

By **Joe Cash** and **Liangping Gao**
July 19, 2024 7:49 PM GMT+8 · Updated 19 days ago

Aa

Reuters article on China's economic goals laid out at the Third Plenum
Media: *Reuters*
Date: 19th July 2024

Meeting signals 'opportunities for foreign firms'三中全会为外企带来新机遇与信心

Original Zhang Yu ShenzhenDaily 2024年07月19日 12:59 广东

Shenzhen Daily article on the opportunities presented by the Third Plenum
Media: *Shenzhen Daily*
Date: 19th July 2024

Chamber shares take on China's growing trade surplus

China's exports to the rest of the world increased substantially in June 2024, resulting in the largest monthly trade surplus since 1990. *Caixin* interviewed Chamber President Jens Eskelund on the development, who outlined how there are now mounting concerns in other markets over the impact that growing imports of Chinese high-tech and new energy goods may have on their own industrial competitiveness.

财新周刊

封面报道｜顺差的烦恼

来源于《财新周刊》 2024年08月12日 第32期

中国贸易顺差不断攀高，是喜是忧？如何应对贸易失衡？

Article published by *Caixin* on China's growing trade surplus
Media: *Caixin*
Date: 12th August 2024

Media seek Chamber's views on Third Plenum

The Third Plenum of the Communist Party of China was held in Beijing from 15th to 18th July. Following its conclusion, a communiqué was published with a longer resolution document released the week after. The European Chamber shared a statement with all its media partners following the release of the communiqué, which was widely quoted by media outlets including the *NYT*, *Reuters*, *The Straits Times* and *CRI*.

Speaking with *CGTN*, Chamber President Eskelund highlighted the need for China to strike the right balance between security concerns and economic development. He also noted that the Third Plenum communiqué provided mixed signals to business on the future trajectory of the Chinese economy, with the document unclear about how Chinese officials plan to square the circle of facilitating the market to play "the decisive role in resource allocation" while also aiming for state-owned enterprises and state capital to "get stronger, do better and grow bigger".

There was also significant interest from domestic media in the Chamber's views on the expected impact of the Plenum's outcomes at the local level. European Chamber Vice President and South China Chapter Chair Klaus Zenkel was interviewed by the *Shenzhen Daily* and *GD Today*. Zenkel told the media outlets that he recognised the Chinese Government's rhetorical commitment to achieve 'high-quality' growth and expand market opening while noting that businesses will be watching to see if pledges are implemented.

Chamber comments on China's EU dairy probe

On 22nd August, China launched an anti-subsidy investigation into a number of dairy products from the European Union (EU) including fresh, blue and processed cheeses, and curds. The probe will evaluate subsidies provided—both by the EU and individual member states—to producers of these products from 1st April 2023 to 31st March 2024. It will focus on the question of whether subsidies have had a distortive impact on the Chinese market. A Chamber statement on the development, which detailed the hope that the investigation would be conducted fairly and transparently in line with the rule of law, was quoted in the *FT*, *Reuters*, the *WSJ*, *AP*, *The Guardian* and the *SCMP*.

Events Gallery

BEIJING, 12TH JULY 2024

Panorama Seminar on the Development of AI

- The artificial intelligence (AI) sector is transitioning to the era of large models, moving from initial exploration to expert systems, machine learning and deep learning.
- The United States employs a decentralised regulatory approach with multiple agencies involved, while the European Union offers a unified framework governing AI systems both within and outside its borders.
- China's AI governance system is continuously improving, and international organisations are playing an increasingly significant role in coordinating global efforts to collectively manage AI risks among nations.

BEIJING, 5TH JULY 2024

Exclusive Tour of the Beijing High-level Autonomous Driving Demonstration Area

- The official opening of the world's first autonomous driving area at Beijing Capital Airport marks a new stage in the development of autonomous driving.
- Representatives from the Beijing High-level Autonomous Driving Demonstration Area and European enterprises both believe that dialogue in the field of intelligent connected vehicles will drive industry development.
- Exploring the opportunities of government and corporate investment and encouraging foreign companies to actively participate in the development of the autonomous driving demonstration area is an effective way to ensure its continued development.

SHANGHAI, 29TH AUGUST 2024

2024 HR Conference: A Better Way to Develop and Retain Talent

- Artificial intelligence can streamline human resource processes, enabling businesses to identify ideal candidates.
- Empowering employees drives business growth.
- Companies should encourage innovative transformations and solicit feedback.

SHANGHAI, 4TH SEPTEMBER 2024

European Chamber 2024 Sustainable Business Awards Conference & Ceremony

- Nature and climate-related issues are recognised as risks to business.
- European companies need to adapt global innovations to local contexts and resource-constrained environments.
- Emphasising regenerative approaches in food, land and ocean use is essential for restoring ecosystems.

TIANJIN, 8TH AUGUST 2024

Tianjin Bureau of Emergency Management Health and Safety Seminar

- Twenty-one participants from 17 companies attended a health and safety seminar where interpretations of various policies were given.
- Companies should ensure they are aware of the safety records of their outsourcing partners.
- Chemical or hazardous material storage areas should be equipped with smoke, flame and temperature sensors.

SOUTH CHINA, 30TH AUGUST 2024

Visit to Shenzhen Yantian Port

- Yantian Port plays a critical role in facilitating trade between the European Union (EU) and Shenzhen, serving as a key hub for mega-vessels and container traffic.
- Companies shipping through Yantian Port benefit from its infrastructure, including natural deep-water berths and strategic global connections.
- The event highlighted the growing importance of Yantian Port for EU-China trade, with increasing exports and a diverse range of products being handled.

SOUTHWEST CHINA, 29TH AUGUST 2024

Chengdu Business Confidence Survey 2024 Launch

- European businesses are increasingly worried about the Chinese economy. Optimism over the near/medium-term outlook is fading and companies are facing more uncertainty.
- Southwest China had the highest rate of respondents reporting market opening (74 per cent) in their sector.
- The region also had the highest rate of respondents (58 per cent) reporting revenue increases compared to 2022.

NANJING, 29TH AUGUST 2024

EU SME Government Dialogue in Jiangsu

- Small and medium-sized enterprises (SMEs) are the backbone of the economy, and the EU SME Centre's services in China cover legal affairs, business development, standards and compliance.
- Nanjing is ranked as one of the top-10 cities in China for its development environment for SMEs.
- SMEs in Jiangsu Province can access various forms of support on the Jiangsu Province Small and Medium-sized Enterprise Public Service Platform.

Advisory Council News

Merck receives EXCiPACT certification

Merck, a leading science and technology company, has achieved EXCiPACT cGMP (current Good Manufacturing Practice) certification for pharmaceutical auxiliary materials at its major global cell culture media production sites. EXCiPACT is a widely recognised standard for the manufacturing of non-sterile excipients. The company is the first in the industry to receive this certification.

Photo: Merck

BASF Coatings opens Application and Technical Center in Jiangmen

BASF's Coatings (BCG) division has officially inaugurated its new Application and Technical Center in Jiangmen, Guangdong Province. Located within the site of BASF Coatings, the centre marks another major milestone in the continuous expansion of BASF Coatings' global refinish technology network.

Established in 2016, the BCG manufacturing facility offers a comprehensive portfolio of refinish coatings products, including premium, value-for-money and commercial transportation solutions.

Driving innovation and sustainability for the automotive coatings industry in the Asia-Pacific region, BCG has made a significant contribution to the launch of a comprehensive range of waterborne solutions, such as Norbin® 66 waterborne basecoat and waterborne clearcoats for Glasurit®.

The Application and Technical Center will contribute to innovation in the coatings industry by simulating customer environments with real-world equipment and conditions. Representing a significant first for BCG, the facility is equipped with two large combination spray booths, and a complete range of equipment for product development, covering the entire process from sanding and mixing to detailing and measuring.

SAP launches Business AI Experience Centre in Hong Kong

SAP has announced the grand opening of its Business AI Experience Centre located at the company's Hong Kong office. The centre aims to showcase the cutting-edge capabilities of integrated business artificial intelligence (AI) in driving

Photo: SAP

innovation, enhancing efficiency and boosting business growth through live use cases and success stories. It is designed to guide enterprises from understanding AI to practical implementation, enabling them to achieve digital transformation, and therefore fully explore the unlimited possibilities brought by business AI.

Think global, act local: Where BMW will make its next generation of high-voltage batteries

The Neue Klasse will usher in a new era of fully electric driving at the BMW Group – the success of which will depend heavily on the production of powerful high-voltage batteries. That is why BMW is expanding its production network significantly for the next generation of high-voltage batteries.

"We are setting up five facilities on three continents to produce our sixth-generation high-voltage batteries," explained Milan Nedeljković, board member for Production at BMW AG. Across the globe, the principle of 'local for local' will apply: "Keeping battery and vehicle production close to each other will make our manufacturing operations more resilient," Nedeljković continued.

Battery and vehicle production closely connected

The Neue Klasse will be the first to incorporate the all-new cylindrical cells. These represent a technological leap by BMW, offering vastly improved energy density, charging times and range. They will be assembled in new facilities located as close as possible to vehicle plants, in keeping with the principle of 'local for local'. State-of-the-art assembly plants for sixth-generation high-voltage batteries are currently under construction in Irlbach-Strasskirchen (Lower Bavaria), Debrecen (Hungary), Woodruff (near Plant Spartanburg in the United States), Shenyang (China) and San Luis Potosí, Mexico. With the 'local for local' approach in place, production will be able to continue even when unexpected events occur. In addition, short distances between battery and vehicle plants will reduce the carbon footprint of car production. The BMW Group is also upgrading its existing sites and securing jobs.

China to produce the Neue Klasse from 2026

From 2026 Neue Klasse vehicles will also be made by BMW Brilliance Automotive (BBA) in Shenyang. Here, too, the sixth-generation high-voltage batteries required for the cars will be manufactured locally. The production hall was completed in November 2023, and the installation of plant and machinery has been underway since March 2024. The first Chinese-made pre-series batteries will roll off the production line at the end of this year. Preparing for the launch of the Neue Klasse, BMW has also set up its largest research and development network outside Germany, with facilities in Beijing, Shanghai, Shenyang and Nanjing.

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European Chamber members are welcome to add news items on their own activities to our website, and share it with over 1,700 members.

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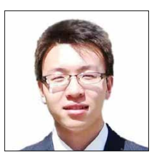

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of the European Chamber

The members of the European Chamber's Advisory Council are active in representing and advising the Chamber, and make an enhanced contribution to the Chamber's funding.

China ShortCuts

The European Chamber launched its new, short-format podcast series in October 2022.

China ShortCuts is a five-minute weekly catch-up about the Chinese business landscape.

Tune in to stay informed on the latest economic data, market trends, and policy and regulatory updates that could shape your industry.

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