Commercial Bank

Entering China: Why Preparation Pays for Life Sciences Firms

For many life sciences companies, expansion into China is an attractive goal. As the second largest healthcare market in the world,[1] China has enjoyed significant growth and a maturing of technological infrastructure, approval processes and financial ecosystems.

However, while China offers clear opportunities, it is important that companies plan their entry into the market carefully to lay the foundations for future success. While it can be tempting to take shortcuts to accelerate market entry, preparation – and consideration of future objectives – can save significant time and resources in the future.

In particular, companies must ensure they select an appropriate corporate structure for their operations in China: it should be designed with long-term regional goals in mind so that potential future pitfalls are avoided.

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Which corporate structure?

China recognizes a wide range of business vehicles, many of which are open only to local investors. For foreign companies, there are several structures to choose from, all of which have their own distinct benefits and challenges. Navigating these options requires input from legal counsel and accounting advisors to ensure the correct entity is established for a company's specific needs.

Since the enactment of the Foreign Investment Law in 2020, foreign investors can establish a commercial presence in China as a foreign invested enterprise (limited liability company or company limited by shares), a representative office, or some other form of enterprise as permitted by PRC laws. According to Ryan Cuddyre of Citi's Commercial Subsidiaries Group in Shanghai, limited liability companies and representative offices are the most common entities established by life sciences companies when they set up in China.

[1] https://www.trade.gov/country-commercial-guides/china-healthcare

- A **limited liability company** (LLC) is classified as an independent legal person that bears liability on its own behalf. The liability of the shareholder(s) is limited to the amount of the applicable capital contribution. An LLC can be wholly owned by a foreign investor or jointly owned by two or more shareholders (with an upper limit of 50 shareholders). The business scope of the entity must be registered with the relevant authorities and operations must fall within this scope. All LLCs should have a registered capital amount contributed by the respective shareholders in the form of equity. There is no requirement regarding the minimum amount and the timing of capital contributions associated with an LLC under PRC Company Law (with the exception of some specific industries). The shareholder(s) of an LLC can, at their own discretion, decide the amount of registered capital and specific time period over which it is paid. Most industries and shareholders determine the capital amount based on the needs of the company. The shareholders of an LLC distribute profits according to the proportion of paid-in capital contributions and share risks and losses relative to the proportion of registered capital.
- A **wholly foreign-owned enterprise** (WFOE) is a common type of LLC in China. It is 100% owned by a foreign investor (i.e., a Chinese partner is not required under investment regulations). A WFOE requires registered capital, and its liability is limited to its equity. This entity can generate income: the entity must allocate 10% of its annual after-tax profit to a general reserve fund account (until this account balance reaches 50% of the company's registered capital); any after-tax profits above these levels can be repatriated back to a home country. WFOEs are popular structures for life sciences companies. One particular attraction is that the structure has no paid-in minimum capital requirements for firms from the sector.
- A **representative office** is the quickest and least complex corporate structure to establish. However, the structure has some significant drawbacks. A representative office, which does not qualify as a legal person, is established by a foreign enterprise and used for marketing or exploratory purposes but cannot book sales or creates profits. Permitted activities for representative offices are limited to product or service promotion, market research of a parent company's business, quality control, or contact liaison. They are prohibited from entering into contracts with local businesses and have no registered capital requirements.

Working with the right partner

International expansion is a big step in the development of a company and the scale and pace of growth in China makes it an obvious target for many firms. Companies are understandably excited by the commercial possibilities of China's market. However, it is imperative to take the time to select an appropriate corporate structure when setting up a new entity if a company is to achieve its objectives and avoid complex and costly changes at a later date.

Choosing the correct partners for support and assistance when evaluating this decision is critical. A company's legal counsel and accountants can provide significant guidance. In addition, the right banking partner can offer insights about appropriate corporate structures for life sciences companies, especially in relation to the impact on in-country treasury operations in China and the implications for global liquidity strategies.

For more information about how Citi can partner with you and your team please Contact Us.

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