

# WHITE PAPERS

## FOOD PROCESSING IN CHINA



# PREFACE

More and more food companies are expanding into emerging markets such as China, capitalizing on growing middle classes and increasing popularity of westernized diets. Yet setting up a food processing facility in China – from financing and permitting to quality control and food safety – is a vastly different process than in the U.S. In this white paper, we explore these issues and offer our tips and insights based on our own experience operating in China.

## FOUR TIPS FOR FOOD PROCESSING SITE SELECTION IN CHINA

The stark differences can be seen at the earliest stages – in site selection. Plan for at least a three to six month process to identify, analyze and secure a site. The infrastructure, business regulations and government processes are vastly different from the U.S., so you'll need to allow ample time, and human capital, to conduct due diligence. Keep the following four tips in mind as you're exploring different site options:

1. **Property ownership:** In China, it is very difficult for a company to own property. Instead, it is often leased from the government. Lease terms are often for extended periods of time, up to 100 years.
2. **Brokers and site selection firms:** Brokers and site selection firms are typically state owned enterprise (SOE) firms.. To find experienced, independent firms, use your existing resources back in the U.S. or reach out to American expats in China to obtain referrals for brokers.
3. **Supply chain analysis:** As part of the site selection process, make sure you conduct a holistic supply chain analysis. Where is your raw product coming from and where is your end user? Map out your transportation and distribution plan. Each province has different tax laws so if you'll be operating across province boundaries, you need to understand the tax implications.
4. **Infrastructure:** Realize that the infrastructure – from roads to utilities to communications systems – is constantly evolving and often not what you are accustomed to in the U.S. Investigate the road system within your supply and distribution chain to ensure you'll have adequate transportation access. Also ensure that the site you select can support your utility and communications requirements.

## FOUR THINGS YOU NEED TO KNOW ABOUT THE PERMITTING PROCESS IN CHINA

Successful U.S. businesses in China know one thing: building relationships with Chinese officials is the key to effectively establishing, running and managing a business. Especially when obtaining the necessary permits and approvals for a new food processing plant – which can be a lengthy and frustrating process – it's imperative to play by a few key rules to ensure a smoother permitting process.

1. **In-person meetings:** Face time between the Chinese government and your key executives is not only important—it's expected. Bring as many members of your U.S.-based team to the table as possible and understand that your primary role is to build a trusted relationship with the permitting authorities. Your U.S.-based team should meet with these authorities each time they visit the country to foster that relationship. In addition, your designated local Chinese representative should attend every meeting and have more frequent meetings – at least every two weeks – directly with permitting officials to ensure the project is on track.
2. **Permitting strategy:** The China-based group that executes your lease will also help define your permitting strategy. Sit down with them and agree on this strategy including the size of the facility, road access, guarantees for utility capacity and consumption, and other operational aspects. Most importantly, get this approved strategy in writing, as it will guide the permitting process and hold everyone accountable.
3. **Permitting manager:** Designate one individual from your team to oversee the permitting process. This can be your general contractor, your own plant engineer, or some firms hire a Chinese representative from the Local Design Institute (LDI) as their engineer of record. This one individual will keep the project on track from start to finish and manage all of the exterior relationships.
4. **Extensive drawings required:** You can obtain a construction permit in the U.S. with very limited drawings of your structural and civil plan, which may be 10 or 20 pages. The Chinese permitting process requires completed plans, which may include hundreds of pages of drawings. Plan for a six-month to one-year approval process. Also realize that any changes to your project, which owners frequently request, requires you to start over with the entire permitting process, which can delay the project significantly.

## YOUR GUIDE TO FINANCING AND STAFFING A FOOD PROCESSING PLANT IN CHINA

Expanding your food processing business into China requires much more than a capital investment—it requires a significant investment in upfront planning and research. Expats who are currently operating a business in the country can be your greatest source of information, both in navigating China's financial industry and in identifying trusted sources. Here are a few key things you need to know about banking, taxes and staffing before expanding your food processing operations in China.

### BANKING

- In order to establish a banking relationship in China, a referring U.S. bank must provide a formal, written letter of introduction that must be hand-delivered to your Chinese bank. This is one area where understanding Chinese customs is crucial. Chinese business in general is very formal and it is important to learn about the cultural expectations, including how to greet colleagues, the proper procedure for handing someone a business card, and the expectation for long, formal business dinners.
- All financial transactions in China are via electronic transfer, which incur additional expenses. There are no checks, and non-Chinese citizens are limited in their ability to obtain credit cards from a Chinese bank.

- Banking in China has very specific requirements as to the types of accounts required. In some cases, three separate bank accounts – capital, tax and checking – are required just to begin operating. In addition, moving money into or out of a capital account is very cumbersome and requires approval of Chinese authorities, so ensure you do your research to understand the process and penalties.

## TAXES

- It's critical that you find a trusted tax advisor, preferably referred from your U.S. advisors or from an expat with experience in this area. Tax advisors do not serve as counselors as they do in the U.S. and each one interprets the law quite differently. Different interpretations can lead to tax rates varying tremendously and creates a new set of opportunities when budgeting for taxes.
- It's also important to understand the fapiao system. A fapiao is a formal tax receipt required to show proof of payment. Deductions for expenses without a fapiao mean the company cannot deduct the expenses when calculating taxable income. As a result of this requirement, every company must have their own unique fapiao stamp in order to fulfill customers' requirements to meet their tax needs.

## STAFFING

- The best advice for establishing a workforce in China is to build a strong local team. Surround yourself with local talent who can help you understand the culture and customs and navigate the complexities of the market. Talk to other firms and expats to help build this team.
- Chinese culture leads to very low level of employee loyalty. Workers will frequently move around for very small pay increases.
- Understand the nuances to employment and payroll. Typical Chinese employees expect a “13 month” of pay as part of their compensation package, a guaranteed bonus that is not typical in the U.S. China also has a very generous holiday policy, which mandates numerous paid holidays and can literally stop businesses from operating for up to a week at a time.

## HOW TO ENSURE QUALITY CONTROL IN FOOD PROCESSING FACILITIES IN CHINA

We have very tight quality control standards in the U.S. and chances are, you'll want to employ those same standards in your facility overseas. China has different, often non-existent, standards so managing quality control is solely up to your team. Ensure that you have a team of individuals who oversee everything from your engineering documents to intellectual property to equipment selection and installation. Here are my top four areas that must be managed closely to ensure quality control:

1. Construction materials, methods and standards must be clear, concise and reviewed frequently. It's critical to work very closely with your general contractor and meet often to review your expectations. Don't ever make assumptions and appreciate the translation barrier. Common words and concepts may mean one thing to you and something completely different to them. I highly recommend using pictures, detailed drawings, schematics, and even physical mock-up environments showing details such as wall penetrations, floor junctures, lighting fixtures, sanitary standoffs, welding in stainless ductwork and more, to ensure you have the same understanding.
2. Background checks on contractors, engineers and installers are a must. Make site visits to their previous projects prior to doing any work to determine their capabilities and qualities.
3. Most Chinese contractors don't specialize in just one area. Your electrical contractor may also be laying your plant's concrete. This requires additional oversight and management.
4. Jobsite safety is an afterthought in China. Regulations are not necessarily enforced like they are in the states through OSHA. It's important to establish your own full-time safety manager onsite to ensure that the contractors are following your jobsite safety rules. Be sure that your contractors understand these rules up front, as they may have additional costs for body harnesses, hard hats, boots, face/eye protection, etc. for their employees.

## HOW TO ENSURE QUALITY CONTROL IN FOOD PROCESSING FACILITIES IN CHINA

Food processing facilities in the U.S. have long made food safety one of their top priorities. Unfortunately that's not the case in China. In recent years the country has been plagued with numerous high-profile food safety scandals, from grilled kebabs made from cat meat to pork buns so loaded with bacteria that they glow in the dark.

China has several government agencies that oversee food safety, but the process is slow, disjointed, unregulated, and certainly not up to U.S. standards. The country has limited expertise and resources to conduct inspections and mandate new regulations.

The best way to ensure your food safety standards are met in your plant in China is quite simple: bring your U.S. standards with you and employ them in your overseas operation.

## HERE ARE A FEW ADDITIONAL TIPS THAT WILL HELP IN IMPLEMENTING THOSE STANDARDS IN YOUR CHINA PLANT

1. Begin with a very stringent and detailed sanitary design process that follows your U.S. standards for food safety. You'll want to conduct frequent onsite visits to equipment manufacturers to ensure that materials and finishes meet your standards for sanitary design.

2. Designate one individual to oversee all aspects of food safety within your new plant from sanitary equipment design to construction materials to training of employees. Ideally, this is an individual from your U.S. operation who is well trained in food safety.
3. China has pollution levels much higher than in the U.S. so it's critical to ensure that the ventilation and conditioned air system in your plant are installed up to U.S. specifications.
4. Conduct a rigorous training program for local employees in cleaning and sanitation. Many local employees haven't been exposed to high sanitation standards so you'll need to conduct regular training and inspections. Don't make any assumptions about their knowledge of sanitary principles – you'll need to cover all of the basics of cleanliness from hand washing to apparel requirements to overall hygiene

*Stellar's team of process engineering experts have designed, specified and installed processing and packaging lines for many of the world's largest food companies.*

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**Published by Stellar 2014**

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