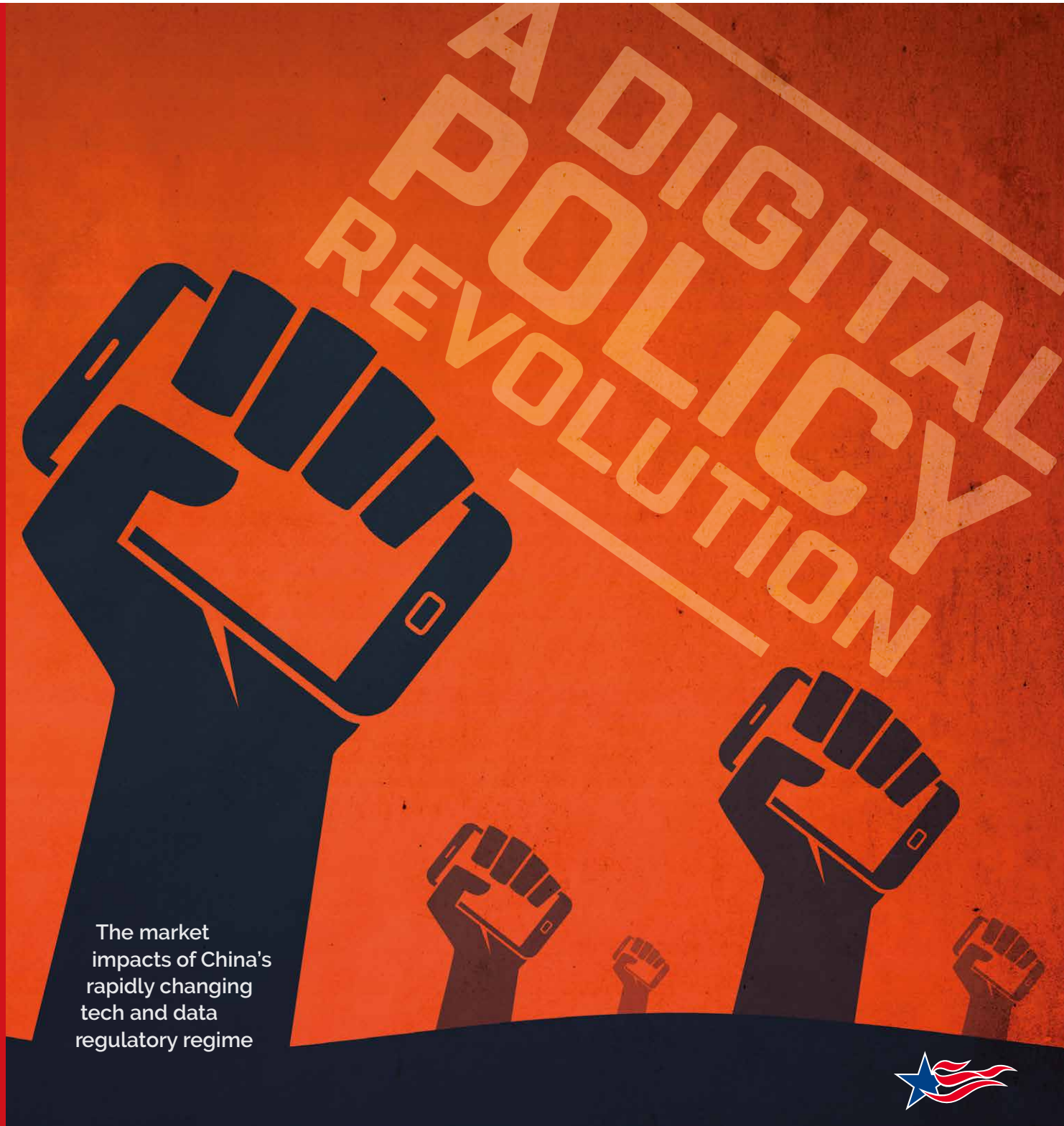
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CHAIRMAN'S NOTE



JEFF LEHMAN
Chairman of The American Chamber of Commerce in Shanghai

This year is, in a surprising number of ways, an in-between year, one of slow transitions. We have long known that 2022 would be radically different from 2020. But the move during 2021 from "the before times" to "the after times" has been frustratingly slow.

On the pandemic front, we ended last year with high hopes that vaccines would bring a rapid return to normal life in the rest of the world, and with it a restoration of international mobility. Unfortunately, viral mutation has outpaced global vaccinations and the cycle of surges in hospitalizations and deaths has continued, with global mobility still frustratingly out of reach.

On the geopolitical front, we ended last year with similarly high hopes that a change in Washington would bring a reduction in bilateral tensions, and with it a restoration of the ever-deepening interdependence between China and the US. Unfortunately, political differences between the countries remain broad and deep, and businesses must adapt to a world where partial decoupling in some domains seems likely to endure.

This year the Chamber has continued to help our members thrive in an environment of uncertainty. Special taskforces have worked to ensure that the most up-to-date information is available – about the epidemiology of the disease, availability of different vaccines and the logistics of travel. An encouraging high point was the August 24 webinar by Dr. William Haseltine in which he outlined a "multimodal" strategy for safely accelerating our return to normalcy. If you did not catch the webinar live, you may watch a recording of it on the Chamber website.

In the policy sphere, we were privileged to hold a "closed door" meeting with China's new ambassador to the US, Qin Gang, just two days before he flew to Washington. Similarly, the American consul general in Shanghai, Jim Heller, frequently provides members with briefings on the new administration's developing China policy.

This issue of *Insight* explores two domains in which environmental concerns are reshaping the Chinese, American and global economies: climate change and electric vehicles. It also reviews two legal areas that are of fundamental significance for many foreign businesses operating in China: the data security law and legal protection of intellectual property. Finally, it includes an interesting interview with the CEO of IKEA.

I hope you enjoy it.

If You Build Them, They Will Drive

The past and future of China's New Energy Vehicle industry

By Stephen, W. Dyer, Ph.D.



Stephen W. Dyer is a Managing Director for AlixPartners, a global consulting firm, and heads their Asia Automotive & Industrials practice to support multinational and Chinese organizations with growth strategies and business results improvement programs. With almost 30 years of corporate and consulting experience, Steve was previously Ford Motor Company Vice President for Business Strategy, Asia Pacific, based in Shanghai. Prior to that, Steve was a Partner at consultancies Bain & Company and Kearney.

Who would have thought the old "Field of Dreams" movie quote "If you build it, they will come" would fit 21st century China? Yet, that maxim applies to many monumental efforts by the Chinese government, whether it be steel production, solar cell or wind turbine capacity, modern expressways or high-speed train tracks. And now the adage can be applied to the electric vehicle industry. In my 16 years in China, I have learned not to bet against the Chinese government when it aligns on something, including new energy vehicles (NEVs) as a pillar industry. There will, however, be winners and losers amidst the rising tide.

Why NEVs are important to China

As China's reform and opening efforts have matured, so have its strategic industrial policies. There are three main rationales for developing the NEV industry:

1. energy security,
2. environmental protection, and
3. economic competitiveness

Throughout the 20th and 21st centuries, hydrocarbons have been the primary source of energy for modern economies. Access to a plentiful and inexpensive supply of oil is high on the strategic agenda of every nation. China imports a majority of its oil; anything that reduces its dependence on foreign oil and shifts reliance to domestic sources such as coal, renewable and nuclear energy, is beneficial.

In the boomtimes of the early 2000s, growing GDP was a primary objective of provincial and local governments, even at the expense of the environment. Now, however, China's government is increasingly prioritizing the environment, seeing it is a key element in citizens' perception of their standard of living.

NEVs present an opportunity to reduce these harmful emissions. Because China's electric power generation is dominated by fossil fuel sources, overall "well-to-wheel" emissions are not necessarily reduced by

electric vehicles. However, shifting emissions away from populated, vehicle-dense areas reduces pollution that citizens see and feel.

NEVs were designated a "pillar" industry in the "Made in China 2025" plan and for good reason. As one of the most technically and commercially complex consumer goods, the impact of automobile design and manufacturing goes far beyond the firms and people that design and manufacture them. Automakers, (known as "original equipment manufacturers" or "OEMs"), rely on a broad and sophisticated supply chain of components suppliers, from tier one (those directly supplying the OEMs) to tier two and below (those who supply the suppliers). The raw material supply, manufacturing expertise, quality and reliability of this supply base benefits many other industrial and consumer product manufacturing sectors.

> "As one of the most technically and commercially complex consumer goods, the impact of automobile design and manufacturing goes far beyond the firms and people that design and manufacture them."

Because China was late to auto production, the government believed there was little chance the country would become a world leader in traditional auto technology. NEVs represented largely "untilled" technological ground. Yet China had planted seeds in its role as a consumer electronics manufacturing base. NEVs were a chance for Chinese firms to "overtake while driving around the curve" and leapfrog into a global leader position. This is feasible due to the government's commitment to supporting local companies through the financially barren initial phases of technology development. And it contrasts with market-driven economies and companies in the West, which struggle to justify these seemingly unattractive capital investments.

How China approaches NEV industry development

A common industrial playbook for China is to set a policy objective and then experiment with measures to achieve it. Officials adapt easily when something doesn't work. This is often referred to as "crossing the river by feeling the stones," an adage attributed to Deng Xiaoping. The measures to promote NEVs have been adjusted several times over the years as the market changed and the government learned what did and did not work.

At first, the government used direct R&D grants, sales subsidies and purchase tax rebates to incent automakers and consumers to build and buy NEVs. These subsidies came from national, provincial and local government entities. The direct subsidies and tax rebates seemed to work well, but also required large government outlays.

Another less costly measure was to exempt NEVs from license plate restrictions that exist in many cities. When car buyers see that they can acquire a hard-to-come-by or expensive license plate (Shanghai plates can cost over 80,000 RMB in the monthly auction), they consider buying an NEV.

In many cases, the purchase is a plug-in hybrid electric vehicle (PHEV), that can run on gasoline after the short battery range is exhausted. These are generally cheaper than BEVs and if a charging station is unavailable, drivers can fill up the gas tank and drive just like any other car. PHEV sales make up 23% of all NEV sales in license plate-restricted cities (and 33% in Shanghai), compared with 9% of NEVs in other cities. However, these NEV license plate exemptions may be phased out as NEV sales increase. Shanghai announced that its current NEV plate policy will continue only through 2023, with PHEVs only eligible for the special NEV plates through 2022.

A major change in China's NEV promotion measures was the establishment of a new "dual credit policy." This is a system that requires OEMs to meet corporate average fuel consumption (CAFC) credit targets and NEV sales credit targets or buy credits from other automakers to comply. The dual credit policy shifted the burden of funding NEV subsidies from the government to the auto OEMs that did not invest in complying by developing low fuel consumption vehicles or NEVs.

As the Chinese NEV industry has developed, the government has relaxed some of the "home field advantage" policies that restricted foreign players from freely participating in China's market. Previously, for a vehicle to qualify for NEV subsidies, automakers had to incorporate a battery from a government approved "white list". Although many foreign battery makers applied, only Chinese manufacturers had ever been approved for inclusion on the list. In 2019, however, the "white list" was eliminated as a criteria for NEV subsidies.

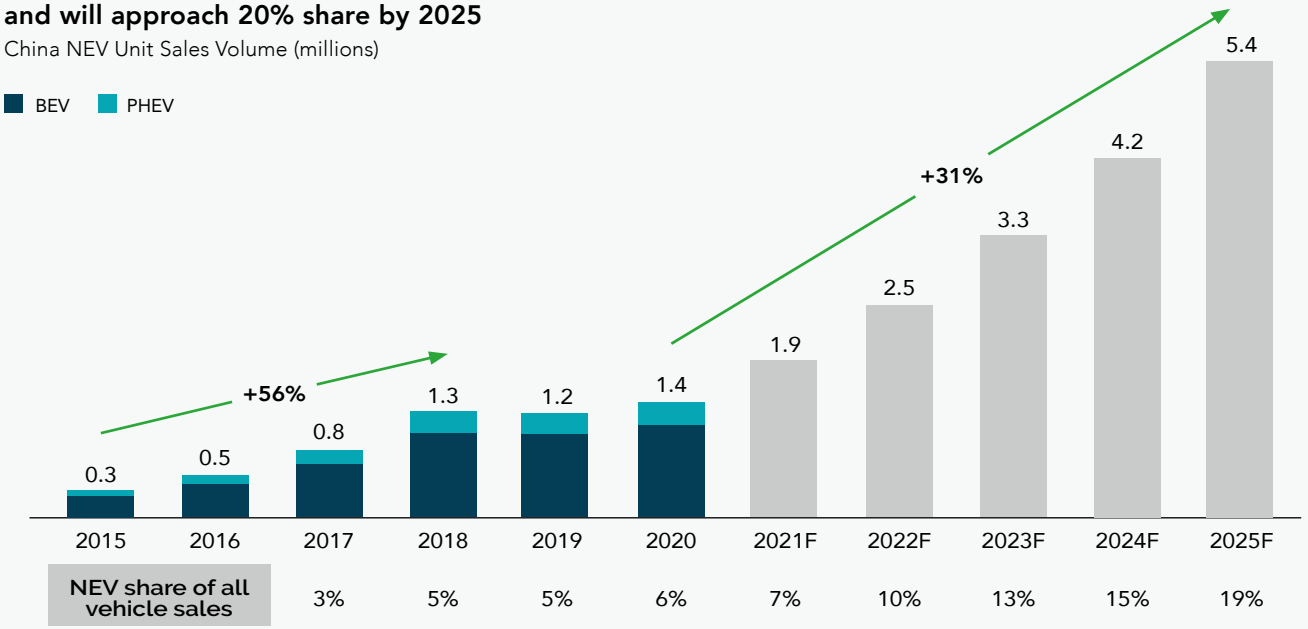
Another significant change was to the longstanding requirement for foreign automakers to form joint ventures with Chinese partners to produce vehicles for sale in China. This program dated back to Deng Xiaoping's approval for the entry of Volkswagen into China in 1984 through a 50-50 joint venture with Shanghai Automotive Industrial Company (SAIC).

This protectionist policy was permitted to continue as part of China's agreement to enter the World Trade Organization (WTO) in 2001, as WTO members perceived China to still be an undeveloped market. The policy gave significant leverage to Chinese automakers and allowed them to learn the crafts of auto supply chain management



China's NEV sales continue to grow, having achieved the government's target of 5M parc by 2020, and will approach 20% share by 2025

China NEV Unit Sales Volume (millions)



Source: CADA, Vehicle Insurance registration data, AlixPartners analysis

and manufacturing.

However, the joint venture requirement may have backfired in the more innovative portions of the auto value chain. Chinese state-owned auto OEMs in JVs with foreign partners enjoyed great profits from making and selling the foreign brands and designs, but they had little incentive to invest in creating competitive new self-owned products. The Chinese privately held OEMs, such as Geely, Great Wall and BYD, meanwhile had to struggle to survive, quickly gaining experience in developing and selling new self-owned branded products. The struggle paid off—as of 2020, while seven of the top ten selling auto brand groups in China were foreign, two of the three Chinese brands in the top ten were privately-owned Geely and Great Wall.

In 2018, however, the JV requirement for foreign automakers was ended for NEVs. Tesla was the first player to benefit from this policy change, as it set up a self-owned manufacturing operation in Shanghai.

NEV market growth

NEV sales have grown consistently over the last five years, apart from 2019, when sales dropped due to the announced phase-out of direct government subsidies. Growth returned in 2020, even in the face of COVID-19, as subsidies were extended, and China's economy recovered faster than most countries. In its "NEV Technology Roadmap 2.0" the Chinese government established the target that by 2025, 20% of new vehicle sales will be NEVs. The market will likely reach close to that level.

> "The dual credit policy shifted the burden of funding NEV subsidies from the government to the auto OEMs that did not invest in complying by developing low fuel consumption vehicles or NEVs"

In recent years, more than three-quarters of NEV sales in China have been Chinese brands. In 2020, Tesla began producing its Model 3 in China, which resulted in a significant increase in its China sales. Other foreign brands will likely also see increased NEV sales as they localize production in China and avoid passing on import tariff costs to consumers.

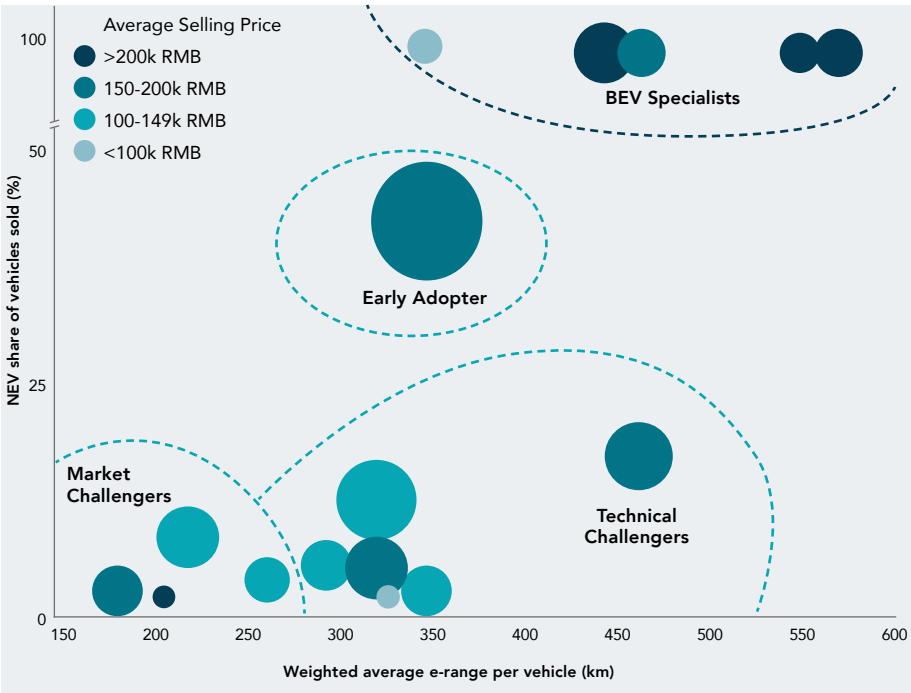
There are two clearly successful price segments for NEVs – a premium price, dominated by the battery electric vehicle (BEV) startups such as Tesla and NIO, often priced at over $40,000, and a cheaper segment, dominated by Wuling's Mini EV, with a starting price of $4,500. NEV buyers in more affluent, higher tier cities tend to buy more of the premium vehicles, while car buyers in lower tier, less affluent cities prefer the lower priced vehicles.

The fight to survive

Currently, there are more than 100 NEV brands and over 300 NEV models in China. Not all of these will survive, as only a few have significant scale. Most NEV players today can't make money without government support (either in the form of direct cash, R&D or tax subsidies or credit sales from the dual credit policy). Battery costs are still high, leading to lower margins per vehicle. Average sales per vehicle platforms are four

Aside from the "big bet" BEV specialists and early adopters, China "Challenger" OEMs seem to pursue different paths

Electrification maturity for leading Chinese OEMs (2020 PHEV+ BEV)



"BEV Specialists" group formed by startup pure-play Battery Electric Vehicle (BEV) brands, such as Xpeng, NIO, WM, and Hozon

"Early Adopter" sells as many electrified vehicles as traditional internal combustion engine (ICE) vehicles, but with a lower e-range mix of PHEVs and BEVs

"Challengers" seem to take one of two paths:

- **"Market Challengers"** build volume market share through PHEVs (which are lower priced than BEVs but also enable access to free license plates in many cities) and lower e-range models
- **"Technical Challengers"** focus on pursuing longer e-range vehicles, often with associated higher cost / price

Source: AlixPartners E-Index, IHS, AlixPartners analysis

times lower than for traditional ICE vehicles. With a several hundred-million-dollar product development investment per model, scale is critical for a reasonable return on investment.

> "In the future, it is unlikely that any global NEV player will succeed without being relevant in China"

For Chinese players, there are a variety of strategies. Battery electric vehicle (BEV) startups focus on a portfolio of 100% pure electric cars. Early adopters, like BYD, sell almost as many NEVs as internal combustion engine (ICE) powered vehicles. Chinese "Market Challenger" OEMs adopt a market volume-focused approach to build presence, often through developing and selling PHEVs, which qualify as NEVs but have low electric range. "Technical challenger" players use a technology-focused approach to build credibility. These companies focus on extending electric range by launching primarily pure battery powered BEVs.

To survive and win in China's new energy vehicle market, it is critical to:

- Get **product positioning** right – currently, the most successful models are either in the premium price segment above 250,000 RMB or the low-price segment below 120,000 RMB. Anything in between is in a "red ocean" of hundreds of models, with none gaining significant market share.
- Earn **pricing power** through **customer experiences** that bolster the brand.
- Stay **aligned with** the evolution of government policy – e.g., meet battery range thresholds, comply with cyber-security policies, bet on the same powertrain technology variants as the government and earn and sell credits.
- **Control the differentiating** portions of the **NEV ecosystem** – e.g., technology integration for in-vehicle and out-of-vehicle customer experiences, direct-to-consumer retail models, etc.
- Continual and persistent progress on **advanced driver assist systems (ADAS)** and autonomous driving – Chinese car buyers are more open to such advanced technology than consumers of any other country.
- **Business model innovation** – e.g., connected services, battery swapping, battery leasing, charging infrastructure, subscription-based features and over-the-air updates.
- A combination of **software and automotive hardware expertise** – which may require close collaboration between new tech companies and traditional automakers; new players, such as Foxconn, Baidu, Xiaomi and Alibaba will struggle to succeed on their own, as will traditional automakers.
- For Chinese players, it will be helpful to gain scale and credibility by **going overseas,** as NIO is doing in Norway. However, they will need to navigate the rigorous homologation process in mature markets, which has been a stumbling block for China OEMs in the past.

China's NEV segment represents an important frontier in the global auto market. This is where startups and traditional automakers will learn lessons and establish a complete NEV customer ecosystem that can spread worldwide. In the future, it is unlikely that any global NEV player will succeed without being relevant in China. It is also likely that at least a few Chinese players, born in the rough and tumble China market, will succeed on the global stage.



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LOOKING TO THE FUTURE

Interview by Kate Magill

Let's start with IKEA's 2020 10 billion RMB investment in the China market. What led to the decision to prioritize China in this way?

We started our China transformation around two-and-a-half years ago. We have been in China for 23 years, and have been very successful. We see that the market is moving, and we operate in the most advanced retail market in the world—data driven, pace driven, innovation driven. So, we launched IKEA's biggest ever transformation, with very important objectives. First was to be accessible to the many. Second, is to really digitalize the business, digitalize the meeting places, be a data-powered company. And third to bring the home furnishing experience to a different level for the consumer here in China.

We did a lot of research, we talked to customers from many markets across China. We know that customers are looking for different things, that their time is more demanding. We know that Covid accelerated the behavior of the customer; they have less time and they shop in a different way. So our strategy is more important than ever.

When you did your market research, what did you find that Chinese consumers were looking for?

There's no doubt that the China market is becoming very digitalized, people are looking for new things. Customers in China have unique ways of buying things and distinct taste. Time is the new currency. We were eager to transform our stores to be different meeting places, to change the components of the stores, the shape and format of the stores, and to be more accessible.



Anna Pawlak-Kuliga is the CEO and President for IKEA China, leading the totality of the Ingka companies in mainland China. Anna has an extensive business background prior to IKEA in law and the retail sector in the UK. She initially joined IKEA in September 2008, and in 2012, Anna moved to Poland as a member of the management board. In September 2016 Anna moved into the role of CEO IKEA Retail Poland and in September 2018, she started her new role in China as CEO and President of IKEA China.



Why did you wait until recently to join Tmall, and how has business been since you began using the platform?

For us Tmall is the complementary component to our own strategy. Our internal strategy is a strong base, but we need to be curious and open to new things as well. We started our Tmall platform in March of last year in Shanghai, Jiangsu, Zhejiang and Anhui provinces, and in May we decided to roll it out across China. But we are not stopping the accessibility of our offline stores and consumer touchpoints as well as continually improving our online channels, including the IKEA app.

In August we opened the first ever "store of the future" for IKEA. We call it the "Home Experience of Tomorrow." China is very important to us from a strategy and investment perspective. We know the future is happening here, so we are keen to build on what is good and experiment with a lot of new things.

What is the IKEA "store of the future"?

It will be very different from stores around the world: different in terms of how it looks and from what people experience. It will be built around the community. How the customer sees the range will be very different from our standard stores. How people shop will be fully digitalized. The third component is it will be a truly sustainable store.

> "The presence of IKEA is not about only the store anymore, it's about online and offline, about digital meeting places as well. The store is like the cherry on the cake"

Are you looking to export this idea to other markets?

Yes, to other parts of China and to other parts of the world. If something works in China, it will probably work in the rest of the world.

What are smaller city markets like in China?

When we enter a market it's quite a long process. We want to be close to customers before the stores open. The presence of IKEA is not about only the store anymore, it's about online and offline, about digital meeting places as well. The store is like the cherry on the cake, but at the same time very rewarding for the customer. Look at Foshan for example, there are very different KPIs from the market perspective, but at the same time, everyone has the same basic needs of cooking, cleaning, doing homework, working at home—human beings are the same across the world.



What about the transition to these smaller, more centrally located stores, have people responded well?

Jing'an was our test in China and it was very successful when it comes to the visitation rate. We have a lot of learnings but bringing IKEA closer to people is our ultimate goal. Even though the store is smaller people can reach out through the phone and buy everything. It's a meeting place, it's a community place, it's a place where people get inspired, spend time with family, eat at some point; the store has many roles.

What are some of the learnings from these smaller stores?

Weekends are very crowded and people are looking for different things. They have less time. So the in-store touch points are constantly moving. For Jing'an we change our offers, we change the products. It's a living organism.

We experimented with our store formats quite a bit. We opened an outlet store in Yangpu a year ago; we opened a shop in Jing'an, which is very small, and in Beijing. We also launched a lot of digital channels. We introduced our account on IKEA.cn [our official Chinese website]; we're running a Tmall shop across China. It's about making sure we have the right components for our internal strategy in China. Because omnichannel is a cohesive ecosystem, our customers can meet us wherever they want, however they want.



In terms of what consumers buy from IKEA, did you see any shifts as a result of Covid?

Looking at home furnishing, our categories were quite stable. Our most important customer group is parents living with children. The customer is still looking for fantastic design, functionality, affordability. People are also more concerned about health, about conscious choices. We see that in our sustainability range — water saving, light saving, lot of goods with recycled materials. People are more conscious of their impact of their lives on the planet. Our sustainability range is growing very fast.

How have you prioritized sustainability from a manufacturing standpoint, in the products being offered and in the consumer experience?

It starts with how we design products. We want our products to be functional, sustainable, good quality, affordable and beautiful. We decided that by 2030 our products will be either recyclable or made from reusable materials. We are injecting innovation into the manufacturing and design process. In China 90% of our deliveries are green; it is important not only how we produce products but how we deliver goods to the customer. Shanghai was the first market in the world to do green deliveries. We put a lot of effort into our store operations. We have a food waste watcher; we are investing in solar panels for some of our stores. Across the whole value chain we want as little footprint on the planet as possible.

> "We were eager to transform our stores to be different meeting places, to change the components of the stores, the shape and format of the stores, and to be more accessible"

In the Shanghai market we introduced the "as is" market for customers to buy older IKEA showroom furniture that is sold at a discounted price. People in China are eager to test these ideas as well.

What have been some of the biggest challenges to the expansion of the China market?

As a company that has been operating in China for many years, we understand that some key decisions have to be made much faster. We have to be more agile, more innovative, brave and willing to try new things. When we announced our strategy two-and-a half years ago, we also decided that we wanted to be in China, for China, with China. It's important that we are relevant in the China market.

As part of that, in Shanghai we have opened a product development center that is designing products relevant to the China market. When we are close [to the market] we are more relevant and much faster. We have introduced a lot of deliveries in the cooking and eating range and also in the cleaning and care range, and perhaps most successfully in the gaming range.

What are some key differences between this market and the West?

For us, the core business is life at home. There are differences driven by culture, behavior, how people eat, sleep, meet, spend time with families. There's a distinct way Chinese people spend time, what kind of holidays they have. There's also a very distinct taste when it comes to design and what makes people loyal to brands. They want surprises, they want new things. They're looking for value for money, for products that bring value to their lives.

Look at how people sleep, in China we have firmer mattresses, our sofas and seating have to be much firmer as well. There are lots of differences when it comes to textile patterns and we have to have different designs for kitchen sets as well.

Looking into the latter part of the year and next year what are your biggest priorities for IKEA in China?

Accessibility, affordability and sustainability. We continue the journey, and as we continue we will accelerate digitalization. Almost two years ago we established a digital hub in China, purely designing digital solutions for the China customers, so we're going to continue this. We're going to develop new ranges for customers in China, we want to be more accessible, we want to remain affordable and sustainable in this market. For us these are the guiding principles that make our strategy more relevant than ever. I



FOREIGN SAAS COMPANIES IN CHINA

By Art Dicker, Director, R&P China Lawyers; Robin Tabbers, Partner, R&P China Lawyers;
Chad Catacchio, Marketing Director, Alliance Development Group; Chris DeAngelis, General Manager, Alliance Development Group

China remains one of the largest untapped markets for many global business-to-business software as a service (SaaS)/cloud company. Beyond the large established enterprise resource planning (ERP) solutions (e.g., Workday) and customer relationship management (CRM) offerings (e.g., Salesforce.com), there are already thousands of global companies operating with SaaS functions in China or considering entering the market. Companies want to take advantage of China's massive potential customer base, which includes over 35,000 companies with revenues north of $150 million, in addition to China's 40 million small businesses.

However, global enterprise software companies are concerned about how to stay compliant while generating a positive ROI in China. These are increasingly reasonable concerns as more software companies continue to transform their delivery models from locally installed (on-premises) installations to "service" delivery formats via the cloud (SaaS).

This transformation puts companies into a significantly more scrutinized area of China's regulatory environment. As regulations evolve, SaaS companies are wondering if there are still paths to China that can be pursued with a modest investment, while avoiding the arduous requirements for SaaS firms to find a local majority partner. Fortunately, there are alternative ways for companies to enter China. In this article we share how SaaS companies can navigate China on their own.

Frequent SaaS compliance issues

The Commercial Internet Content Provider License ("ICP License") is the most often cited Value-added Telecom Service (VATS) license that SaaS businesses apply for in China. However, there is much debate about whether an ICP license is strictly necessary for a company that simply offers its own solutions over the cloud or does not transact directly through its website in China. Even for these companies, there is a risk that local regulatory authorities may not have a nuanced understanding of the regulations and will default to the view that a SaaS business requires a Commercial ICP License.

The main concern around the ICP license is that it requires a joint venture, which is a non-starter for many foreign executives. Even for those who strike a JV deal, licenses are difficult to obtain. SaaS companies handle lots of data, including personal data, making them more vulnerable to close regulatory scrutiny. China is stepping up its data regulatory regime with the new Data Security Law (DSL) that was passed in June 2021 and the Personal Information Protection Law (PIPL), which passed in August and will come into effect on November 1.

Perhaps the most direct impact of these new laws on international SaaS companies that operate in China is the increased sensitivity to the processing of personal data and the scrutiny of cross-border data transfers. The silver lining to these new requirements is that the rules are becoming clearer, especially once implementing regulations come out within the next year. Companies should be aware of these changes, but we expect with this new clarity, firms will be able to comply without too much concern.

Where many companies start is not always the right place

Historically, most SaaS companies start their China journey through a cross-border approach. Companies leverage their existing global infrastructure and then build out a sales and marketing program on the ground, either independently and/or with partners. Depending on the type of solution and its technical performance requirements, this can be an effective strategy for many companies, at least initially.

However, this strategy is typically limited for several reasons:

1. The company may struggle to understand and meet the needs of its China customers from afar.

2. Larger customers and state-owned entities are often hesitant to purchase from companies without local technical and operational support.

3. The company's IT infrastructure will typically encounter performance issues due to its location outside of China's Great Firewall.

All that said, many companies eventually need to do more than provide their solution from abroad and may need to set up a cloud in China when:

1. Their products simply do not work well enough to support their customers in China from abroad, or

2. They are providing services in China from abroad and have hit a cap on their potential, and/or

3. They are concerned that the data they are capturing is at risk of being blocked or running afoul of increasingly stringent data residency requirements in China.

In most other markets, hosting a solution locally is as simple as spinning up new AWS, Azure or Google Cloud instances. However, the process is more complicated in China. The closest alternative is working with a local IT partner (value-added distributor or VAD). Many foreign companies start by speaking with one of these VADs that can obtain the necessary licenses for local operation.

> "Other companies do – on the face of it – seem to require a Commercial ICP license. For those companies, however, there are many variables that can determine if such a license is really necessary (it's often not)"

While initially attractive to many SaaS companies (they often expect the VAD to take the business and run with it in China) the realities and downsides of working with these distributors usually become quickly apparent. These include:

- A high upfront fee and revenue sharing. For companies without an existing business in the country, they will typically push for exclusivity to offset the risk of bringing an unproven company into China.
- The VAD makes the company's business a low priority (both because SaaS is hard, and for new entrants especially, because there isn't an existing pipeline).
- The company must still spend resources to understand and customize its cloud for the China market.
- The VAD is unable to fully understand, sell and service the company's complex SaaS solutions in the market.
- Complex decisions need to be made in the operation's early stages, and the company and partner need to communicate effectively and coordinate resources to make decisions together on suitable China pricing models, product features and business strategy.

Regardless of the downsides, some companies do start by partnering with a VAD. In our experience, however, after a couple of years many of these companies become disillusioned and look for alternatives to re-energize their China business.

Whether new to the market and looking to go it alone or a company that started with a partner and now wants to consider a more active approach to China, companies have the same



key question: do other options exist for SaaS companies that want to control their own IT infrastructure and China strategy?

Option 1 - You may not actually be a SaaS company in China, so why not stay that way?

Simply launching servers in China and running aspects of a business through the cloud does not automatically mean a company is considered a "SaaS" by Chinese regulators. Thus many SaaS companies' business and/or delivery models do not require a Commercial ICP license (and a local JV) in order to operate in China.

Other companies do – on the face of it – seem to require a Commercial ICP License. For those companies, however, there are many variables that can determine if such a license is really necessary (it's often not). Some common variables include:

- Pricing models and where payments are processed
- The type of data collected and where and how the company aggregates and processes that data
- How products are delivered (on-premises, local installation, cloud)
- The type of customers targeted in China (MNCs, SOEs, SMEs)
- The size of the business

The strategies to avoid needing a Commercial ICP License are unique to every company— competent legal and GTM advisors can help companies work through alternatives. For some companies these strategies can be a permanent solution. For others, they act as a delaying mechanism until the company has validated its opportunity and is ready to consider a more significant investment in China.

Option 2 - Some companies ARE SaaS companies and should have a license, but...

Many B2B SaaS companies took the direct route into China (whether independently or with the help of services providers). They made an upfront investment, created a WFOE, put boots on the ground, filed an ICP registration, set up their services on local cloud providers or on their own servers and then started to serve China customers. These companies may not be technically in compliance and need to look at their options. However, many of these regulations have only been introduced over the last four years, so many of these companies are still working on compliance.

These companies may have some risk exposure, but thus far we haven't seen regulators pursue companies that are technically out of compliance, but which are not acting illegally and are not touching sensitive data. While this could change, in practice we continue to see many new companies follow the same path. China, like all countries, wants to attract good companies to invest and increase its tax base. Generally speaking, when companies get in trouble for lacking full proper licenses, it is more likely that a local competitor blew the whistle because they felt threatened by a foreign company's success.

Option 3 - VIE

Variable Interest Entity (VIE) structures have historically been a potential work-around for restrictions on foreign-invested companies obtaining VATS Licenses. However, there are some regulatory indications that these structures are falling out of favor with regulators (and not just for SaaS businesses):

- A domestically invested company is first established as an operating company to apply for and hold the ICP License.
- The foreign business must find local Chinese citizens – sometimes key local management – to act as nominees to hold these shares of the local operating company on the foreign company's behalf.
- A set of contracts between the foreign and local company (and its shareholders) ostensibly offer the foreign company 100% control over the local company.

VIE structures have been used for over 20 years, especially by many Chinese internet companies when listing on stock exchanges outside China. While it is an option, there is much debate about the risk of the structure, especially if the relevant parties' relationship appears to exist primarily to avoid the regulations. There are other possible issues as well, such as the risks of the foreign company losing control over nominee shareholders, as well as contracts ultimately lacking enforcement in court.

Balancing considerations for SaaS companies entering China

There are challenges for business software providers entering and operating in China, especially those built exclusively for using an SaaS model, but opportunities clearly exist for both SaaS and non-SaaS software companies alike that are willing to make the investment.



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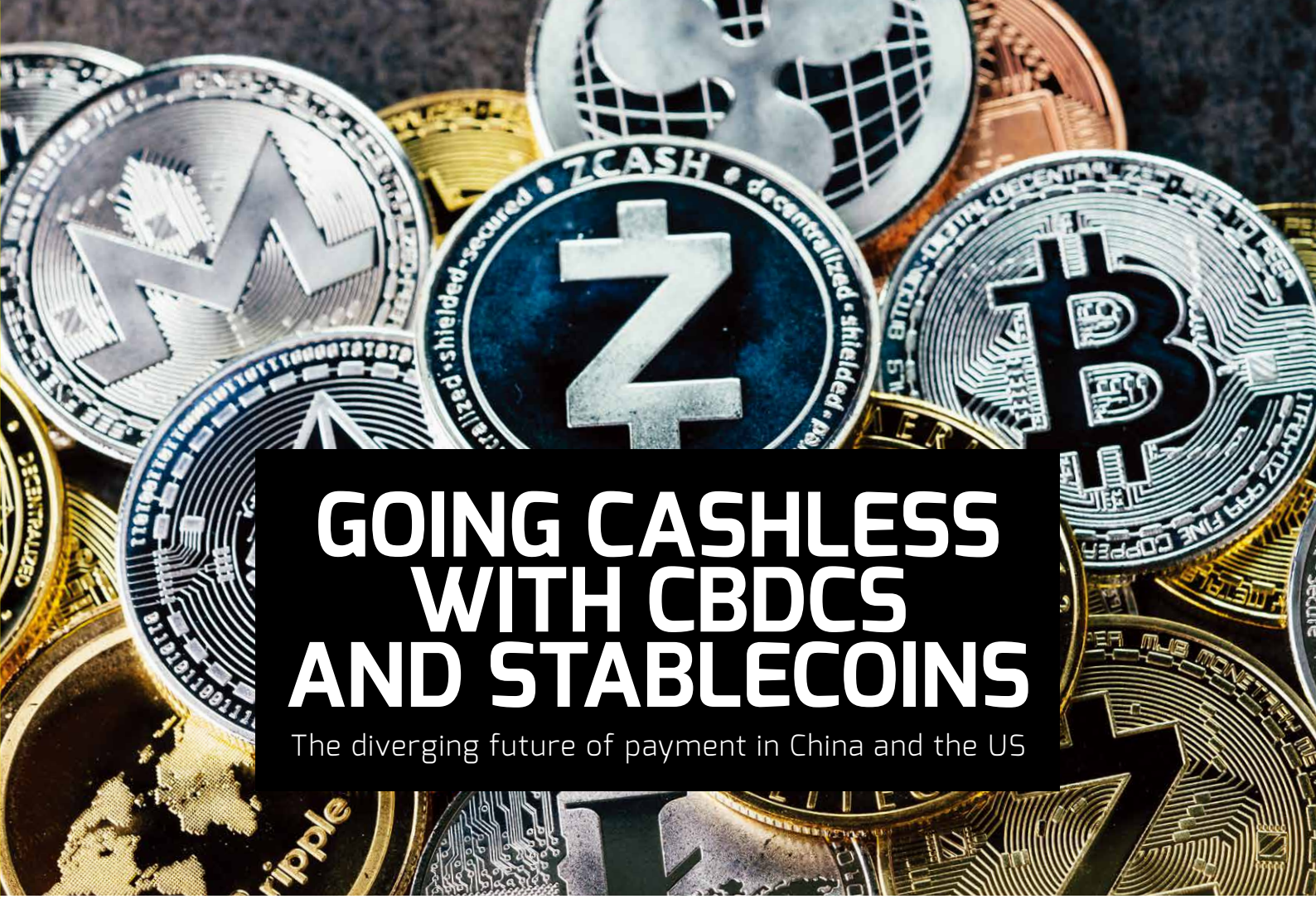
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GOING CASHLESS WITH CBDCS AND STABLECOINS

The diverging future of payment in China and the US

By Rich Turrin



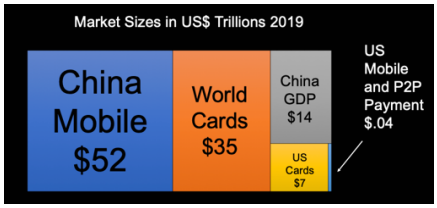
Rich Turrin is the international best-selling author of "Cashless - China's Digital Currency Revolution" and "Innovation Lab Excellence." He is an award-winning executive previously heading fintech teams at IBM following a 20-year career in investment banking.

China's new Central Bank Digital Currency (CBDC) is already changing the world, and it hasn't even launched. China's CBDC is partly responsible for a global rush to develop new CBDCs, with 87% of central banks around the globe "exploring" them, according to the Bank for International Settlements survey of central banks in January 2021. Meanwhile, the US Federal Reserve remains undecided. Federal Reserve Vice Chair for Supervision Randal Quarles called the global push for CBDCs nothing more than a "fad," while Fed Governor Lael Brainard commented that she "can't wrap her head around the US not issuing a CBDC." Fed Chairman Jerome Powell remains steadfastly non-committal.

Alipay and WeChat Pay's launches in 2014 resulted in China's transition to a largely cashless society, making the country the world leader in mobile payment. China's mobile payments in 2020 topped $52 trillion, 3.7 times larger than China's GDP. In the US, instant and potentially free mobile payment is promised to arrive in 2023 with the launch of the Federal Reserve's FedNow system. In the meantime, Apple Pay, Google Pay and PayPal, which charge 3-5% fees on some transactions, are the major players in the US but with minimal market reach.

The Fed has been reluctant to discuss CBDCs as the next step in digital payments, publicly stating that there is "no rush" to develop such technology. Even if a US CBDC were approved tomorrow, it might not reach the market until 2028 if it takes seven years to painstakingly research, as did China's. With the US dollar's standing as the world's reserve currency, the Fed has every reason not to rush and tread carefully. However, citizens now accustomed to the immediacy of cryptocurrency and disillusioned by bank fees aren't willing to wait.

This has given rise to calls for the launch of "stablecoins" in a bid by the private sector to beat the Fed to the punch with instant payments. Stablecoins are a form of privately issued cryptocurrency. The issuer ties the value of the cryptocurrency coin to





the dollar or other currency by maintaining cash reserves equal to the value of coins issued. The stakes are high—the cost of cash transfer globally is estimated by McKinsey & Co. to be $2 trillion annually, and the IPO valuation of the new stablecoin "Circle" topped $5.4 billion in July 2021. The promise of free and immediate cash transfers similar to those enjoyed in China is big business.

For anyone not following financial technology (fintech to the cognoscenti) or cryptocurrency, these emerging cash transfer methods represent a new and unknown future. Let's examine their pros and cons.

Central Bank Digital Currencies

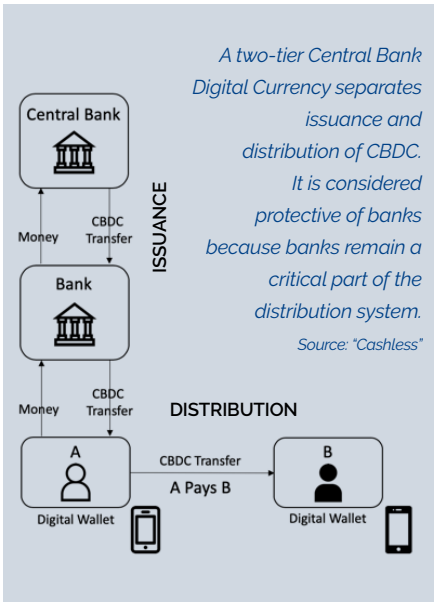
China is the first major industrialized nation to launch a CBDC, though it is not the world's first. The Bahamas issued the world's first central bank digital currency, the Sand Dollar, in October 2020. Still, China's CBDC, known as the digital yuan or e-CNY, is making headlines because it will be used in domestic and global markets, making it a competitor to the US dollar. Moreover, China's new CBDC is not just a new currency but a digital currency transfer system that breaks its dependence on the ubiquitous SWIFT system. This means that digital yuan payments will be hidden to the US and its allies, who have historically monitored and controlled access to the SWIFT network.

CBDCs, as the name implies, are a digital currency and are the distant cousins of cryptocurrencies like Bitcoin. However, unlike Bitcoin, whose value is determined by fickle market sentiment, CBDCs are backed by a nation's central bank, just like the paper bills they are designed to replace. This means that a CBDC has the same value as a banknote, an advantage over notoriously volatile cryptocurrencies.

CBDCs are custom designed, and not all are created equal. The general design concept uses cryptocurrency technology to create a cryptographically secure digital representation of cash which is stored in a digital wallet on a phone or computer. Anyone using Alipay or a Western bank payment system would be correct in saying that they are using a form of digital payment. The critical difference is that most CBDCs are stored directly on your phone. When you pay another person, the digital money leaves your phone and transfers to the recipient's. No bank or third party is required for this transfer. This contrasts to Alipay or a Western bank system where the money moves between accounts controlled by third parties.

CBDCs are disruptive to incumbents because they allow digital payment without a bank, credit card or other third-party intermediaries. Even if a central bank builds features into their CBDCs to protect banks, it is likely that when CBDCs launch in the West, banks and credit card companies will face the same disruption as they did in China with the launch of Alipay and WeChat Pay. Consumers will no longer pay a hidden tax of 3-5% in card fees.

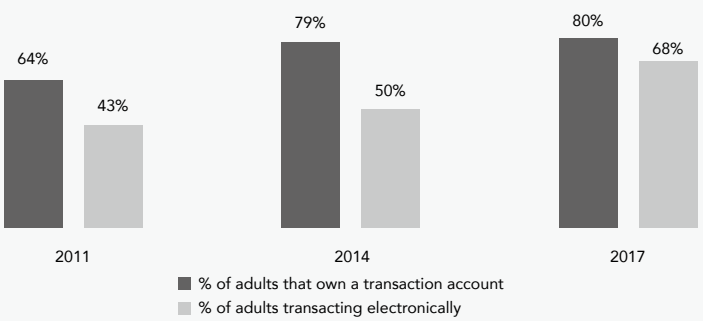
CBDCs are considered by many to be a natural evolution of money, and there are many advantages to their use, including reduced payment costs, improved security, increased tax collection, and the increased ease of making social welfare payments. However, these pale to CBDCs' two most important roles—bringing financial inclusion to the vulnerable and increasing societal digitization. While about 20% of China's population still lacks a bank account, China's unbanked population was reduced considerably through the launch of electronic payment, the convenience of which spurred the populace to open either easy to create online or traditional bank accounts.



A two-tier Central Bank Digital Currency separates issuance and distribution of CBDC. It is considered protective of banks because banks remain a critical part of the distribution system.

Source: "Cashless"

Percent of adults with bank accounts and transacting electronically



China's impressive progress in providing electronic banking services played a role in attaining its poverty alleviation goals ahead of schedule.

Source: The World Bank, Universal Financial Access 2020

Stablecoins

The US is likely to fall back on private stablecoins as a means of bringing digital payment to the country. While CBDCs represent a deeper commitment by the central bank to digitize payments and benefit from a central bank guarantee, the use of stablecoins first in the US is the right approach, even if only as a stopgap.

In a dollar-based stablecoin, each dollar that buys a coin is held in reserves whose value is tied one to one with the number of coins sold. Stablecoins have two risks obscured by the word "stable" that have led some to call the name a misnomer.

The first risk is that the value of a dollar-based stablecoin is assumed to be pegged 1:1 with the dollar. This assumes that stablecoin reserves are equal to the dollar value of coins issued and are high enough quality to be sold in the market. These are two big "ifs." Unlike CBDCs, which have the backing of the central bank, stablecoin values depend on faith in the issuer's skills in managing reserves.

This faith can be misplaced, and one of the most popular stablecoins named "Tether" serves as a textbook example of how the quality of the assets held by a stablecoin issuer can be questionable. A *Financial Times* analysis of Tether's financial reports shows that cash and cash equivalents cover only 74% of Tether outstanding, of which dollar deposits account for only 2.9% of the total. A not-so-stable stablecoin.

The second problem with stablecoins is that if they proliferate, they could outstrip the supply of high-quality, short-term investible assets, causing liquidity problems when buying and selling. This could cause asset prices to rise when in buying mode but potentially crash their value when selling. Tether also illustrates these risks. With reported commercial paper (a cash-like investment) holdings of $30 billion, Tether is the seventh-largest commercial paper holder globally. Liquidating even a fraction of this portfolio is serious business.

Stablecoins, like CBDCs, offer the promise of free cash transfer without the use of third-party intermediaries to transmit the transaction. Stablecoins may lack the "official status" of CBDCs, but they offer actual savings in third-party transfer fees at the cost of holding an asset marginally more risky than real dollars. Because the US lacks a real-time payment system and a CBDC, there simply are no other options, which is why stablecoins are in such high demand.

Look for regulators to announce precisely how they will regulate stablecoins in the coming months. The issuers will likely be large companies like Circle or Facebook, whose Diem Coin may be the first to make a splash. Diem Coin is the evolution of Facebook's first attempt at a stablecoin, the now infamous Libra, which regulators across the globe rejected because it represented a supranational currency. Corporate-backed coins like Facebook's Diem, however, may harvest user data as a means of increasing their profitability. This further highlights the advantages of CBDCs, which lack an underlying profit motive and will likely provide greater privacy than stablecoins.

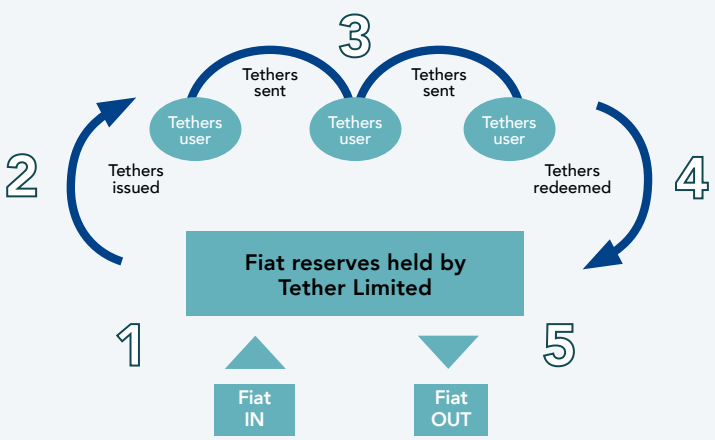


> "Look for regulators to announce precisely how they will regulate stablecoins in the coming months. The issuers will likely be large companies like Circle or Facebook"

China and the US are taking different approaches to digitize payment. China is moving quickly to launch its second generation digital payment, while the US is on its first. China will enjoy a first-mover advantage with CBDCs, but it does not guarantee the international demise of the dollar, as some may speculate. That said, complacency is ill-advised and digitizing the dollar is necessary to preserve its reign as the reserve currency.

Chinese residents will likely have access to the trial version of China's CBDC this year, if they are not already using it in early trials. Ironically, it will seem like nothing new for many, since free and instant payment is the norm here. Meanwhile, US digital payment users will likely have a private stablecoin option sometime in the first half of 2022. This will likely be a significant event in the US, perhaps on the same scale as the launch of WeChat Pay and Alipay in China. The payment world is changing fast and how we pay for things will get faster and cheaper. I

Five steps in the lifecycle of a Tether coin



Source: Tether Whitepaper

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CHINA'S DATA SECURITY LAW

What you should know

By Ron Cai

The Standing Committee of the National People's Congress of China passed the Data Security Law (the DSL) June 10, 2021, less than a year after publishing the first draft and after two rounds of revisions and public comments. As one of the highest-level laws governing data security and protection in China, the DSL, together with the Cybersecurity Law, which came into effect on June 1, 2017, form the legislative basis for data security protection in China.

The DSL will take effect on Sept. 1, 2021, leaving companies with a grace period of less than three months to conduct self-evaluation and self-correction. As summarized below, the DSL contains a number of core obligations on data security protection for entities engaged in data processing activities in China.

I. Jurisdictional scope and extraterritorial application of the DSL

The DSL applies to both domestic companies in China as well as data-related activities conducted by foreign entities and individuals. Article 2 of the DSL states that data processing and security supervision activities conducted in China fall under the law's purview. It also states that data processing activities taking place outside of China that are to the detriment of national security, the public interest or the lawful rights and interests of citizens and entities of China are subject to the DSL. Notable is that under the DSL, the term "data" refers to any record of information in electronic or other forms, and "data processing" activities include the collection, storage, use, refinery, transfer, provision or public disclosure of data.

Foreign entities whose business and activities include processing Chinese citizens' data, or whose data processing activities may substantially impact China, should be cautious about potential liabilities under the DSL.

II. Notable obligations imposed on companies and individuals under the DSL

In general, companies' obligations under the DSL include: (i) establishing and improving a data security management system that integrates every part of data processing activities; (ii) organizing and carrying out data security education and training; (iii) taking necessary technical measures to safeguard data security; (iv) strengthening risk monitoring and



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taking timely remedial measures; (v) for entities who carry out data processing activities via information networks, such as the internet, performing the above data security protection obligations by obtaining certifications under the multi-level protection system (a mechanism mandated by the Cybersecurity Law); and (vi) for "important data" processors, performing strict data security obligations.

Under the DSL, "data security" refers to taking necessary measures to ensure the effective protection and lawful utilization of data and to safeguard the continuing state of security (Article 3 of the DSL). More specifically:

i. Article 21: Establish and deploy a data classification system

Article 21 of the DSL emphasizes that China will establish a national classification and hierarchical data protection system, which can be viewed as high-level guidance for companies' establishment of their data classification. The DSL provides that to establish the national data classification protection system, regulators must consider the data's level of importance to state economic and social development. Regulators must also consider the degree of harm caused to national security, public interests or the lawful interests of citizens and entities if the data is tampered with, destroyed, leaked or illegally obtained or utilized. Once the national system has been established, companies should conduct self-examination and self-correction as soon as possible to ensure that their own classification system will comply with the national system.

> "The DSL emphasizes that China will establish a national classification and hierarchical data protection system, which can be viewed as high-level guidance for companies' establishment of their data classification"

ii. Formulation of important data catalogs at national, regional and industry levels

Since the Cybersecurity Law took effect, there has been no definition and scope given for "important data." For enterprises carrying out data-processing activities, there is no clear guidance to help them determine what data can be categorized as "important data."

Under the DSL, China will establish a national mechanism to coordinate relevant authorities to prepare an "important data" catalog. More importantly, based on the national level important data catalogue, each regional and industry authority will determine regional, ministry and relevant industry and sector level data-specific lists. In addition to national level legislation, companies must be mindful of the important data catalogues issued by local governments in the areas where they operate, and by relevant authorities governing their industry. This may present a challenge to small- and medium-size companies with limited resources for data compliance.

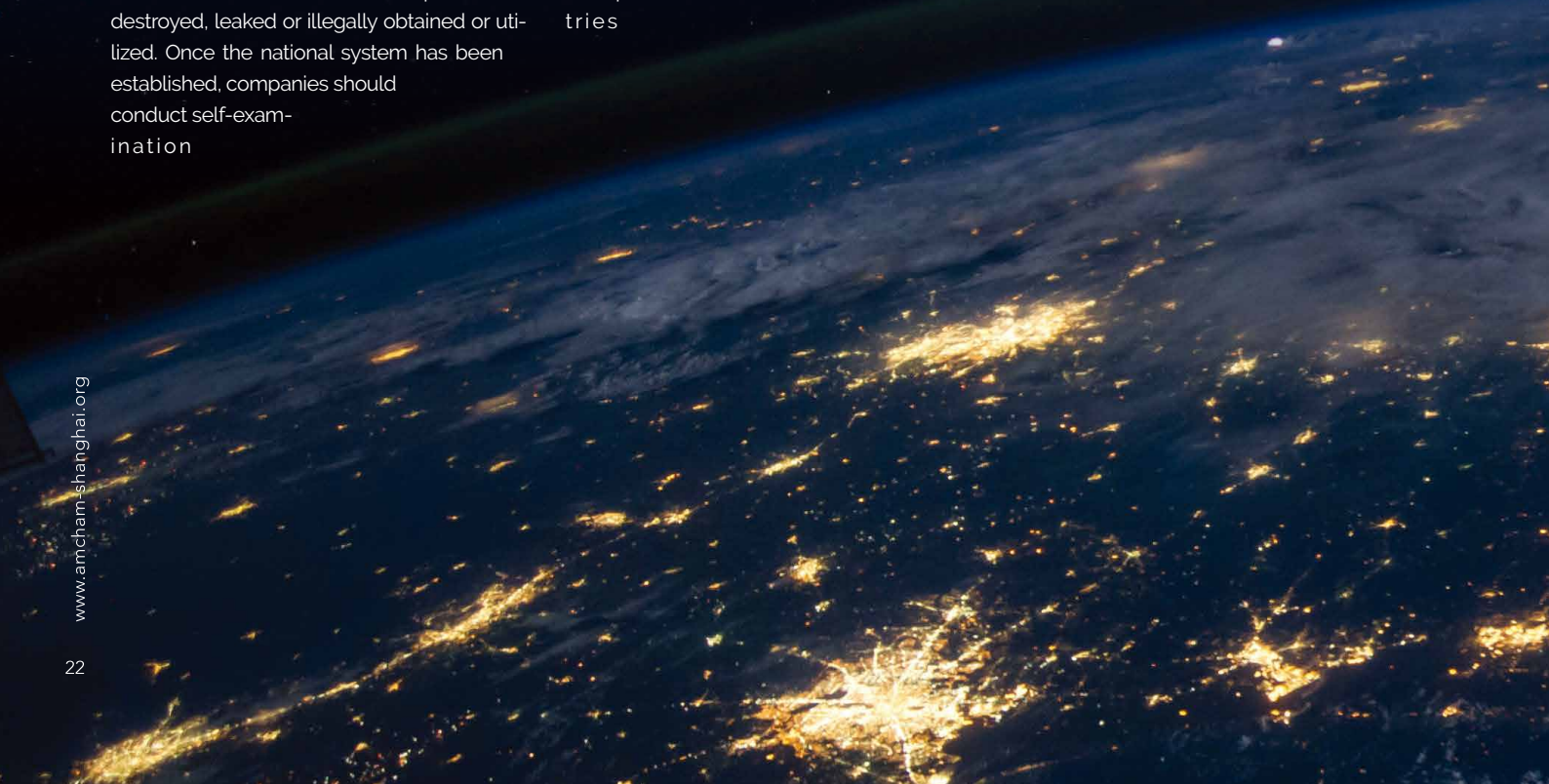
Article 6 of the DSL provides examples of industries that need their own important data catalogs. This provision of the DSL stipulates that "regulatory authorities in industrial, telecommunications, transportation, finance, natural resources, public health, education, and scientific technology are responsible for the regulation of data security in their respective industries or sectors." By looking at existing and future rules and industry standards issued by relevant ministries, it is possible to glean more information on industries of concern for data protection.

For example, on May 12, 2021, the Cyberspace Administration of China (CAC) published the Several Provisions for the Administration of Automotive Data Security (Draft for Comments), which is China's first ministerial regulation for data security management in the automotive industry. The document is a regulatory response to data security issues that have brought increased attention to smart car development.

iii. Enhanced requirements for protection of important data

The DSL also puts forward regulatory requirements for the protection of important data, including:

(i) Designated person and department: An entity processing important data must designate a person in charge of data security and a management department to perform data security protection obligations (Article 27, paragraph 2). The Cybersecurity Law



has similar requirements, including that a network operator appoint a person in charge of cybersecurity.

The Second Draft of the PRC Law on the Protection of Personal Information also requires a personal information handler to appoint a responsible person. However, it remains unclear whether such designated person under the DSL should or could be the same responsible person under other relevant laws. The DSL also does not specify the composition of the data security management department or its membership requirements.

(ii) Risk assessment: Entities that process "important data" must periodically or regularly conduct risk assessments in terms of their data processing activities and submit risk assessment reports to the appropriate government authority. The risk assessment report must include items such as the category and quantity of important data processed, specifics on data processing activities, the potential risks of data security and corresponding risk management measures (Article 30).

(iii) Cross-border transfer of "important data": The Cybersecurity Law regulates the cross-border transfer of important data by critical information infrastructure operators (CIIOs). Similarly, the DSL provides that cross-border transfer of important data collected and generated by CIIOs must follow the Cybersecurity Law. A security assessment must be conducted before the cross-border transfer (Article 31).

The DSL also stipulates that non-CIIO data processors should follow the security management measures on cross-border transfer of important data, and such measures will be announced by the CAC as well as other relevant State Council ministries (Article 31). The Cybersecurity Law only regulates the cross-border transfer of important data by CIIOs. This clause of the DSL regulates the cross-border transfer of important data generated by non-CIIOs.

> "The system to protect national core data will face higher scrutiny compared with that of important data, and companies should therefore establish their own national core data catalogues (if applicable) and important data catalogues"

Entities violating the above obligation in cross-border transfer of important data (this applies to both CIIOs and non-CIIO data processors) may be fined anywhere from RMB 100,000 to RMB 10 million, depending on the severity of the violation. Such entities may also be subject to the suspension of certain business, suspension of the company's entire business for overhaul, revocation of permits for specific types of business, or revocation of the company's entire business license. The direct responsible person-in-charge and other directly responsible persons may be subject to a fine ranging from RMB 10,000 to RMB 1 million (Article 46).

iv. Stringent regulations on a new category of data: "national core data"

Article 21 of the DSL introduces the new data category "national core data." This refers to data related to national security, the national economy, important aspects of people's livelihoods, or substantial public interest (Article 21, paragraph 2). Compared with other categories of data, national core data will fall under a more stringent management system; this can be seen by looking at the severity of relevant penalties.

For violation of the national core



data management system, the entity may face a fine ranging from RMB 2 million to RMB 10 million, and an order of suspension of certain business, suspension of the company's entire business for overhaul, revocation of the permit for specific types of business or revocation of the company's entire business license. Moreover, the offender may face criminal liability if the offense is serious enough (Article 45, paragraph 2).

Although it is unclear how the scope of national core data will be determined, and the DSL does not specify management obligations relating to national core data, the regulators will likely formulate implementation rules in the near future. Notable too is that the system to protect national core data will face higher scrutiny compared with that of important data, and companies should therefore establish their own national core data catalogues (if applicable) and important data catalogues, respectively.

v. Controls on providing data to foreign judicial or law enforcement agencies without government approval

Under the DSL, without the approval of the relevant authority of China, entities and individuals are prohibited from providing data stored in China to any foreign judicial or law enforcement authority (Article 36). Offenders may be subject to a fine ranging from RMB 100,000 to RMB 5 million. An entity may be ordered to suspend or temporarily shut down its business or have its licenses or permits revoked (Article 48, paragraph 2). The previous two drafts of the DSL did not include provisions for such severe punishment. This demonstrates China's current high degree of caution in relation to providing data to foreign authorities without approval. Under the DSL and faced with conflicting legal requirements, multinational companies and their subsidiaries may face dilemmas in navigating and complying with requirements imposed by China and foreign jurisdictions.

vi. Obligation for entities who provide data trading services

The DSL sets out an obligation and corresponding liabilities for agencies that provide data trading services. When providing such services, data trading agencies must require data providers to explain the sources of the data, examine and verify the identity of transaction parties on both ends, and must retain transaction records (Article 33).

For violations of these obligations, regulators may order corrections, confiscate any illegal gains and impose a fine between one and 10 times the amount of the illegal gains. (Where there is no illegal gain, or the illegal gain is less than RMB 100,000, the fine imposed may range from RMB 100,000 to RMB 1 million). The violator may be ordered to suspend relevant business and take corrective actions or face revocation of relevant business permits or business licenses (Article 47).

vii. The DSL and Export Control

In 2020, the Chinese government amended the PRC Export Control Law and the Catalogue of Technology Prohibited or Restricted from Export by China (the Catalogue). Under the Catalogue, data related to certain technologies, such as AI, 5G, aviation and space, may be subject to export control. Article 25 of the DSL echoes such provisions in the Export Control Law. Multinational companies with technology research and development activities in China must pay particular attention to such legal restrictions, as the technologies and data developed by Chinese subsidiaries of multinational companies, even with financial and technical support from overseas parent companies, may still be subject to export controls.



viii. Countermeasures and Retaliations

Multinational companies may be concerned by the countermeasures and retaliatory steps that Article 26 of the DSL authorizes the Chinese government to take when a foreign government restricts Chinese companies or citizens on development, investment and trade in data or data-related technologies. Such tug of war may put multinational companies into a difficult situation when there is a trade conflict between China and a foreign country.

ix. Antitrust and Unfair Trade Practices

Like the US and European Union, the Chinese government has, in recent months, campaigned against major internet companies that have allegedly violated anti-trust and unfair trade practice laws. Article 51 of the DSL specifically prohibits unfair trade practices such as stealing data, using discrimination or exclusion tactics or other anti-competitive means. Some multinational companies' subsidiaries in China have been investigated and penalized in this campaign. Multinational companies operating in this sector may wish to carry out a self-assessment of their policies and practices.

x. Cooperation with Government Investigations

Article 35 of the DSL requires all companies and individuals to cooperate with investigations conducted by the police and national security authorities. The law also requires investigators to strictly follow procedures and obtain relevant approvals when collecting data for such investigations.

When multinational companies are requested to provide data to investigators in these circumstances, they are obliged to cooperate. They also have the right to request evidence of the investigators' identities and legal authority.

III. Key takeaways

With the DSL having now taken effect, but with many details of the law remaining unclear and implementation rules still pending, companies should immediately take proactive actions to self-review and self-assess their data processing activities. It would also be advisable for AmCham member companies to monitor and study the upcoming implementation rules and industry standards related to the DSL to ensure they are fully up to date. I



Sustainable Development

China's plan for the future

By Dr. Huan Zou



Dr. Huan Zou is a Reader in International Management at SOAS, University of London. Her recent research focuses on international entrepreneurship, sustainable entrepreneurship, economic development and international business under climate change. Huan has led and participated in international research projects focusing on climate change and sustainable development funded by EPSRC, Newton Fund, Royal Academy of Engineering and Foreign & Commonwealth Office UK and the British Academy. She works closely with multi-stakeholders in the UK and China, as an advisor to firms, government agencies and institutions.

When President Xi announced at the UN General Assembly in September 2020 that China would accelerate reductions in carbon dioxide emissions and reach carbon neutrality by 2060, the international community was surprised at the ambitious goal. In the 2015 Paris Agreement, China pledged that its CO2 emissions would peak around 2030, as did most other signatories to the deal.

Carbon neutrality by 2060, however, signals a far more significant commitment and has raised doubts globally about both China's motivation behind the goal and its feasibility. How will China reach carbon neutrality? Is it just a shift in policy language rather than practice? Or is it purely a diplomatic gesture to appease the West? Most of these concerns are due to the absence of specific plans on how carbon neutrality would be achieved when Xi's announcement was made.

The 14th Five Year Plan, which was anticipated to give more hints about China's environmental policy, seems weak at first sight. Compared with other key policy phrases that appear frequently in the document, 'carbon neutrality pledge' appears just once in the entire plan. However, China's political structure and governance show how this goal could be delivered as the 14th FYP clearly messages how China might achieve the 'carbon neutrality pledge' in three aspects: a new direction for economic development; climate change mitigation at sectoral and regional levels; and multi-stakeholder engagement and collaboration.

Sustainability as the new direction for economic development

The de-emphasis on economic growth targets in the 14th FYP is a departure from the previous emphasis on double-digit growth. Instead, it emphasized sustainability, which is the fundamental driver behind the carbon neutrality pledge. Economic growth in the past decades has heavily depended on an export-led development model. However, the global financial crisis and the Covid pandemic demonstrated the vulnerability and constraints of such an economic development model.

As a global factory, China's fast economic growth is associated with high environmental costs. A study in the journal *Nature Climate Change* mapped the emissions generated by multinationals' assets and suppliers abroad, and found that investment typically flows from developed countries to developing ones— meaning that emissions are in effect outsourced to poorer parts of the world. According to research from the Carbon Trust, supply chains were responsible for over 70% of CO2 emissions in most industrial sectors in China.



The emphasis on sustainability in the 14th FYP pinpoints the 'dual circulation' strategy proposed in May 2020, indicating the importance of structural change away from the export-led development model to a domestic-driven and sustainable path. It is quite likely that the trajectory of China's economic development in the following decades will build upon domestic consumption, while simultaneously facilitating greener foreign investment and production for exports through its position in global supply chains. Undoubtedly, the pledge requires a complete transformation of the Chinese economy, changing how food and services are produced and provided, the way energy is produced and consumed and how social and work travel is arranged.

Within each industry sector, the entire value chain must be transformed in an innovative and greener way, a heavy task given the large disparity in production and consumption within and across China's sectors. While the Plan sets an 18% cut in CO2 emission per unit of GDP, known as "CO2 intensity" and a 13.5% reduction target for energy consumption per unit of GDP ("energy intensity") from 2021 to 2025, this general target can be interpreted and implemented differently across regions and sectors.

Carbon neutrality pledge as a critical part in climate change mitigation and adaptation policy

Although 'carbon neutrality' is not a high-frequency word in the Plan, energy production and consumption are paramount in tackling climate change. The Plan clearly requires an action plan for hitting peak emissions by 2030 and for setting CO2 emission caps. Some observers have critiqued the 14th FYP for its lack of clarity on definitive emissions targets, however, it allows more flexibility for sectors and regions to map their own carbon emission trajectories.

For example, northern China has historically been dominated by heavy industry. The provincial-level 14th FYPs therefore focused on the transformation of the traditional energy structure, achieving efficient and safe coal mining and clean energy use. Hebei province set a target to cut 4.2% of its CO2 intensity. Eastern China, as the most economically prosperous region in the country, prioritized the acceleration of the replacement of fossil fuel energy with new energy. Anhui, Jiangxi and Zhejiang provinces all set up quantified targets. Southwest China, according to the Plan, is to build three major clean energy bases in the upper stretches of the Yangtze river, to support clean energy transfer to eastern China. There are also five additional planned energy bases across China to be built and put in use by 2025, according to the 14th FYP.

China ultimately aims to systemically tackle climate change by investing in R&D, infrastructure projects and green energy transition. The carbon neutrality pledge is only one piece of this plan. Since early 2020, China has spent $27.5 billion on its clean energy sector, and according to IRENA statistics, China now has more than 30% of the world's total renewable energy capacity, leading in hydropower, wind and solar PV, as well as the second-largest bioenergy capacity globally. The National Energy Administration also outlines further increases in renewable energy generation, aiming to account for two-thirds of total power production and 11% of total energy consumption, as a pathway to achieve its carbon emission goals.

China holds over 70% of battery cell production capacity in the global electric buses and automobile market and leads the world in the availability of public charging infrastructure. Following the 14th FYP, the New Energy Automobile Industry Plan (2021-2035) targets that 20% of vehicle sales be zero-emission vehicles by 2025. There are other goals proposed for charging infrastructure, battery reuse and recycling and FCEV development, which fit in the context of the 2060 carbon neutrality pledge.

Multi-stakeholders stepping up in green finance and public-private partnership

China is expected to engage more proactively in international institutions to tackle climate change. From the 14th FYP, there is a clear message that China will work



closely with other countries through international organizations and will strengthen the Global South collaboration.

Domestically, the 14th FYP emphasizes the importance of collaboration between private and public sectors. Similarly, further guidelines from the National Energy Administration support the idea of market competition by phasing out traditional government stimulus measures and instruments in renewable energy consumption. Given these changes and the long-term prioritization of sustainable development and dual circulation strategy, both domestic and foreign investors are expected to increase their presence in the country's greener economy. The Chinese Ministry of Commerce's 2017 *Industry Catalogue Guiding Foreign Investment* lists renewable energy as an encouraged area for investment, which would allow foreign investors to establish wholly foreign owned enterprises in the country.

China has taken further steps to align its financial investments with its climate pledge. The 'Guidance on promoting investment and financing to address climate change,' jointly issued by the Ministry of Ecology and Environment, the National Development and Reform Commission, the People's Bank of China and the China Banking and Insurance Regulatory Commission, and the China Securities Regulatory Commission, was released in fall 2020, months after Xi's carbon emissions announcement.

According to the latest notice from the People's Bank of China, beginning in July 2021, China will enact a green finance evaluation scheme for financial institutions and an updated green bond projects catalogue. With more detailed guidance and schemes, China's green finance sector, which has been booming since 2016, is expected to provide new impetus to facilitate financial flow towards addressing climate change by mobilizing financial capital into green technologies and improved energy and emission intensity.

> "With more detailed guidance and schemes, China's green finance sector, which has been booming since 2016, is expected to provide new impetus to facilitate financial flow towards addressing climate change"

Meanwhile, private-public partnership (PPP) will act as a core component and organizational mechanism to create social and environmental value in support of China's long-term environmental and socio-ecological development. By 2020, the China Public Private Partnership Center reported a cumulative total of 5,782 low carbon and green energy projects, with an investment amount of 5.5 trillion RMB. Continuous investment in renewable energy infrastructure, key urban infrastructure systems and eco-city planning will also support the transformation of green production and consumption.

However, there is a persistent challenge in delivering transparent, impactful PPP projects and exemplifying the social and environmental value as expected. Institutional complexity is inherently embedded in these partnerships and can cause structural conflicts of interests between partners and difficulties in partnership relationships. The absence of a legal framework can also be an obstacle for partnerships.

The newly-published 2021 IPCC report warns catastrophic consequence of climate change globally. One of the important messages in this report is that reduction in carbon emissions could manage the 1.5 Celsius global temperature threshold needed to heed the worst of the climate catastrophe. Reaching this threshold requires an unprecedented level of effort from both China and the international community. With the strategic view from Beijing for a new green pathway in economic development, China is on its way to fulfil its environmental pledge across regions and sectors and establish a more systematic, sustainable collaborative mechanism at home and on the global stage. I

China's Campaign to Strengthen IP Enforcement

What's going on and what will impact foreign rightsholders

By Horace Lam, Partner, DLA Piper Beijing
Qiuyang Zhao, Legal Assistant, DLA Piper Beijing





Horace Lam is DLA Piper's Co-Country Managing Partner in China, and Co-Head of the Intellectual Property and Technology (IPT) group in Asia. He advises multinational clients on complex IP matters, including pan-Asia brand protection strategies, cross-border IP litigations, infringement and enforcement, multi-jurisdictional technology and know-how transfer and licensing matters, and complex IP structuring and transactions.

Qiuyang Zhao is a legal assistant in DLA Piper's Intellectual Property and Technology group based in Beijing. His work covers all aspects of IP & technology law, from trademark, patent and copyright to cybersecurity and data privacy.

In recent years China's top leaders have urged a whole-of-government push for strengthened IP protection at an almost unprecedented scale. As a result of endeavors across the courts and other government agencies across the country, rightsholders are enjoying stronger enforcement of their intellectual property (IP) rights, whether in civil lawsuits, criminal proceedings or administrative actions. What's more, we expect further improvements in this ongoing campaign. Foreign rightsholders are in no way outsiders in this initiative, but rather the beneficiaries of the opportunities that will emerge from less burdensome legal procedures and the higher damages and fines that await violators.

A glance at the changing landscape

Civil IP lawsuits in China have under-



gone significant changes in recent years. Low damage awards and lengthy legal procedures are often the top two issues that dissuade rightsholders from pursuing civil lawsuits against IP infringements in China. However, damage awards are soaring now. In Guangdong province (which receives around one third of all civil IP cases nationwide), for example, the average damage award for patent infringements went from about 338,000 RMB in 2018 to about 633,000 RMB in 2020, an 87% increase.

At the same time, civil IP lawsuits are moving faster. With the establishment of the IP Court of the Supreme People's Court in 2019, the average length of appellate procedures of technology-related civil IP cases (mainly invention and utility model patent infringement cases) went from over a year to 121.5 days in 2020. These positive changes have brought an increasing number of rightsholders to the courtroom to enforce their IP rights—the number of first instance civil IP cases received by all courts across China surged from 283,414 in 2018 to 443,326 in 2020.

> "We are in the midst of an enhanced IP protection campaign that China kicked off in 2019"

Criminal enforcement is also growing stronger. In 2018, public security bureaus across China seized 27,966 suspects for IP infringement crimes and fake and substandard commodity crimes, with the involved products/services valued at 9.87 billion RMB. The numbers climbed to approximately 32,000 suspects and 18 billion RMB in 2020. The number of IP crime cases that went to court also rose from 4,458 in 2018 to 5,848 in 2020, while the number of prosecuted suspects rose from 8,325 to 12,152.

State and local Administrations for Market Regulation (AMRs) and China customs have intensified their actions against IP infringements. In 2018, AMRs across China investigated 515 million RMB worth of products/services in trademark infringement and counterfeit cases and imposed fines and confiscation orders of 493 million RMB. In 2020, the numbers climbed to 765 million RMB and 678 million RMB respectively. The number of trademark infringing goods seized by China customs also increased by 133% from 23.98 million items in 2018 to 55.83 million items in 2020.

Administrative and criminal enforcement agencies have also begun collaborating much more closely. In 2020, 811 trademark infringement cases that were initially investigated by the AMRs in administrative actions were criminally prosecuted. This far outpaces the 236 cases that were criminally prosecuted in 2018.

What's going on behind the scenes?

The improvements discussed above did not come out of nowhere. We are in the midst of an enhanced IP protection campaign that China kicked off in 2019. The campaign is not only part of China's continuous endeavors to improve its business environment and build a "strong IP country," but is also a response to IP-related concerns repeatedly expressed by the US during the trade war. The campaign is a comprehensive implementation of China's commitments made in the Phase One trade deal.

A milestone that marked the start of the campaign was the release of the *Opinions Concerning Enhancing Intellectual Property Rights Protection ("Opinions")* on November 24, 2019, by the General Office of the Chinese Communist Party and the General Office of the State Council, two of China's top political agencies. The *Opinions* set out two key goals: 1) By 2022, the country will curb the ease and frequency with which IP is infringed. The country will also rectify problems with IP enforcement, including difficulties in producing evidence, time-consuming proceedings, high costs and low compensations. 2) By 2025, social satisfaction with IP protection in China will reach and maintain a high level.

To reach the two goals, the Opinions set out several key action items, covering nearly all China's commitments made in the Phase One trade deal and more. To name a few, the action items include: 1) increasing the amount of damages, introducing punitive damages and substantially increasing the maximum statutory damages; 2) lowering thresholds for initiating criminal enforcement, increasing criminal penalties and improving coordi-

nation between administrative and criminal enforcement; 3) increasing administrative penalties and conducting special administrative actions against key areas; 4) strengthening trade secret protections; and 5) promoting destruction of counterfeit and infringing goods.

Following this roadmap, we have seen a series of drastic changes to China's IP legal framework since 2019. The Trademark Law, Patent Law and Copyright Law have all been revised to introduce punitive damages, increase the maximum statutory damages and ease the rightsholders' burden of proof for damages. The Criminal Law was revised to extend criminal protections to more IP rights, such as service marks and the right to disseminate works on information networks, as well as to increase criminal penalties. In addition, the Supreme People's Court (SPC) has issued several judicial interpretations to implement the action items, including provisions that ease difficulties in producing evidence and facilitate the imposition of preliminary injunctions and punitive damages.

Many of these legal changes are recent (for example, amendments to both the Patent Law and Copyright Law became effective on June 1, 2021), and some are pending. One can expect further improvements in the near future, such as a continued increase of damage awards.

Despite all the encouraging changes, some of the long-standing issues with IP enforcement in China would not and could not be resolved overnight. For example, while the SPC's amendment to a judicial interpretation in 2020 has removed the notarization and legalization requirements on most types of foreign evidence, most Chinese courts still adhere to the old onerous requirements, which causes major inconvenience to foreign IP rightsholders.

As another example, although the SPC has long pushed for more preliminary injunctions in IP litigations, the courts have yet to develop effective levers to enforce such injunctions in cases of an uncooperative defendant. At the same time, the level of damages in IP cases, albeit on a rapid rise, remains far below other jurisdictions. China's grand campaign to strengthen IP enforcement is still a work-in-progress, despite all the notable successes.

> "The Trademark Law, Patent Law and Copyright Law have all been revised to introduce punitive damages, increase the maximum statutory damages and ease the rightsholders' burden of proof for damages"

What's there for foreign rightsholders?

Foreign rightsholders have largely received fairly equal IP rights protection compared to Chinese rightsholders in almost all aspects, particularly in civil enforcement of their IP rights. According to research conducted on all (1,663) publicly available final patent infringement cases decided by the Chinese courts in 2014, when compared to Chinese plaintiffs, foreign plaintiffs enjoy a slightly higher win rate (84.4% vs 79.8%) and an average damage award three times as high (201,620.5 RMB vs 66,217.9 RMB).

Foreign plaintiffs typically also get a higher ratio of claimed damages awarded. For example, the Beijing IP Court awards around 40% of claimed damages on average in patent infringement cases, while the ratio in foreign-related cases is 87.4%.

Under the enhanced IP protection campaign, Chinese courts, especially those in which most foreign-related cases are decided, including courts in Beijing, Shanghai, Guangdong, Jiangsu and Zhejiang, are aiming to become the "preferred venues" for international IP disputes, and have made commitments to further strengthen the enforcement of foreign rightsholders' IPs, including to increase damage awards.

We have seen signs of foreign rightsholders becoming more confident in using the Chinese court system – the number of foreign-related civil IP cases received by the courts across Guangdong more than tripled from 317 in 2018 to 1,018 in 2020. Foreign rightsholders should reasonably expect to benefit equally, if not more, from China's enhanced IP protection campaign. We are hopeful that the enforcement of IP rights will continue to get easier with less burdensome formalities, and that damages and fines will continue to rise. We are optimistic that the entire IP enforcement regime will become more effective and user-friendly as China continues to improve and perfect its IP enforcement regime. I





Ashley Wu

Chair of AmCham Shanghai's Retail Committee

Interview by Dominic Woetzel



Ashley Wu is the Head of Corporate Digital Marketing Partnership at Shiseido. Ashley has 15 years of experience in digital marketing, branding and retail strategy with data solutions in the consumer goods industry. As Head of Corporate Digital Marketing Partnerships at Shiseido, Ashley leads strategic partnerships with key media, live streaming, KOL and martech partners to drive more efficient marketing solutions and support company growth for Shiseido. Before Shiseido, Ashley was the head of Business Development at The Trade Desk, a US-based technology company. Ashley was responsible for localizing and executing sales strategy in China and revenue delivery. Ashley also previously worked for Tencent as Director in Advertising and Marketing Solutions.

What are the Retail committee's goals and objectives and what do you hope to achieve this year?

The retail industry has been changing dramatically over the years and it brings huge opportunities and challenges to existing and new retail brands. The goal of the Retail committee is to serve as a platform for members to meet, exchange knowledge and share best practices. We welcome all types of retail brands to become committee members, from traditional brick-and-mortar brands to e-commerce businesses.

My goal for this year is to gather a diverse group of retail brands in the committee, so that everyone is able to catch up on the latest retail trends, discover new technology and learn from each other.

Could you tell us a little bit about your background, including your current position?

My background is related to retail and digital marketing. I worked at Nielsen for 11 years on retail management, business analysis and digital marketing. Then I went to Tencent and worked on advertising and marketing solutions that helped brands build end-to-end consumer journeys leveraging Tencent's ecosystem. After that I worked for The Trade Desk, an advertising technology company.

I'm currently Head of the Corporate Digital Marketing Partnership department at Shiseido. My job is to lead strategic partnerships with key media, livestream, KOL and martech partners to drive more efficient marketing solutions and support company growth.

What are some of the biggest issues retail companies in China face?

The way of doing business today versus a few years ago is quite different, meaning companies need to adapt and change if they want to survive and grow. For example, traditional retail companies now face challenges stemming from the increasing costs associated with brick-and-mortar stores and figuring out a balance between offline versus online presences, as well as the consequent need to reposition offline sales roles to online ones.



Another big challenge is understanding and providing the right products to the young generation. Generation Z is a group of people that all brands are targeting. This is a very noisy market, which means it takes a lot to get their attention and loyalty.

In your years of experience with digital marketing, what changes have you seen in Chinese retail marketing campaigns?

I have seen a rise in the sophistication of style and content in retail marketing campaigns, as well as the prevalence of omnichannel marketing. Previously, marketing campaigns were conducted via one-way communication. Brands would



tell consumers, "I am good, come and buy me". This format of marketing communications was relatively simple and was mostly done through an OTV (online TV) format.

Today's brands are willing to build linkage with consumers and make a connection with them through multiple social channels. They try to understand consumers, listen to their feedback and adjust to fulfill their needs. Companies have moved from being product-oriented to people-oriented.

In what ways is the average Chinese consumer unique when compared to consumers from different countries?

Chinese consumers are confident about their needs and are used to receiving branded messages in a highly digitized format. To the average Chinese consumer, shopping is now a form of social entertainment, and they expect brands to provide unique and attractive products or services to enhance their shopping experience. In recent years, consumers have also become more attuned to their mental health and the protection of the environment. They care about the quality of the product and the way products are produced, as well as their health in general.

What advice would you give to retail startups in China? Conversely, what type of advice would you give to already established brands hoping to expand into China?

The core ideas are the same—clarify who your target consumer is, how they spend their time, what content they like and what channel they usually buy products from. For startups, they really need to deeply think these things through before they actually start up. They need to think about their consumer's needs, rapid digitalization of the company, setting up a simple operation model and getting ready to move quickly.

For established brands, be open and keep studying your consumer. Ask yourself questions like: Have my consumers changed in any way? Do they have new needs that they can't get from me? Do I need to target another group of consumers? Are there any new channels that I need to invest in? Can I speak the same vocabulary that my target consumers use? They need to be open to evolving alongside their consumers and channels and be ready to make a change.

> "The CSL launched the government's all-out effort to ensure that all organizations, including government, critical infrastructure and businesses have a minimal baseline level of cyber security and data privacy protection practices"

Do you foresee any new disruptive innovations causing a noticeable impact in the retail industry?

I see there being a more thorough consolidation of offline and online retail, in addition to a break in the boundary between offline and online in terms of the products offered, pricing and logistics. In short, a total integration that intensifies the shopper's experience.

It's like creating a link between a social experience and a purchase. As I mentioned before, Chinese consumers consider shopping as a social experience. So by creating this connection and making purchases more entertaining, Chinese consumers will be more satisfied.

If you were trapped on a deserted island and you could only bring two things with you, what would they be?

I would bring a fishing rod and a bucket of oil paint. One to save my life, and the other to kill some time while waiting for rescue. I'd paint SOS on the beach first and if there was any paint left I could paint some other stuff, like my dog or my family. There's a lot of other things I could paint! I



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Member Briefing on July 6 at the Hyatt Regency Shanghai Global Harbor



AmCham Moments



Chinese Ambassador to the USA Vice Foreign Minister Qin Gang visits AmCham Shanghai on July 26









Future Leader Award ceremony on August 3 at the PwC Innovation Center









Summer BBQ Party at the Kerry Hotel on July 11









Fireside Chat with Joyce Ling, Chief Strategy Officer and Food & Cooking KOL on July 28







July & August











Learning & Development Fair on July 23



AMCHAM SHANGHAI FUTURE LEADERS OF THE YEAR 2021 AWARD CEREMONY

AmCham Shanghai recognized the extraordinary efforts of some of the city's young leaders at our sixth annual Future Leaders of the Year Awards on August 3. The awards are a chance to celebrate the young professionals leading the way in Shanghai's business community with their transformative ideas. We are excited to announce that our 2021 winners are Ivy Wong, co-founder of Diversity and Inclusion Consulting for the Future Leader Award and Matt Spriegel, Founder & CEO of Atiom for the Entrepreneurship Award.

Our two winners were chosen out of eight finalists, and in two categories: Future Leader of the Year Award and Entrepreneurship Award. Chamber members and non-members were invited to apply and nominees were accepted from both self-nominations and those submitted by colleagues, supervisors or others. Nominees were accepted from any industry, but were required to be under the age of 39.

Finalists for the Future Leader of the Year Award included Ivy Wong, Co-founder of Diversity and Inclusion Consulting, Matthew Jimenez, Chief Brewer at Beast of The East, Melody Li, Senior Director, Sales & Marketing at SPORTFIVE, Sara Tanhaee, Vice President at Honey-Can-Do and Tao Liu, R&D Manager, Florine Product at Honeywell. The finalists for the Entrepreneurship Award were Matt Spriegel, Founder & CEO of Atiom, Maximilien Perez, CEO of XSuit and Nadya Liu, Founder and CEO of Linke Consulting Co., Ltd.

The judge's panel consisted of five individuals: Curt Ferguson, Managing Partner at Ventech China, Sharon Yang, Head of HR at SPD Silicon Valley Bank, Han Lin, Assistant Professor of Practice, Financial Markets at NYU Shanghai, Hongfei Zheng, Managing Director at Cargill Animal Nutrition and Health, and Eric Hoang, Director of Strategic Planning and Business Transformation at Herbalife Nutrition.

Nominees were judged on detailed criteria, ranging from their leadership skills, vision for their long-term professional goals to innovation, sustainability, and CSR. The eight finalists had the opportunity to present their work before the AmCham community on August 3, describing their professional background and innovative work. Chamber members then voted in real-time to decide the winners.



QIN GANG VISITS AMCHAM SHANGHAI

On the eve of departing for the United States to assume the post as Chinese Ambassador to the USA, Vice Foreign Minister Qin Gang visited AmCham Shanghai on July 26 and met with member companies. During the two-hour meeting, Mr. Qin discussed the business environment in China and learned how American businesses view the market. In addition to the meeting, he visited AmCham Shanghai member companies including J&J, Honeywell, Disney and GM.

AmCham Shanghai members reported that they continue to value the China market and are committed to growing their presence in China. However, issues including the need for a level playing field, limited mobility in connection to COVID restrictions, and changes in the individual income tax regime remain challenges to business growth. They thanked Mr. Qin for reaching out to the business community and learning more about American businesses.

AmCham Shanghai Chair Jeff Lehman stressed the importance of the US-China relationship to the business community and thanked the Ministry of Foreign Affairs (MFA) for continuing to engage with AmCham Shanghai. AmCham Shanghai met with Vice Foreign Minister Xie Feng in April.

Lehman also expressed appreciation for the MFA's efforts to facilitate the return of foreign business executives to China. He noted that mobility continues to be a top issue for many American companies that rely on foreign talent. Lehman also mentioned that making mRNA vaccines available in China, such as those manufactured by Pfizer or Moderna, would also make cross-border mobility safer. He hoped for further cooperation between AmCham Shanghai and the MFA on these and other issues that impact the business community. I

Major Upcoming Events

Sep 15	2021 AmCham Shanghai Automotive Conference - China's Auto Industry in the Age of Disruption
Sep 17	2021 Global Mobility Conference
Sep 23	Release of 2021 China Business Report
Sep 24	Talent Acquisition & Employer Branding Fair

See all upcoming events and register at:
https://www.amcham-shanghai.org/en/events/Upcoming

AMCHAM SHANGHAI'S

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AMCHAM SHANGHAI WELCOMES NEW MEMBERS

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Renaissance Academy
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Collectors Universe (Shanghai) Ltd.
Ferrara Candy (Shanghai) Trading Co., Ltd
Gilead Sciences Shanghai Pharmaceutical Technology Co., Ltd.
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Suzhou Xiangcheng Bureau of Commerce
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