China for Dummies

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Introduction- What Do You Need To Know Before Starting An Oracle Implementation In China?

For more than a decade, China has boasted one of the world's most dynamic economies. This dynamic economy provides global enterprises with a multitude of opportunities to either outsource or to do business in the massive Chinese market.
Effectively capitalizing on these opportunities requires successfully dealing with a number of challenges. Configuring enterprise resource planning (ERP) systems to meet local legal, linguistic, and cultural practices is one of the biggest hurdles corporations establishing operations in China must overcome.

This paper draws insights from the experience IT Convergence has accumulated by helping numerous clients expand their Oracle systems into China. While the complexity involved in such a task should never be underestimated, this paper provides some basics which are critical to the success of a China implementation project.

China Overview

Today, China always attracts the attention of the world for its rapid economic growth and huge market potentials. The coming events like the Olympic Games and World Expo puts even more only intensify the activity and attention focused on the hottest economic spot on earth.

The China's population of 1.3 billion not only provides a vast pool of lower cost laborers but also is a huge consumer market that is craving for goods and services. If you consider the recent economic growth only started 30 years ago, you will be amazed by the economic achievement made today and will not be surprised by the turbulence that has accompanied this growth. It's a land where things change fast and laws and regulations can barely keep up with the pace of economic development.

From a legal perspective, there are some local compliance and statutory requirements that need to be met. China's accounting practices originated from the former Soviet model, when China had a planned economy; today, however, the current China GAAP more closely resembles the USA GAAP and the IAS after reform and adaptation. As such, the main part of the statutory requirements fall in the area of tax reporting, while companies have the flexibility to choose any accounting standards to account for their business transactions internally. Another major compliance requires the presentation of financial data in Chinese characters and in some cases the format of the report is stipulated. Also to attract foreign investment, China has set up various economic zones and duty-free bounded areas. For example, the SIP (Suzhou Industrial Park) is a joint effort between the Singapore government and the Chinese government. These areas usually enjoy various benefits and incentives particularly in the field of tax and trading ability. However as a result, extra reporting requirements must be followed in order to stay qualified.

Challenges and Critical Success Factors

China has a very brief history of adopting information systems, particularly with respect to business applications like ERP software. Manual operation still prevails in the working environment. The early high failure rate of ERP software in China adds additional obstacles for change management. Apart from the relative failure and unfamiliarity of the user community, culture also plays an important role in a China project implementation.

While there is no universal formula for success, several factors repeat themselves in projects that end successfully.

- Cultural differences. Companies expanding into China need to be aware of the drastic difference t between norms that govern Chinese work culture and those that we are accustomed to in the West. These differences must be taken into account at every level and during each stage of the project.
- The nature of the company and its operations. Foreign companies that operate in China fall into three categories: Wholly Owned Foreign Enterprises, Process Trade firms, or Joint Ventures. There are regulations and business practices unique to each category.
- Statutory requirements and local configurations. China has its own set of local customs and regulations. New businesses expanding into China need to adjust both their business practices and customs to accommodate for these differences.
- Bonded and non-bonded products. This relates to raw materials that are imported to be processed and then exported, as opposed to products that are imported to be exported to the domestic Chinese market.
- Staff Turnover. Staff turnover has been on the rise in China in recent years, marking an important change in the local work culture.

Planning ahead for a China Implementation

With the trend of globalization and the objective to making full use of the centralized system, a typical system scenario includes a single global instance, a global template, and a rollout standard. In addition each project generally incorporates some local compliance requirements, a group license contract signed aggregately, and a global team to support the system.

One way to respond to a typical system scenario would be to prepare an “Oracle in a box” solution. The solution should include a deliberate implementation methodology to manage the project scope and complexity, commitment to gaining corporate and local sponsorship, adequate resources with a realistic project schedule, qualified staffing, and a clear understanding of China’s statutory requirements related to Oracle. This type of “Oracle in a box” solution is designed to provide reusable project tools that can be used in repeated Oracle rolls outs in China. It is also important to note that the roles and responsibilities of project staff need to be defined before the project even kicks off.

Training is an area that that needs to be stressed. Ensuring that users have the skills they need is always the most critical yet easily manageable. A training plan needs to take into consideration high turnover in certain regions. The train-the-trainer approach is effective for projects that involve a large number of users as well as for a phased project implementation. Remote instruction may be a good option in the event that users are spread around or when these users have difficulty getting away from their daily jobs. The language of training materials shall be consistent with the system's operating language to avoid confusion and loss of information. It is strongly suggested that instruction be conducted in the local language.

Training accomplishes knowledge transfer and fosters adoption of the new system. Knowledge transfer can be supported through continuous teamwork.

Cultural Differences

Companies expanding into China need to be aware of cultural differences that exist between the Chinese workplace culture and western culture. These differences extend to communication, the nature and role of personal relationships, and how to shift management style to accommodate for these differences. Likewise, the Chinese tend to take a longer-term view of things than do westerners, and the perception of individualism in Chinese culture is very different from its perception in Western culture.

The Nature of a Company and Its Operations

Foreign companies that operate in China can be grouped into three categories: Wholly Foreign Owned Enterprises, Process Trade firms, or Joint Ventures. There are regulations and business practices unique to each category.

WFOE - These are enterprises set up in China by foreign individual people or firms in accordance with Chinese law and where the investment is 100% provided and operated by only foreign investors (without any Chinese partners). If several foreign partners jointly invest in a company, the company will also be regarded as a WFOE, according to Chinese law.

A WFOE is a legal entity and is a limited liability company. The liability of the shareholders is limited to the assets they brought to the business. Setting up of a WFOE requires currency input or equipment contribution, and the registered capital shall correspond to the enterprise's business scale. In recent years the Chinese government has steadily increased the scope of business allowed to WFOEs. However, although a WFOE basically can engage in an increasing range of sectors, some restrictions still exist on certain industries. WFOEs offer the advantage that foreign investors have complete control over major decisions, products, costs, and employee culture. They also allow strategic alignment with the parent company and greater protection of intellectual property.

Processing Trade refers to the business activity of importing all or part of the raw and auxiliary materials, parts and components, accessories, and packaging materials from abroad in bond and re-exporting the finished products after processing or assembly by enterprises within the mainland. It includes processing with supplied materials and processing with imported materials. Under processing with supplied materials, the imported materials and parts are supplied by the foreign party which is also responsible for selling the finished products. The business enterprise does not have to make foreign exchange payment for the imports and only charges the foreign party a processing fee. Under processing with imported materials, the business enterprise makes foreign exchange payment for the imported materials and parts and exports the finished products after processing.

These enterprises are established in China as a result of a joint investment or cooperation with foreign individuals, firms and/or Chinese economic organizations, based on the principle of equity and mutual benefit, subject to approval by the Chinese Government. However, a contractual JV has more flexibility in terms of contractual freedom and structure (i.e. in a Contractual JV the profits and losses are distributed between the Chinese party and foreign investor in accordance with the specific contractual provisions as opposed to the respective equity interests in the Contractual JV). Capital contributions to both Equity JV and Contractual JV can be in the form of cash, or in kind, such as buildings, machinery, materials, and know-how. For a Contractual JV, the JV parties can decide how the value of their contributions should be determined, whereas for an Equity JV, this process and value attached to contributions normally needs an independent third party or value to access the "market price" of the assets to the contributions. A Contractual JV project usually involves the foreign partner to provide most or all of the funds and technology, key machineries whilst the Chinese partner will contribute land, facilities, natural resources and perhaps a limited amount of funding. But as the PRC economic environment has changed, land has become a rare resource, and Chinese companies are not in shortage of money; therefore, forming a Contractual JV has become less popular.

China has also established a number of special economic zones. The two most important areas are the Singapore Industrial Park (SIP) and the Export Processing Zone (EPZ.) The SIP was established in Suzhou, China in 1992 to provide a modern, industrial community that would be capable of supporting China's industrial development.

The Export Processing Zone is located in the SIP, and as the name implies, it is a special economic zone specifically created to boost Chinese exports. Businesses that operate in the EPZ enjoy a number of special advantages. They are exempt from the quotas that normally govern how much an enterprise can export and/or import. Additionally, they can import products without paying the normal import duties, and products exported from this zone are not taxed.

Bonded/Non-Bonded Materials

There is one more local configuration that bears further discussion, and it is the issue of Bonded and Non-Bonded materials. Manufacturing materials that are imported into China are classified as being "Bonded" or "Non-Bonded." Customs allow enterprises in China to defer payment of tariffs and import-related taxes on all materials and parts imported, whether they are purchased with foreign exchange or supplied by foreign customers. The amount of imported materials and parts actually used in the making of the finished products for export is exempt from tariffs and import-related taxes. For bonded materials and parts imported for processing or finished products which are allowed to be sold in the domestic market, Customs will levy duties and interest on deferred payment on the bonded materials and parts based on valid approval documents for domestic sale issued by relevant departments. If the bonded materials and parts are under import restriction, the business enterprise must also submit the import license to Customs. All processed finished products for export are exempt from export tariffs. Products made from "Bonded" materials may not be resold as finished products in the local market. If they are sold domestically the producing company must pay the import tariffs and the VAT, obtain a Domestic Sale Approval Certificate, as well as pay a penalty ranging from 30% to 100% of the value of the goods.

Cross-functional & Localization Consideration

When it comes to the Oracle E-Business Suite, there is a host of other China localization requirements which businesses expanding into China need to solve creatively. These localized configurations cover everything from configuring Oracle's Multiple Language Support pack[1] to compliance with local tax laws. The list below details several common localization requirements.

Local Supplier documents need to be in Chinese. Examples of some data elements which need to be in Chinese are item descriptions, supplier names, unit of measure, freight terms, FOB, etc….

Financials localizations: China uses a value added tax (VAT) system for business transactions. Oracle provides a globalization flexfield for the invoice format of the VAT system. It also supplies flat files on Accounts Receivables VAT and Accounts Payables VAT in the government approved format.[2]

Financial statements must comply with government regulations and must be in Chinese currency (RMB).

Inventory and fixed assets may be required to be valued at actual costs, and the minimum value which must be reported is far less in China than it is in the US.

Asset Report: An asset list report needs to be prepared for local government auditing purposes. Asset Description needs to be in Chinese.

The capitalization threshold is 2000 RMB and transportation fees, handling charges, and other costs incurred on the asset are treated as asset costs.

All assets transfers from one company to another company are based on the Material Price value at the time of transfer.

Straight Line (STL) depreciation method is used for all asset categories. Residual value can be determined by the company within a proper range.

All assets and depreciation amounts reported on the Financial Statement must have asset movement details of asset number, movement descriptions, debit balance, credit balance, and net balance.

Set of Books structure: The Chinese government mandates a statutory account prefix. It is a 4-digit coding with description provided by the government. Companies can add additional digits (sub-accounts or child accounts) to meet their own accounting requirements.

Financial calendar: Financial reporting is based on fiscal year from January 1 to December 31.

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1 The solution needed to configure the Oracle MLS pack to do business in China goes beyond the scope of this paper. However, the white paper "Rolling Out Oracle in China: Language and Localization Solutions" lays out a comprehensive solution.

2 More details about using Oracle to comply with VAT regulations can be found in the "Understanding China's VAT and Golden Tax Systems and How to Integrate them with Oracle" white paper

However, the end of each period within a fiscal year can differ from the end of the fiscal month. Income Tax is pre-paid quarterly. The final tax is recalculated at year-end from January 1 to December 31.

Voucher printing: The Chinese government may require all transactions to have a voucher and supporting documents attached for validation and approval purpose. All vouchers attached need to be printed with information such as voucher number, debit amount, credit amount, transaction currency, functional currency, preparer, and approver.

Document sequence: Document sequence must be consecutive within an organization.

Checks: Checks issued to the local parties need to be in Chinese and use the correct local format. Checks printed from an Oracle system are generally not accepted by local banks. In fact, a company has to use paper checkbooks obtained from the bank. To use Accounts Payable invoice data to print out checks, an interface between Oracle Accounts Payable and the local check printing system is needed.

E-banking: There is no standard e-banking system. Each major commercial (state-owned) bank has developed its own e-banking system. Therefore, a custom interface is typically required for Oracle to exchange data with these systems.

Purchase Order: System generated purchase orders are not commonly accepted by local vendors. Signed paperwork is usually required for the contract to be binding.

Supplier invoice: All local purchases of goods and materials need to separate item cost, VAT rate, and VAT amount. VAT amount also needs to be captured in a separate account in order to claim a refund.

Red Invoice: Normally, the Chinese government does not allow cancellation of VAT invoices unless there is valid reason. VAT invoices can be cancelled by the vendor if it is issued in the same month. Otherwise, a “red invoice” (negative invoice) needs to be obtained from the vendors.

Invoicing: Vendors are required to pay the VAT before the invoice can be issued. Sometimes when the vendor suspects that the client may be unable to pay the invoice, the vendor will choose not to issue an invoice to avoid paying the VAT tax. This can result in a situation where many deliveries are completed without invoicing.

RMA process: If a company wants to refund on the Export Tariff, the Chinese government requires the product to be returned to China and does not allow the product to be scrapped overseas.

Shipping process: The government requires companies to apply customs declaration before exporting goods to customer, including contract number, export license number, and so on.

Shipping documents for the local customers, for example:

Packing List (Item description needs to be both in English & Chinese)

Commercial Invoice

Shipper’s Letter of Instruction

Customs Declaration Form

Inventory transfer: Chinese government regulations do not allow inter-organization transfer between an organization in China and an organization overseas.[3]

Costing: Under China GAAP, manufacturing variances are capitalized, whereas under US GAAP, they are expensed. Therefore, adjustments are needed.[4]

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[3] More information about using about using Oracle to track inter-organizational transfers see the white paper, “Oracle Inter-Company Financials.”

[4] More detailed information about the differences between US GAAP and China GAAP is can be found in “Bridging the GAAP: Solutions for Reconciling the Differences between US and China GAAP.”

Other Considerations for China Localizations:

There are other issues that should be considered for China localization when planning a global instance. For instance,

Time zone: If the Applications server is located in a different time zone than that of China, the date/time that users in China see is the server date/time. The time difference should be considered for work calendars, work shifts, and all time-sensitive data, such as planning and scheduling data.

Performance: For a multi-site instance, if the server is located on a different continent, the project team should pay attention to the server and network performance. For example, when late-night server maintenance work is scheduled in US, it is the business rush hour in China. Users in China may experience system performance problems as a result of server maintenance work. Decision makers are advised to take note of this when developing systems maintenance plans.

Personnel Turnover

Staff turnover is another, relatively new issue that companies expanding in to China must deal with. The average overall voluntary staff turnover increased from 10.0% in 2004 to 13.2% in 2005, reflecting most likely a tightening of the labor market conditions. Some industries experienced higher voluntary turnover among employees than others. Across all industries, 47 percent of companies surveyed had turnover rates of more than 10 percent in the past 12 months, and 13 percent said that the rate was more than 20 percent. China's staff turnover rate was highest in Asia, more than twice that of Japan. Unsatisfactory compensation and limited career progression were blamed for China's high turnover level. The report predicted a persistent increase in salary levels in China because of limited talent resources. Companies also provide more business training for their employees hoping to retain their talents.

So how effective are these solutions when they are applied to actual business situations? To help answer that question we have provided a case study.

Case Study One

This case study involved an end-to-end wireless infrastructure provider that has posted over one billion dollars in sales. This company employs over 4,000 people and has 24 operating facilities operating in 15 countries. The company had recently acquired three global enterprises that operated in the same space. These moves had given the company three manufacturing plants in Suzhou and Shanghai China.

Accordingly, the company needed to bring all of the new business units on to its Oracle footprint while unifying and streamlining business processes between the three of them. The first step was to define standardized global data definitions and processes for the merger, with a specific focus on the definitions for Bill of Materials, customer, and supplier data. One of the recently acquired units had been operating on the Filtronic's Sytline 7.0 ERP system, and that needed to be migrated to the Oracle E-Business Suite.

The first challenge the company faced was obtaining the buy-in from Syteline users, and this was solved by educating these end-users on the benefits of an Oracle 11i system. The second challenge was to map and convert static legacy data and dynamic transaction data from Syteline to Oracle. It was particularly important that the company get its item schema change and the Bill of Material data converted correctly. The next challenge was to integrate the Oracle E-Business Suite and the company's Bills of Material with the company's Agile PDM system. Likewise, the company needed to integrate Oracle's WIP (Working in Progress) and OM (Order Management) shipping systems with the company's Felix Shop floor control system. Finally, the company needed a solution that would allow it to deploy a global Oracle Warehouse Management solution at its Suzhou factory.

The company was able to accomplish all of these goals in five months, which is a very short timeframe for a project of this scope. The project finished on time, and Go Live happened on schedule. As a result of this successful initiative, the company now has only one Set of Books that covers each of its three China factories. The company also successfully configured the following Oracle 11.5.9 tracks: Accounting to Finance, Procedure to Pay, Order to Ship & Demand to Build, in addition to the Warehouse Management System. The company's global engineering department now controls a synchronized process for item creation and Bill of Materials maintenance processes. Finally, the company was able to successfully integrate Oracle with its Agile and Felix Shop Floor systems.

Conclusion

Effectively implementing Oracle 11i in China is a challenging task. However, this challenge can be successfully met with the proper planning and foresight. Based on experience implementing Oracle 11i in China, this paper has been developed to provide decision makers and Oracle implementers with a road map to guide them through Oracle 11i rollouts in China. The paper has highlighted both the basic use and implementation of Oracle 11i's MLS pack and the key configurations needed when using the MLS pack to localize Oracle 11i in China. Insights have been offered into some of the key issues which decision makers must resolve as they work to provide solutions to local Chinese reporting and documentation requirements.

Although this document has been written to be as comprehensive and an inclusive as possible, there are many issues that will need to be resolved on a case-by-case basis. Accordingly, the information presented here should be regarded as a starting point to be used when planning major ERP initiatives in China.