

## Tapping The Chinese Domestic Toy Market

Home to more than 4,500 toy companies, Guangdong is one of China's leading toy production and export bases. In 2000, the province's toy exports accounted for 70% of the national total, with the number of export markets exceeding 120. The US, Hong Kong, EU and Japan are the largest markets, which together make up 80% of Guangdong's toy exports. Toy manufacturing enterprises are mostly located in the Pearl River Delta area, with the biggest concentrations found in Shenzhen, Dongguan and Guangzhou. Most of the manufacturing facilities are processing trade enterprises run by Hong Kong investors.

### Foreign Enterprises vs Domestic Makers

Foreign-funded toy manufacturers and mainland toy makers have different advantages in conducting domestic sales in China. Generally speaking, foreign toys are superior in design and quality and foreign investors are familiar with global market conditions. However, since most of them are involved in export processing and lack experience in domestic sales, they tend to have limited understanding of the Chinese market. Moreover, their prices are relatively high and the types of toys being marketed often fail to appeal to Chinese consumers. Domestic toy makers, on the other hand, have been in the business for many years and have developed a niche in the market. Not only are their production costs lower but they also have a better understanding of the domestic sales channels, consumer preference and product position.

Various sales channels are currently available for the distribution of toys in the mainland. Many of these are also open to foreign companies. In terms of retail, the most popular outlets include large department stores, warehouse style supermarkets, specialised shops, children's shops and individually-run retailers which have sprung up all over the province. Wholesale distribution is primarily conducted at specialised wholesale markets or through sales agents. Working with domestic agents is one of the effective ways for foreign toy makers to tap the Chinese market. These agents usually have their own established sales networks, understand consumer preference, and have a deep penetration into the market. Some even have experience working with foreign companies.

Foreign toy makers interested in selling direct to the Chinese market should take note of regulatory requirements. In addition to the three basic laws on foreign-invested enterprises, namely sino-foreign equity JVs, contractual JVs and foreign-capital

enterprises, domestic toy sales in China are also governed by the "Trial Measures Regarding Sino-foreign Joint-Venture Commercial Enterprises" and "Interim Measures Concerning the Approval and Management of the Domestic Sales of Raw Materials and Parts Imported for Processing". China has recently amended the three laws on FIEs lifting restrictions on domestic sales ratios, paving the way for foreign investors to tap the market.

However, the corresponding implementing measures have yet to be revised and uncertainties remain as to how the new laws should be interpreted in practical terms. Few toy companies benefit from the Trial Measures yet because of the stringent requirements stipulated therein. As for the Interim Measures, they are mainly directed at processing trade enterprises. Under normal circumstances, all raw materials and parts imported via bonded zones must be 100% exported. Hence, the best option to develop Chinese domestic sales is through setting up a FIE.

### Options for Domestic Sales

Foreign toy makers with factories on the mainland may carry out domestic sales by establishing branch companies, business units and sales offices. They may also opt for setting up another enterprise and share the use of the brand name, thereby achieving the goal of chain operation through attracting outside capital.

For companies without production facilities on the mainland, viable market entry options include setting up a domestic trading company under the name of a foreign person (currently only allowed in Guangzhou on a trial basis); setting up a domestic trading company under the name of a Chinese citizen; and setting up an individual business operation (again allowed in Guangzhou only). For the first option, although it is stipulated that the registered capital must not exceed Rmb1 million, it can basically match the expectations of foreign investors in wholesale and retail business. However, the shortcomings of this option are that profit repatriation and import-export trading are not allowed, and the enterprise concerned is not eligible for preferential policies applicable to FIEs. The second option is relatively straightforward and is subject to few restrictions. However, legally speaking, the Hong Kong investor concerned is not the owner of the enterprise. Hence, there will be bigger risks in the event of commercial dispute. As for the third option, the business is relatively small in scale and does not have the status of a legal entity, thus making it difficult for the operator to enter the mainstream distribution networks.

Many foreign toy makers are concerned about intellectual property rights (IPR) in the mainland market. To effectively safeguard their IPR, foreign

companies should apply for patent registration in China. In the event of suspected infringement by others, the enterprise concerned may either report it to the IPR administration department at the locality where the suspect is located or where the alleged act of infringement takes place, or resort to litigation. By comparison, the first option warrants a speedier and less costly resolution but the complainant must be able to present proof. Besides, if the case involves import-export goods, it should also be filed with Customs for the sake of protection.

All in all, with China's WTO accession and the continued opening up of its domestic market, toy makers can expect promising market prospects. foreign companies should study the Chinese toy market more closely and explore domestic sales. At the same time, they should also understand that the Chinese toy market has yet to mature. IPR and payment problems continue to be major concerns for foreign investors. New entrants to the Chinese domestic market should take note of this and get prepared for tackling such problems.