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Shanghai's STAR Exchange A Source of Capital. A Source of Chinese Partners for International Partners?

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China's version of NASDAQ was established on July 22, 2019 and has been spectacularly successful. China has become the center of global capital raising with 40% of global IPOs in 2020 taking place in mainland China and HK SAR. Indeed with 233 IPOs the Shanghai Stock Exchange and its Star Market ranks No 1 in the world followed by NASDAQ and then the Shenzhen stock exchange.

The total value of the SSE Star Market's companies is RMB 3.2 trillion (approx. USD 500 billion). The Shanghai Stock Exchange has a market cap exceeding USD 5.01 trillion.

The STAR exchange's focus is the tech of tomorrow such as New Energy; Biomedicine; New Materials; New Gen IT; High End Equipment; Energy Conservation and Environmental Protection.

What does it mean for Foreign Tech Companies?

Clear Indicator of China's Priorities – China has a clear goal to become a dominant player in the next phase of global high-tech manufacturing. Coupled with this ambition China is keen to improve its "self-sufficiency" in respect of high-tech industries. Although China is ramping up its indigenous innovation the country is still keen on international technology. Accordingly, opportunities abound for international technology.

Why is China of particular interest for International Tech Companies?

China Only Economy with GDP growth – Although COVID has had a major impact on the economy China has enjoyed a V shaped recovery and is now the only major world economy experiencing economic growth. China's GDP continues to close in on the US and is now expected to overtake the US by 2030. Times are a changing and many international tech companies increasingly look to China as the major growth market.

China Too BIG to Ignore – Decades of continued economic growth has resulted in China being already the biggest global market for many products– automotive, smart cities, e-commerce, AI, hi-tech manufacturing to name a few. For many international tech companies China is the second home market already or the market that holds out the most promise for growth. The already massive middle class in China continues to grow and wealth continues to increase across the country. In 2021 every tech company will need a strategy for China – even if it means sitting it out. However, most will want in.

Challenges for International Tech Companies

However, although China's market is too big to ignore it can be for many tech companies too difficult to conquer alone. Common reasons include:

China is BIG – although, Western media coverage almost exclusively concentrates on Shanghai, Beijing and newly Shenzhen ... there is a lot more to China than those cities. International tech companies need to cover a market beyond the first-tier cities. China has more than 150 cities with a population exceeding 1 million – these cities are no longer the market of the future ... they are the market of 'NOW'. If you are selling to the Chinese automotive industry, or providing a software solution to the financial sector, or wishing to sell a hardware/software environmental solution to Chinese cities ... it will be difficult to do this practically without a strong and connected Chinese partner.

Things are Moving Quickly – China is not the China of 10 years ago – or even 5 years ago. Many international companies cannot fully appreciate how quickly the market is

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developing on the ground. Competition is extremely fierce as the whole world plus Chinese indigenous companies battle it out. Accordingly, the days of bringing old tech to China are long gone. A true JV will allow the international company to be closer to the action and catch the trends.

Tech Company has Limited Bandwidth– Cutting edge tech companies have management and resource limitations. They need to continue to develop their tech; secure the home market; raise capital etc. In addition, many recognize that China is a massive opportunity but feel unsure they have the resources to pull it off – many Western companies feel they can handle Europe and USA but scratch their heads when it comes to China and South East Asia. Crucial markets but how can we manage businesses there?

Adapt or Perish – the limited bandwidth is also a challenge when adapting the business to China. Many international tech companies will need not only to localize their product / technology but also their way of doing business to meet China market requirements. This challenge of being short of resources is compounded by the fact that many international tech companies do not have a China ready team with the necessary experience to build a meaningful business in China. It can be difficult to launch much less adapt your business to China – the right partner can help with both challenges.

Why the renewed Interest by International Companies in Sino-foreign JVs?

China's Economy –China's sustained economic boom has resulted in a massive domestic consumption market and also a cohort of Chinese companies that are able to compete globally in all manner of products and services. Accordingly, many tech companies wish to have access to Chinese consumers or to be suppliers to Chinese manufacturers. Companies wishing to be a suppliers to government tenders (ranging from pharma to environmental projects) or Chinese consumer facing businesses will often benefit from the resources of a local Chinese partner. 30 years ago JVs were often created based on the promise of market access – today it far more likely that such promises will be kept.

China's New Champions - the last 30 years of development has also led to many more Chinese companies having the scale and international experience to be suitable partners. The STAR exchange listed companies are examples of well run, well-funded companies looking to rapidly build their businesses. However, they are just the tip of a very large Chinese iceberg. There are many other private enterprises and state-owned enterprises that are well suited to be JV partners for international tech companies in China.

New Exit Options – In the past most international JVs partners did not really have much of a plan post signing ... much less an exit plan for the JV. The transformation of China into a generator of capital and innovation means that successful JVs may potentially IPO in China or be strategically acquired. In addition to capital markets China has a vibrant PE and VC sector. Indeed, generally valuations for high tech companies are much higher in China / HK than in Europe. These valuations are often on par or even higher than the USA.

Why the renewed Interest by Chinese Companies in Sino-foreign JVs?

Biggest Opportunities at Home – Many Chinese tech companies see the China domestic market as the most lucrative opportunity. Indeed, many overseas acquisitions have been centered on the strategy of taking a successful overseas company and “super-sizing” it in China. In addition, the Chinese partner is more confident that it can add value to the business in China and of its ability to be involved in the decision-making process.

Overseas Investment has a Hassle Factor – Many Chinese companies find overseas acquisitions challenging due to 1) unfamiliarity with the offshore jurisdiction's laws and practices; 2) many opportunities are auction processes and require expedited decision making; 3) approval requirements; and 4) foreign exchange controls. The post-acquisition process can also be challenging for Chinese investors – retaining talent can be challenging – although this is not an issue that is unique to Chinese investors it does add to the overall risk profile of doing an offshore acquisition – what is the value of a tech company if the talents leave? All in all, an overseas acquisition involves a lot of complexity and risk. However, many innovative Western companies are looking for relatively modest amounts of investment which may not justify the hassle factor. It may be that a Sino-foreign JV in China may provide a more certain path for all parties.

Issues to Think About – a Sino-foreign tech JV is not just a cut and paste exercise but requires careful consideration of issues such as 1) Structural – can the business initially be set up as a WFOE – any legal restrictions? 2) Investment – any minimum requirements? Any need for higher investment due to operational licenses. How to introduce the Chinese investors? 3) IP – are all trademarks; patents; software copyright registered in China? Can the IP evolve on a different path from the original jurisdiction? How to ensure the IP transfer can support an IPO? How to deal with improvements? and 4) Leasing/Location – Where to set up? Many local governments are eager to attract the IP heavy companies and can provide local subsidies and often even access to local PE firms and local strategics.

Summary

is it for me? However, the main issue for many will be – can I be a true partner? Any JV entails a certain loss of control. In the past many JVs in China were with a partner with some relevant experience or with a relevant supplier relationship to support the international company’s development within China. The brand, product and service were all invariably those of the Western partner. Initially, in the 1990s JVs in China were to take advantage of China’s low production costs. The next phase of Sino-foreign JVs targeted B2B sales – suppliers to the automotive sector; advanced materials; industrial parts etc.

China has been a major beneficiary of globalization. Many commentators noted that globalization led to a shrinking of the world. Not really. Globalization has also led to far more prosperous, bigger world with opportunity not limited to North America and Europe. However, Western tech companies may find that it is more lucrative to have a true partnership in a very large business in China than being the sole owner of a niche business. The valuable Chinese partners of today are unlikely to be satisfied in a supporting role. They also would like to have a meaningful share of a very large and successful business in China.

As international companies look to China as a market, competitor and increasingly even as a source of capital we expect to see many more JVs with China partners. The companies on the STAR exchange are good examples of potential tech partners for international companies to build a business in China and beyond.

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