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Consulting

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# Cultivating growth in China.

Lessons learned, success factors, and consulting solutions for  
multinational companies growing their business in China





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# A checklist: Top 10 practical success factors in China

- 1. Temper your **entry strategy** with realistic expectations on launching operations, localising products and services, and establishing company culture and employee base
  - 2. Refresh your **expansion strategy** to keep pace with the rapidly changing regulatory environment, business model options, and intellectual property risks within China
  - 3. Acknowledge and plan for the unique complexities of **M&A due diligence, negotiation, and integration** in China
  - 4. Regularly assess both **customer and product profitability** to identify opportunities to improve pricing and recover costs to serve as market conditions change
  - 5. Validate you have the right **compensation, benefits, and performance measures** to find and keep critical talent in China
  - 6. Heighten awareness of the **organisational transformation** required of your Chinese employees to sustain double-digit annual growth rates
  - 7. Recognise that **sourcing from China** is much more than just switching suppliers - evaluate supplier performance and supply chain footprint to optimise cost, quality, and timing
  - 8. Upgrade your China business units' **information systems** so they achieve global standards while meeting local requirements
  - 9. Improve **financial strategy, controls, and planning & budgeting processes** for running China businesses and integrating with global HQ
  - 10. Prepare to **compete with Chinese companies globally** for market share, talent, and capital
- + Bonus Tip: Maintain an **open mind**, a sense of **humor**, and a **long term perspective!**

See page 4 for some lessons learned about these tips by multinationals in China.

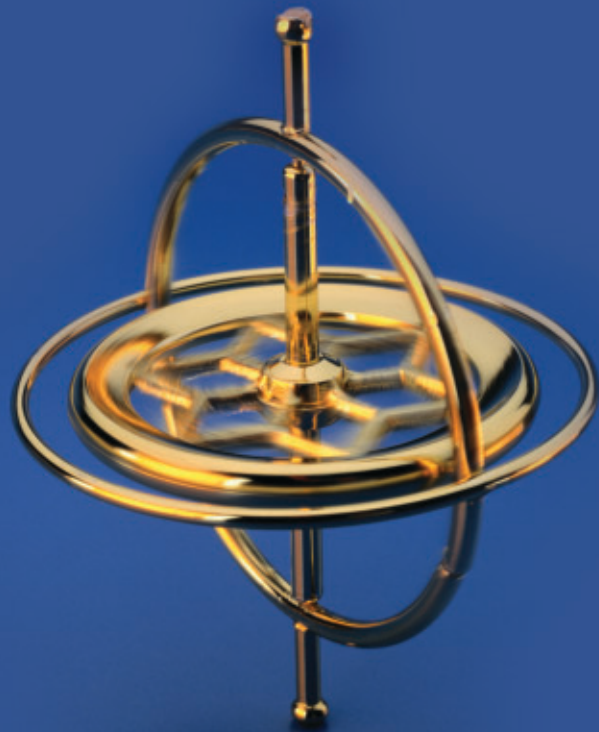
# Balancing opportunity with reality

Executives and Boards of multinational companies (MNCs) are generally aware that growing a business in China presents unique challenges that should be factored into investment and profitability objectives. However, in the rush to take advantage of the seemingly never-ending and gravity-defying statistics that abound about China's growth and scale, companies can make strategic and operational missteps that compromise their ability to meet these goals.

How do multinationals optimise the global value generated from their China business units? The tips in the preceding checklist summarise the most important practical success factors - and challenges - for multinationals entering or expanding their operations in China. The following pages' real-life lessons learned by global companies in China for selected tips may help avoid some common pitfalls.

Success in China requires pragmatic strategic ideas balanced with operational recommendations that are actually executable. Moreover, since solutions required depend on a company's experience and maturity in China, needs will change over time. For instance, a multinational may initially require assistance developing an entry strategy, conducting M&A due diligence and integration, and establishing a baseline HR infrastructure. Later, profitable expansion, organisational transformation, and technology implementation may become more important. Sound financial controls and processes, low cost country sourcing, and supplier performance assessments may be its priorities throughout the life cycle.

Deloitte's consulting practice is uniquely positioned to guide multinationals as they grow in China. We provide practical solutions that are tailored to our client's specific business objectives. The following case studies highlight a few examples of multinational companies in various stages of evolution we have recently assisted in China, their challenges, our collaborative approach, and the results.



# Some lessons learned in China

## About market entry (Tip 1):

- Relationships with key government officials can accelerate progress but will not solely ensure success
- Proper consideration must be made to a company's governance model that integrates China operations with global while still retaining in-country business unit autonomy
- Market information in China is fragmented and non-transparent, and many industries are not well-published
- Most of the information in China upon which business decisions can be made comes from primary research
- Market dynamics are changing rapidly in light of high growth and influx of both foreign and local private enterprises, so market research data should be regularly refreshed
- China is not one uniform market, it has significant uneven economic development and regional cultural differences
- Branding is distinctively different in China and major global players spend significant resources localising their market positioning
- The unique regulatory and infrastructure conditions of China often make outside products unfit without some modification
- Local brands may not have the global reach and reputation of foreign ones, but they do have local roots and loyalty
- Western management practice often fails in the context of Chinese business culture
- Good talent is difficult to find, and even more difficult to retain

## About merger integration (Tip 3):

- One of the most formidable and longest lasting obstacles to sustainable M&A success in China is human capital integration
- The increasing M&A activity in China leads to major people issues, including retention of key staff, development of new reporting organisation, non-alignment of compensation structures, cost and staff reduction, and culture differences and communication problems
- Accordingly, in an M&A transaction, key barriers and obstacles must be identified, change management plan designed, talent management programme implemented, and new organisation and compensation structures created
- Other key business functions with unique merger integration complexities in China are sales & marketing, supply chain, and finance & accounting

## About pricing and profitability (Tip 4):

- Prices often vary by region within China - not just coastal vs. inland, but also north vs. south
- Given the dynamic nature of most sectors in China, customers with long term pricing agreements can become unprofitable over time
- More time is required to collect, cleanse, normalise, and analyse price and cost data in China than in other markets (2x to 3x vs. US or Europe), but...
- ...A thorough and objective analytical approach is needed to counter the inevitable push-back from sales reps in China to raising their customers' prices
- Relationship in China is key, more so than in other markets. Actual price realisation will depend on the abilities of the sales force and their relationships with their customers
- Most customers in China are not accustomed to increasing prices, so a thorough understanding of segments, channels, and change management challenges is key
- A paradox exists: Chinese consumers are extremely brand conscious but may not pay a premium for additional value-added services or brand
- Acquisition of low-end products or brands may be needed as a defensive strategy

## About human capital (Tip 5):

- Most surveys in China rank employee retention as the number one HR problem
- A common misconception is that compensation is the root cause of these retention problems. Multinationals erroneously believe as long as they pay more than their competitors, they can retain Chinese staff. However, this is a major blind spot
- The three major cornerstones for retention are internal equity, career development, and training
  - Guanxi (or social capital through personal relationships) is widely regarded as an essential element for doing business in China; it also holds true for human capital. However, the guanxi should not affect internal equity, including compensation, appraisals, and promotions
  - For fresh graduates, young professionals and Chinese returnees, career development is another motivator to stay with the company
  - Training makes a difference. Chinese staff views training as a benefit as well as a sign that their company treats people as valuable capital rather than labour. Companies with comprehensive training programmes generally enjoy lower turnover rates in China

- Accordingly, many multinationals in China have begun to promote talent management programmes, which combine these three cornerstones into comprehensive and collaborative action plans, resulting in improved employee retention

#### **About sourcing (Tip 7):**

- Recognise that switching to Chinese sources will represent a significant change in the way your company does business. Costs will be lower, but supplier development/management and risk will be higher. Expect - and manage - healthy debates over risk-reward tradeoffs
- Carefully select suitable products - start with simple, labour-intensive products and, as internal expertise and supplier capability grow, migrate to more complex commodities
- Buyers need to be prepared for resistance to shifting supply to China from both internal and external stakeholders. Senior level support for such a low cost country sourcing (LCCS) strategy is critical
- Supplier capability - and therefore your risk - varies immensely in China, so conduct thorough financial, operational, quality and social responsibility due diligence including site-visit evaluations. Reliable data will be difficult to find, so creativity is required to validate and cross-reference it
- Whilst LCCS programmes deliver reductions in total landed cost, unless addressed, such programmes can also cause longer lead times, reduced delivery reliability and fewer product innovations
- Staff need to be located in China for supplier validation, integration, monitoring and - especially - development. You will not recognise the full potential of China sourcing if you don't invest in developing your key suppliers
- Relationships are vitally important to the Chinese, so build a high degree of trust, communication and integration with the supplier from the outset. The more strategic and complex the commodity, the greater the level of integration

#### **About system implementations (Tip 8):**

- Many MNCs deploy their own system roll-out teams to China without really considering:
  - Do we have the right cultural appreciation within the team?
  - Can we justify the cost, including the cost of not getting it right?
  - We are about to change the roles and responsibilities of a group of people. Do we understand the change management issues that we will be faced with?

- Allow adequate time for training, not just for initial implementation but also for ongoing training of user and/or outside system support, taking into account high turnover levels at MNCs in China
- Demand for skilled IT implementers in China is very high - voluntary turnover is greater than 20%
- When changing a financial system, even from a manual one, MNCs need to obtain Finance Bureau certification. The requirements vary from province to province and can be very bureaucratic
- If a China roll-out is contemplated, Chinese resources should be involved early to minimise surprises and provide a basis for commonality
- Infrastructure in China is changing rapidly and what held true last year may not be true today
- There is generally a lack of understanding or appreciation for the need of complex system security

#### **About process improvement (Tip 9):**

- While Chinese processes are generally simpler than US or European processes, they are usually not documented and communication gaps tend to be more severe between key functional areas
- Additionally, geographic gaps - between regions within China and among countries in AP - present another level of complexity
- Finally, business operations may vary from province to province - there is no "one-size-fits-all" concept in China
- As a result, these differences increase the likelihood that financial control weaknesses exist in China processes and their integration with global operations
- At a minimum, MNCs must understand the specific statutory and regulatory requirements and enhancements
- Before considering a shared services strategy, the corporate structure must be reexamined from a legal and tax perspective
- Justification for process and system improvements in China will be driven less from a "cost-saving" mentality and more from a "market-expansion" mentality

# Relevant case studies and success stories in China

## Case study 1 - Market expansion strategy

### Challenges

A US-based manufacturer of medical devices faced increasing competition from domestic manufacturers in China. Amidst an eroding market share, the client needed to refocus efforts and regain momentum. Since its China entry, the company had relied on a single distributor and hence did not have a direct presence in China. In addition, its broad AP regional sales organisation did not adequately focus on the tremendous growth potential and sales & marketing challenges unique to China.

### Results

Deloitte worked with the client to design a China market strategy, branding strategy, and sales organisation. For the market strategy, we studied the medical device market in China through primary and secondary research, assessed the client's market positioning, and developed a market forecast for its products. Next, we designed a branding strategy to launch a new brand of middle tier products to compete effectively with local manufacturers. Finally, we recommended a practical sales organisational structure to manage the AP region with objective of supporting China's aggressive revenue growth goals.

### Complexities managed

Conducting external interviews and focus groups with over 40 hospitals nationwide and reconciling results with desktop research; understanding the "real" hospital/physician buying processes and assessing the implications; introducing a new middle tier brand while protecting the premium margins and image of the existing high end brand; identifying M&A candidates for consideration.

### Teaming approach

Despite geographic separation of core client and consultant team members, communication remained open and collaborative throughout the project through regular global update meetings.

## Case study 2 - Pricing and profitability improvement

### Challenges

A US-based specialty chemicals company was pressured by investment community to improve local prices and variable margins in China.

### Results

Quantified and prioritised over 6% of addressable revenue (goal was 3%) or \$5M in short- and medium-term opportunities to increase price or reduce cost to serve.

### Complexities managed

Leading multiple simultaneous projects with China-specific and Asia Pacific-regional market requirements; accounting for several joint ventures and new acquisitions; addressing provincial pricing differences within China; and working around underdeveloped IT systems and transaction data.

### Teaming approach

Client and Deloitte worked side-by-side to conduct interviews, perform analysis, and transfer knowledge.

## Case study 3 - Low cost country sourcing

### Challenges

A global integrated oil company needed assistance in executing its low cost sourcing strategy in China.

### Results

The company leadership validated that the Yangtze Delta Region was its preferred location for a procurement office and evaluated potential suppliers to source materials. The client quickly gained an understanding of the Chinese market and built relations with a number of potential business partners.

### Complexities managed

Identifying and pre-qualifying suppliers (e.g., to secure just 8 site visits, over 150 local suppliers were contacted); educating client on basic realities of doing business in China such as logistics and transportation challenges, industry capacity, and cultural nuances.

### Teaming approach

Deloitte worked closely with the client team in the US HQ and AP region to conduct analysis, plan supplier visits, generate conclusions, and implement results.

## Case study 4 - Enterprise application implementation

### Challenges

A US-based and world leading manufacturer of household care products needed to standardise its business processes and technology.

### Results

The implementation integrated over 10 different ERP solutions into one single SAP platform across 28 subsidiaries, thereby streamlining operations, improving customer service, and leveraging scale with suppliers. Deloitte in China led the country roll-out as well as provided change management expertise throughout the entire project in all regions.

### Complexities managed

Accelerated time frame for China deployment; managing the variances between the global configuration template and local business processes; transferring requisite skills to client team members.

### Teaming approach

People from different regions were brought together for template and implementation design to reduce the potential issues in roll-out activities; change management and change readiness assessments were emphasised; communication among China team, Asia Pacific Centre of Excellence, and global Centre of Excellence was a major focus.

## Case study 5 - Human resource due diligence

### Challenges

An American electronic appliances company was preparing to engage in a joint venture with a Chinese enterprise but had not focused on HR due diligence.

### Results

Deloitte investigated the JV partner and uncovered some significant HR problems, including employee retirement issues, under-provision of social insurance, and non-compliance with local labour regulations. As a result, the US company was able to negotiate a more favorable deal and minimise the risk. Additionally, Deloitte prepared a report of the HR environment of the industry which offered insight on its specific HR challenges and opportunities in China.

### Complexities managed

Identified and analysed HR risks with information that would have been difficult for the US company to ascertain.

### Teaming approach

Before investigating the target, Deloitte collaborated with the US company to understand its business objectives in China generally and with the JV arrangement specifically.

## Case study 6 - Acquisition target/supplier due diligence

### Challenges

A European-based global chemical manufacturer was considering a strategic acquisition or long-term supply arrangement. They had identified 5 potential targets and wanted to quickly assess which had the greatest potential.

### Results

Based on rapid assessments in 4 key areas: Market Position; Operational Strength; Financial Standing and Readiness for M&A; the company was able to quickly identify its top target and two backups. For each of the candidates, the company gained a deep and specific understanding of background/current state/future plans and positives/concerns - greatly improving their ability to begin negotiations and focus directly on potential sources of value and risk. In addition, the company received an overview of the industry structure and evolution - and the implications for M&A opportunities.

### Complexities managed

Reconciling multiple, conflicting sources of data from the target companies, government bureaus and external data collection agencies; rapidly gaining agreement from the targets for onsite meetings with senior executives - getting to "yes" after hitting multiple barriers; conducting productive discussions with targets - many of whom were quite hesitant to talk; quickly "boiling down" large volumes of information to assess implications on target attractiveness/feasibility - "profound analysis" according to the client project leader.

### Teaming approach

Deloitte led the assessment and conducted a mid-point status check and final workshop to share findings.

## Case study 7 - M&A change management

### Challenges

A Korean tire-manufacturing joint venture in China was facing low staff morale due to cultural differences in management styles and inefficiencies in operations.

### Results

Deloitte diagnosed people issues via employee surveys, leadership interviews, and employee focus group meetings. Nine key areas were found as barriers to organisational changes, and five individual task forces were formed to design and implement the change management plan. These areas included performance measurement, leadership, talent management, culture and communication.

### Complexities managed

Identified and analysed various cultural differences; recognised the different language skills and cultural sensitivities needed to implement the change management plan; provided local HR functional knowledge that was valuable to a foreign company.

### Teaming approach

Staffed the team with the appropriate functional, language, and cultural skills to develop an implementable change management plan and complement the client team's capabilities.

## Case study 8 - M&A integration planning and programme management

### Challenges

A US-based and world leader in medical devices needed to prepare both internally and externally for a global merger. The two organisations involved have some overlap in products and sales channels but they have different financial practices, application systems, compensation structures, and culture.

### Results

Regional teams were formed to plan and execute tasks to manage internal organisational, process and systems changes for both companies following global strategies and guidelines. Based on the projected integration date, public events and external communication to related official departments and business partners were scheduled and organised. The go-forward China organisational structure for Sales, Marketing, Finance and Supply Chain were defined and approved. A new office location was identified and layout designed. Internal communication and materials to stakeholders in both companies were developed. Staff from both organisations were prepared for the new structure, sales and marketing approach, finance policy, systems and culture.

### Complexities managed

The merger required official approval from European and US authorities. The projected integration date has been delayed several times waiting for the required official announcement. The original planned date imposed a very tight schedule for both the global and China team. Although the delay allowed opportunity to further prepare for the approaching changes both internally and externally, it also imposed difficulties to confirm external events arrangements and began to cast uncertainty among staffs from both organisations.

### Teaming approach

Key representatives from both companies in China were brought together for the initial identification of tasks. Departments involved included Sales, Marketing, Supply Chain Customer Service, Finance, Legal, Medical Affairs, Public Relations, Information Management and Human Resources. A dedicated Programme Management Office in China monitored internal and external progress and issues resolution, and facilitated communication among local parties.

## Case study 9 - Programme management for complex initiatives

### Challenges

A global manufacturer was developing a major joint initiative with both a Chinese Mainland and an overseas partner. Teams had been assigned to address issues ranging from manufacturing to R&D and distribution. Each team was responsible for its own deliverables, but the timelines were very tight, resources were limited and the output of the teams had to be integrated and based on shared assumptions about business structure, regulatory issues, etc.

### Results

The team deliverables were on time, supported by representatives of each of the partners and tightly integrated allowing very effective review and decision making by the joint Steering Committee. Key issues were effectively raised and addressed; as a result, the partners adopted a fundamentally different business structure and approach than originally envisioned.

### Complexities managed

Integrating multiple streams of work across three business partners with different objectives; multiple future scenarios; limited availability of partner executives; complex legal and regulatory issues; controversial issues requiring extensive partner negotiation; shifting objectives and management agendas in each of the partners.

### Teaming approach

Client asked us to function as the "Programme Management Office" for the initiative. In this role we worked with each of the teams to define and develop key deliverables, and identify and raise key issues for executive resolution. In addition, we planned and managed Steering Committee sessions. Despite the fact that we were engaged by only one of the partners, we developed highly effective working relationships with the other partners, which allowed the PMO to be particularly effective.

## Case study 10 - Intellectual property protection

### Challenges

A specialised metals manufacturer wanted to set up a greenfield operation in China; however, the trade secrets and know-how associated with its production processes were highly valuable and at risk. This client wanted to design its HR practices to maximise intellectual property protection.

### Results

Though application of our IP protection framework, experience with human capital best practices in China, and interviews with leading MNCs, we recommended a series of leading practices for HR management designed to protect IP during the full employment life cycle – recruiting, hiring, compensation structure, development and separation. In addition, we developed strategies and tactics such as physical and system access controls, classification levels and ways to control paper and electronic documents.

### Complexities managed

Recognising that it is possible to protect some trade secrets some of the time, though improbable that all trade secrets can be protected all of the time; understanding that, as a result, MNCs operating in China should not depend only on the formal legal system for support; rather, they should implement internal control practices throughout the HR lifecycle to minimise IP leakage.

### Teaming approach

Deloitte leveraged our relationships with multinationals in China to complete this study in an accelerated timeframe in order to meet the client's aggressive deadline. A global client service team worked closely together to perform the engagement and prepare a Board presentation.

# Why do our clients choose Deloitte for Consulting services in China?

- 1. Specialised team:** Dedicated teams with proven expertise delivering specific solutions in China, including Strategy & Operations, Human Capital, Enterprise Application & Technical Advisory, and Financial Management Transformation Services.
- 2. Local expertise:** Balance of both local and foreign practitioners and leaders with experience serving not only multinational corporations but also Chinese companies and State Owned Enterprises.
- 3. Multidisciplinary approach:** Uniquely positioned to provide our clients with a full range of professional services, including tax, corporate finance, and enterprise risk advisory services.
- 4. Execution:** Bias towards action - work with our clients to first create practical strategies for China and then implement operational, technical, and human capital improvements.
- 5. Flexible approach:** Able to serve clients of all sizes, including the largest Fortune 500 companies as well as emerging middle market leaders.
- 6. Global network:** Key part of 135,000 person global firm operating in 150 countries with relationships around the world to leverage when serving our clients in China.

## Our mission, vision, and shared values

Our **mission** is to help our clients and our people excel

Our **vision** is to be the standard of excellence, delivery exceptional value to clients by being world-class innovators, market leader, and having world-class talent and culture

Our **shared values**:

- Demonstrate integrity
- Deliver outstanding value to our clients
- Show commitment to each other
- Gain strength from cultural diversity

# In our client's words

“Deloitte’s work is ‘outstanding, exemplary, and should be the benchmark’ for future pricing projects.”

- China Business Unit Director

“Deloitte’s China practice provided thoughtful insights to our executive team as we considered both the opportunities and challenges in expanding our business to China. We appreciate the value Deloitte provided and hope to collaborate again in the future.”

- Chief Operating Officer and Vice President

“Deloitte has greatly helped us on clarifying our complicated issues; they formulated a comprehensive roadmap for our corporate change and continuous improvement. They also tailored an excellent approach and provided us the right solutions based upon an in-depth assessment of our organisation. The team spirit, knowledge, expertise, and true professionalism they demonstrated, together with the seamless collaboration with our core team, have assured the value delivered to us and the realisation of our expected outcomes.”

- Division Head of Corporate Management Team

“I learned more about China in Deloitte’s three hour presentation than in three years of our own experience in China.”

- Senior Vice President, Sales

# Solutions for multinationals in China

**China Investment Services:** More and more medium-sized companies have solid plans to invest in the China market or increase their China sourcing more aggressively. Deloitte helps these companies as they enter in China by providing consulting solutions, as well as tax, enterprise risk, and financial advisory services during this critical period of global expansion.

Examples of consulting solutions provided include:

- **Market studies and entry strategies** - conducting market research and designing market entry strategies supplemented relevant operational knowledge on challenges such as tax constraints, location selection, and human capital availability
- **Supplier assessments** - designing evaluation tools; assessing suppliers' operational, financial, technical, and human resource capabilities; developing plans to address weaknesses
- **Merger integration** - evaluating M&A as part of overall China strategy; conducting HR, IT, and business due diligence; planning for Day One milestone and subsequent integration, including communication, HR, IT, sales & marketing, supply chain, and finance & accounting issues
- **Technology infrastructure planning and implementation** - designing and implementing technology architecture required to support China businesses and integrate with global operations; aligning technology strategy with overall corporate strategy
- **Enterprise, financial, and human resource system design and implementation** - implementing improved business processes and new technology for enterprise-wide applications (e.g., SAP, Oracle, PeopleSoft, JD Edwards) and financial reporting tools (e.g., Hyperion, Cognos); conforming with global templates while adapting local requirements; providing application maintenance outsourcing (AMO) activities
- **Shared services** - designing a shared services strategy to support China and regional operations; assessing appropriate location; implementing results
- **Human capital strategies and process designs** - developing HR strategies to recruit, retain, and develop critical talent in China; designing and implementing new HR processes and tools to support growth
- **Performance management** - developing and applying financial, operational, and HR performance management processes, metrics, and tools
- **Intellectual property protection** - designing and implementing business processes, human resource practices, IT and physical security procedures, corporate structure and governance models to protect IP

**Business Optimisation Services:** Major multinationals in China, established for more than ten years with many established joint ventures around the country, face fierce competition and need further re-structuring and re-engineering their organisation, processes, and technologies. Deloitte assists these companies align and expand their operations in China.

Samples of consulting solutions offered include:

- **Pricing and profitability improvement** - increasing profitability of products sold and customers served in China by evaluating pricing strategies, costs to serve, sales organisation, and distribution channels
- **Financial management control and process enhancement** - improving financial controls and business processes within China and across global operations
- **Activity-based costing analysis** - conducting cost analysis of key operational activities; reducing or recovering these costs
- **Supply chain management** - improving supply chain and distribution/logistics operations in China and the AP region
- **Low cost country sourcing** - identifying, qualifying, and selecting low cost suppliers in China; developing and implementing transition plan from existing suppliers; measuring ongoing supplier performance
- **Enterprise application deployment** - implementing technology solutions in China as a part of global ERP rollout; modifying worldwide implementation guidelines based on regional nuances and regulations
- **Change management** - developing and implementing change management and communication plans needed during enterprise transformations such as acquisition or JV, new IT systems, or major business process improvement initiative
- **Global and local programme management** - leading local complex project management teams and coordinating with global programme offices; working with external parties such as suppliers, service providers, JV partners, or government authorities
- **Enterprise governance** - designing and implementing appropriate operational and financial controls and organisational structure for China businesses; aligning measures with global requirements

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We have considerable experience in China and have been a significant contributor to the development of China's accounting standards, taxation system and local professional accountants. We also provide services to around one-third of all companies listed on the Stock Exchange of Hong Kong.

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