China opens the outbound travel business sector to foreign investment

Description

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On May 23, 2011, China National Tourism Administration (the â€œ**CNTA**â€•) posted on its website an announcement (the â€œA**nnouncement**â€•) about the three most fortunate foreign invested travel agencies that have recently been selected to be allowed to conduct outbound travel business from within China, a token that China is shyly opening its outbound travel business sector to foreign investment.

Outbound travel is seen as one of the most profitable businesses in Chinaâ€™s tourism industry with more and more affluent Chinese people attracted by foreign exoticism. However this outbound travel sector is insulated from foreign investment until August of last year that CNTA and China Ministry of Commerce jointly issued the Interim Measures on Supervision over Pilot Projects for Sino-foreign Equity Joint Venture Travel Agencies Conducting Outbound Travel Business (the â€œ**Interim Measures**â€•) pursuant to which the above mentioned selection of three travel agencies in the Announcement were made.

1. Who are these three lucky dogs?

It will be advisable to look into why these three foreign invested travel agencies are so lucky, and probably, through this analysis, we will draw some hints on CNTAâ€™s policies regarding selection of foreign invested travel agencies under the Interim Measures. According to the Announcement, these three agencies are: TUI China Travel Co. Ltd., CITS AMEX, and JTB China.

Based on public information available at this moment, let us look at the basics of these three travel agencies in terms of their shareholders, equity structure, registered capital.

Name	Regis capital	JV Parties	Equity Ratio	Location	Formation Yea
TUI China	USD 6.1 million	TUI AGCTS	75%25%	Beijing	11/24/2003
CITS AMEX	RMB 20.7 million	American ExpressCITS	49%51%	Beijing	1/11/2002
JTB China	RMB 5 million	JTB (Japan)CITIC	49%51%	Beijing	4/27/2000

From the table above, for a foreign invested travel agency to be designated under the Interim Measures, we may reach the following inferences:

(1) The registered capital shall not be too small. Among the three, the least amount of registered capital is RMB 5,000,000. As a general principle, China wants to see big foreign investment.

(2) The joint venture parties to the three agencies are respectively big names either in the international

arena or in the domestic market. It is worthy of a note that the Chinese parties to these joint venture agencies are all domestic travel agencies themselves. In other words, it seems that a foreign travel agency hoping to tap China outbound travel market in the future will have to partner with a Chinese travel agency. While this practice offers obvious advantages to foreign investors, it also carries with it a big risk that the Chinese party will sneak or compete for the business opportunities from the joint venture agency. As to how to protect foreign investors in a joint venture with Chinese partner, please refer to: http://www.sinobizlaw.com/Zh/DianZiTongXun_1088.aspx.

(3) From the â€œequity ratioâ€• column, foreign investors shall feel a bit relieved that at least we can infer that when selecting foreign invested travel agencies, CNTA will also consider those in which foreign investors hold a majority stake, as with the case of TUI China in the table.

(4) It is kind of strange to see that all these three agencies come from Beijing. Shanghai, as another hot destination for both inbound and outbound travels, is not a good apple in the eyes of CNTA? Probably, the next round of selection may favor Shanghai. Otherwise, it would be a blow to Shanghaiâ€™s ambition to build itself into a global tourism center.

2. Problems lurking ahead of the three agencies

From the table above, all these three foreign invested travel agencies were incorporated quite early, at a time when China maintained a strict control over tourism industry prohibiting foreign investment in outbound travel business. It will be reasonable to assume that upon entering into the partnership with Chinese partners, those foreign investors do not have any consideration and arrangement with their Chinese counterparts in relation to operation of outbound travel business. In respect of inbound travel, the joint venture agencies serve the goals of both foreign and domestic parties very well as they complement one another with foreign party bringing in foreign tourists and Chinese party helping to foreign travelers to tour China.

However, in respect of outbound travel business, while there is still mutual complementation to some extent, there will be also competition between the Chinese parties and the joint venture agencies because those Chinese parties to the three joint venture agencies have already had their own outbound travel business permits. Therefore, it is easily foreseeable that those Chinese parties will pose risk of conflict of interests between the Chinese partners and the joint venture travel agencies. Such competition may well destroy the goodwill fostered before. History has taught foreign investors good lessons of avoiding such conflicts of interests, as in the case of dispute between Wahaha and Danone which ended with Donone bruised and heart-broken.

So it is a time for these three foreign invested travel agencies to feel good after the Announcement, but it is not a time for celebration yet.

3. Suggestions for upcoming foreign investors

Foreign investors that covet Chinese outbound travel market shall not come in with any rush but with a well crafted strategy.

In accordance with the Interim Measures, foreign investors intending to benefit from Chinese outbound travel market shall only begin with an equity joint venture agency that is engaged in inbound and domestic travel first, and the joint venture agency shall only be entitled to apply to CNTA for outbound travel business permit after it has duly conducted its operation without being punished by government departments for infringing upon consumersâ€™ rights and interests.

That said, and in light of the analysis under section 1, the following suggestions shall be taken into account when foreign investors plan investment in China tourism industry:

(1) Whether you want to take a share of Chinaâ€™s huge outbound travel market. This will largely determine your overall access plan. If the answer is no, which means you want to do inbound and domestic travel only, you may set up a wholly foreign owned travel agency with a substantially smaller investment budget.

(2) If you do want a share of Chinaâ€™s outbound travel market, you will have to find a Chinese partner to jointly set up an equity joint venture travel agency in order to qualify for being selected under the Interim Measures which provides that only Sino-foreign equity joint venture travel agency shall be eligible under it. In such a case, you have a lot more to consider before signing any substantive agreement, in particular, you need to make sure in case that your joint venture travel agency is luckily granted the outbound travel business permit, your Chinese partner will not be engaged directly or indirectly in any other outbound travel business that will compete with the joint venture agency.

You also shall be very careful and diligent in choosing your Chinese partner for this joint venture. This partner should have a relatively strong market image with good relations with governments.

Youâ€™d better inject a nice amount of capital into the joint venture, indicating your firm commitment to the investment. Personally, I believe the amount of registered capital will be an important criterion CNTA will look at when making selection pursuant to the Interim Measures.

(3) As mentioned above, CNTA has shown clear favor for Beijing over Shanghai in granting the outbound travel business permit to foreign invested travel agencies. We have noticed that CNTA has approved more foreign invested travel agencies formed in Beijing than in Shanghai since China lowering its threshold for foreign investment in 2009. However, we believe that given Shanghaiâ€™s position in the national tourism industry, CNTA will not let Shanghai down in the next round of selection. In other words, foreign investors may look into the opportunities in Shanghai and other localities in China.

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