CNN Money
http://money.cnn.com/2016/08/02/news/foreign-firms-doing-business-china/

Struggling in China, foreign firms seek to become more Chinese

by Sophia Yan @sophia_yan August 2, 2016: 10:44 PM ET

It's no secret: Doing business in China can be tough.

Big foreign brands like Apple (AAPL, Tech30) have fought to get a strong foothold in the country, despite significant regulatory and cultural barriers. With 1.4 billion consumers, China is a market so huge and potentially lucrative that many companies simply can't afford to ignore it.

But as some global firms find themselves on the back foot in China, they are now choosing to dial down their involvement.

"Companies are caught up in a 'Catch-22' ... China is the second-largest economy in the world -- it doesn't seem like a smart business plan to lock yourself out of that," said Drew Bernstein, a partner at Marcum, a New York-based accounting firm that works with Chinese companies. But "it can be tough to play by Chinese rules."

"What you're seeing now is how companies are achieving 'Sino-fication' through different means," Bernstein said, describing how multinationals must adapt to China.

Essentially, many foreign firms are finding they have to become more Chinese in order to survive.

The latest example came on Monday, when ride-hailing colossus Uber announced it would sell its China business to homegrown competitor Didi Chuxing, ending a bitter and costly battle for market share.

There are other recent cases. In June, Walmart (WMT) handed off its online shopping website to Chinese e-commerce giant JD.com (JD) in exchange for a stake in the company, although the U.S. retailer continues to operate its own brick-and-mortar stores in China.

By the end of October, Yum! Brands (YUM), which owns and runs fast food chains KFC and Pizza Hut, is expected to complete the spinoff of its China arm as a separate, publicly traded company that will pay back licensing fees to the parent firm. Yum China will operate under a franchise agreement and be run by a predominantly Chinese leadership team.

And McDonald's (MCD) has said it's looking for local strategic partners for its businesses in China and other Asian markets. The China operations of Yum and McDonald's both suffered in recent years after food safety scandals.

The Chinese government has long required foreign firms to have a local partner in industries it deems sensitive to the country's security, such as the media sector, where news and information remain tightly censored.

But what's increasingly happening now is that multinationals are opting to find a Chinese firm to work with.

As China's economic growth has cooled off in recent quarters, overseas firms have complained of a worsening climate.

U.S. companies cited "increased Chinese protectionism" as a growing challenge, according to a survey published earlier this year by the American Chamber of Commerce in China.

More than 75% of the survey's respondents also said foreign businesses are less welcome than before in China.

That's not a surprise -- the Chinese government wants domestic players to become internationally recognized brands as well. Critics say local firms are favored over foreign rivals.

For example, with tech companies like Facebook (FB, Tech30) and Twitter (TWTR, Tech30) shut out of the market, Chinese internet companies like Tencent (TCEHY) have thrived.

Sweeping antitrust investigations and a broader anticorruption probe in China have also added to the challenge, affecting companies including Microsoft (MSFT, Tech30), Qualcomm (QCOM, Tech30) and GlaxoSmithKline (GLAXF) in recent years.

In some cases, working with a local partner can help a foreign brand better handle government relations and domestic competitors. But at times, companies struggle to protect their intellectual property. Foreign firms producing everything from luxury goods to tech gadgets have long faced an ongoing battle against counterfeits in China.

It may be a hard lesson, but companies are "learning how to play the game in China," Bernstein said. China's economy is "not run by supply and demand; [it's] run by the government, and that's not a risk that Western investors fully understand."

CNNMoney (Hong Kong) First published August 2, 2016: 3:13 AM ET