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GLOBAL CONNECTION

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Never Too Late: Leveraging the Chinese Economic Opportunity

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With more than 1.4 billion consumers, China is an integral participant in the global marketplace and has made great strides in modernizing its economy and taking a strong position in the international economic and political community. However, China has been known for manufacturing the technology developed in other countries, it is quickly developing the resources—human and capital—to take the lead in future technological advances.

United States companies may want to consider what impact the Chinese economic influence will have on future market demands and supply chain management. At some point, a United States business will likely interact with a Chinese-dominated company; and those businesses that develop a strategic approach are likely to be better positioned to take advantage of such opportunities.

Many United States companies fail to appreciate that they are unable to immediately leverage a Chinese connection. Whether the opportunity is to (1) enter the Chinese market, (2) utilize a traditional business arrangement where a Chinese partner provides components as a part of an international supply chain or (3) partner with a Chinese company that seeks direct opportunities in the United States, the first step is intelligence gathering, otherwise known as performing “due diligence.”

Intelligence gathering does not begin with a review of the external Chinese opportunities. Rather, the first step is an honest internal review of the United States company. This might include a complete review of the types of services or goods at issue. It is obviously important to have an understanding of the industry's technical identification of a company’s goods or services. But, when dealing with the Chinese, it is just as important to understand the company’s goods and services from a *governmental* perspective—both the United States’ and China’s governments. Such an understanding can assist with costs, pricing, timing of agreements and whether or not the envisioned transaction can legally take place.

It may also be wise to engage a Chinese entry partner regardless of what types of opportunities are being sought. As in much of the world, the Chinese market is primarily based on relationships. This may include relationships with other businesses or, more importantly, the Chinese government. Such relationships open up a host of other considerations, including, among others, compliance with the Foreign Corrupt Practices Act (FCPA), employee or agency considerations, non-disclosure agreements and non-competition agreements. In addition to these legal considerations, the cultural issues should be clearly understood. For example, until a contract is actually signed, there is no real agreement in place. So, although a United States company believes that a relationship is established, it actually may not be.

If the United States company intends to enter the lucrative Chinese market, the company should consider the differences in setting up operations in the United States or another foreign country. For example, setting up a Delaware limited liability company is quite easy. But, due to China’s Company Law and the special laws and regulations concerning foreign investment enterprises, setting up a similar entity in China is often time consuming and frustrating. Therefore, the United States company may want to consider whether it would like to enter via (1) direct sales, (2) commercial agency agreement, (3) distribution agreement, (4) joint venture, (5) a Wholly Foreign Owned Entity (WFOE), (6) a branch office or (7) a franchise arrangement.

Each entry option carries its own legal risks and benefits and should be fully understood so that the entry is successful. Further, the legal structure of the deal should be carefully negotiated. As with any international agreement, the party with the leverage will likely set the tone of the negotiation. But, the United States company might consider walking away from a deal and seek other opportunities if the deal is either being rushed or too much is being demanded. For example, a United States company cannot agree to any term that would violate United States law.

Considerations related to export and import controls, intellectual property, technical and quality issues, non-competition, INCOTERMS 2010, currency and pricing should be clearly agreed upon, without any ambiguity. Further, issues concerning payment, tax considerations and the ability to repatriate profits are better addressed *before* an agreement is signed. These major issues can result in determining whether the opportunity will be profitable or a failure.

Finally, a major issue that many companies—regardless of nationality—refuse to address during the negotiation stage of a transaction is dispute resolution. Simply, a United States company should consider an exit strategy in place that will allow it to efficiently and legally extricate itself from a losing business venture. The exit strategy would take into consideration the legal issues—from both a Chinese and United States perspective—for winding down a business venture or even dealing with every day disputes that *will* arise in any business relationship.

The United States company that fails to appreciate the Chinese impact on its business is likely to be at a competitive disadvantage. The Chinese influence provides a multitude of business opportunities, but also risks and obstacles. A United States company may want to *proactively* investigate and engage such opportunities, while complying with applicable laws.

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