Bird & Bird

Doing business in China

John Koh, partner, China

With clients who are coming in from either America or in Europe they have a way they do things, they have a particular way of looking at a problem. One of the things when they're coming in to China is to realise that, actually, China's a completely different animal.

I mean one example is whatever is not permitted by law is prohibited, and that's a very significant difference to, say, a European or an American way of doing things, where everything that is not prohibited by law is permitted. So one example of that is if you set up a company, whatever the company is permitted to do is set out completely in its business scope. So if you don't set it out in your business scope you're not permitted to do it.

The other thing that I talk to clients about is basically understanding the business that they're going in to in China. Legal and financial due diligence is really, really important. We often go with clients to the first meeting and they see a production line, they see all these workers, everything's coming off the production line great, you know, we're really keen to sign, and then when we actually do the due diligence what we find is that the factory isn't owned by the company that they're buying, the workers haven't been paid for four months, the products that are coming off the production line contain counterfeit parts. So there's a whole range of things. And down to even, you know, the owner has three sets of books: one for the taxman and one for his partners and one for himself. Right.

So getting to that level of granularity with clients is really, really important. I think the approach, especially with American clients is that they want to see, you know, a good level of documentation. And my view on these things is that the documentation is probably not worth the paper it's printed on the day after you sign it. So we're talking about much more fundamental practical controls over what you're buying, understanding what you're buying, and then controlling if after you've bought it. That will be of greater value than worrying about what's in the documentation necessarily. So helping clients understand that difference is critical.

The first thing is to realise thing are different. The assumption that what works in America or in Europe will necessarily work in China won't get you very far.

The second thing I would say is, you know, there are rules. In certain of these places the assumption is almost that the rules are there to be bent, but as a foreign investor coming in to China I would say the rules apply to you especially, so don't assume you can cut corners and bend the rules.

The third one is do the due diligence, don't try and save money on the due diligence because it's doesn't save you money in the long run. So really understanding what you're buying and what the risks are.

The fourth thing I would say is come in early. A lot of the time we tend to get approached when, say, the deal has been structured and we're asked to document it, which is the way, you know, you would do it in America or in Europe. But our advice is probably more critical to structuring of the transaction. You know, I had a transaction where a CEO of a European company had negotiated this deal to buy a Chinese company, he'd spent many years in private equity in the States and in Europe, so he structured it like a private equity investment, and when we came to look at it we realised, actually, the deal couldn't work the way it was structured and we had to literally rework it such that the people that he was buying the company from got the same economic benefit, but in a different way to what he'd originally planned. So if he had come to us in an early stage we could have saved him a lot of grief. Getting us involved early is critical. And also having us involved in the wider picture is critical.

If you are a traditional manufacturing business you'll be looking to set up in the South of China. If you were a business maybe in the retail sector you'd be looking to set up in Shanghai. Shanghai is very much the business centre of China. It's probably one of the easiest places to set up a business now. And I would say probably about 70 to 80% of my clients would choose Shanghai as a primary destination. You know, a few years ago I would have had more clients going to South China, primarily to set up factories. I would say I'm seeing less and less of that. South China is a very convenient place to do business.

The thing that I would say is, you know, compared to 10 years ago China has just become a much easier place to set up, you know, and to enter. That's not to say it's without its risks, but I would say the further and further away you go from the centres, the major centres, like South China or Shanghai, things are going to get more interesting. And consultation with local authorities is probably going to be one of the most critical bits.

One of the things I do enjoy very much about the practice at Bird & Bird is we get to know our client's businesses very, very intimately. We do work in all sorts of sectors, from, you know, retail, distribution, luxury goods, branded goods. We have a wide experience of helping companies do business in China, and one of the things that I would say, Bird & Bird's footprint in China allows us to support clients in all the major areas in China. Also our breadth of experience allows us to approach where pressure points for clients are, and allow us to support clients with specific advice, which is maybe required in particular industries.

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This document is a transcript of an edited video recorded in October 2013.