"Not All Is As It Seems" —Know Your Business Partners in Asia

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The continent of Asia represents some of the most attractive business and investment opportunities for U.S. and European companies in today’s international economy. This is especially true for the country of China. With a population of more than 1.3 billion—a population eager for the advancement, innovations, and wealth evident among counterparts in Western countries—China is ready to claim a permanent spot among worldwide economic superpowers. International investors and businesses are only too eager to lend a hand, from merging with expanding Chinese companies to providing financing for promising start-ups to supporting private companies seeking a place among public conglomerates.

While such opportunities are indeed attractive, investors and businesses would be wise to take the time to educate themselves on the background and reputation of potential business partners and to learn about the inner workings of the Chinese culture. By taking the time to seek answers and to understand, one will be that much closer to becoming successful with whatever the business endeavor may be in Asia.

Since Richard Nixon’s historic visit to the People’s Republic of China in 1972, an amazing amount of change and progress has taken place with the Chinese economy. In 1978, the year in which the country instituted reforms and opened up its economy, China’s gross domestic product (GDP) was 364 billion yuan. By 2007, that figure had increased to 13.7 trillion yuan. GDP per individual rose during that same period from 379 yuan to 10,502 yuan.

China has also managed to sustain an admirable growth rate, especially compared to the rest of the world. In May 2008, the International Monetary Fund (IMF) adjusted its forecasts for the global economic growth in 2008 downward to below 4 percent; however, it predicted a growth of just above 9 percent for the Chinese economy.

Yet, with such promise and potential comes the need for caution. China and other Asian entities may, at times, seem to be countries with rules unto themselves, and foreign investors—especially those from the West—would do well to educate themselves regarding certain aspects of these countries in order to increase their business acumen for conducting business in Asia.

For the Chinese people, the maintaining of “guanxi” has always been of great significance. Guanxi may be explained as a relationship or connection. If one has good guanxi with the right people, opportunities will be available to him/her. As such, in order to initiate or maintain guanxi, it has always been within Chinese tradition to present gifts to those who may assist with furthering one’s endeavor. Gifts may be items / tokens of appreciation, but are most likely cash. In the Chinese culture, cash gifts are considered the norm. However, in today’s international business economy, not to mention the reach of the U.S. Foreign Corrupt Practices Act (FCPA), such gifts may be frowned upon and considered unacceptable.

As such, it would be beneficial to a foreign business party to determine whether a potential Chinese partner may have overstepped the boundaries of guanxi. To offer payments to government officials, for instance, may still be considered business-as-usual in certain parts of Asia. However, for a U.S. company, this constitutes a violation of the FCPA and could possibly result in criminal sanctions, as well as hefty penalties levied by the U.S. government. In December 2007, Lucent Technologies was ordered to pay US$2.5 million in fines for having spent millions of dollars on trips for Chinese government officials. That same month, the U.S. Securities and Exchange Commission charged the former Chairman and CEO of Schnitzer Steel Industries, Inc., with violating anti-bribery provisions of the FCPA by approving cash payments and other gifts to officials at Chinese government-owned steel mills to entice their business. Robert W. Philip of Portland, Oregon, agreed to pay more than US$250,000 to settle the charges against him.

Corruption / bribery is certainly not unique to China. This is also readily apparent in countries such as Cambodia, where some estimates suggest that more than 10 percent of the country's annual GDP is lost to corruption. Bribes are reportedly frequent and normal to ensure efficiency of service, and many companies write them off as simply a cost of doing business. (Interestingly, the size of the bribe does not reportedly correspond to the speed of the administrative procedure.)

According to the Business Anti-Corruption Portal (www.business-anti-corruption.com), studies in Vietnam have also shown that in this country, 67 percent of businesses pay bribes as a way of getting things done. Meanwhile, in Thailand, up to 79 percent of businesses have had to bribe officials and administrators to obtain desired contracts of services. In fact, these bribery costs have been estimated to add up to 20 percent of the overall costs of a contract.

While the stark reality of corruption and bribery in Asia should not be considered major deterrents to engaging in economic activity there, the risks should be apparent to the savvy investor. Proper due diligence should be conducted to determine whether there may be FCPA violation concerns regarding a company and/or its principals, to include whether a subject has extensive political connections.

Another concern with doing business in Asia is that these countries' regulatory structures have not yet caught up with those of western standards. The September 9, 2008, edition of the Wall Street Journal noted that the European Union Chamber of Commerce in China, which represents about 1,300 member companies operating in that country, recently expressed concerns that "the (Chinese) regulatory climate has failed to keep pace with China's growth … In general, we have the feeling that the reform process has slowed down." The group noted that such issues may block future foreign investments and acquisitions.

As such, it would be prudent to seek as much information as possible with accessible regulatory agencies. In China, for instance, Altegrity Risk International has access to more than 60 government regulatory databases. Most of these databases provide information only in Chinese, and even if English information is available, it may be limited. Searching for information on the subjects of interest within these databases may help provide additional insight into their background and reputation.

One of the most intriguing concerns of doing business in Asia—especially countries such as Japan—is the widespread presence of organized crime groups. Such groups conjure up images of seedy, dark-lit bars where organized crime bosses wield their power. However, this is not usually the case in Asian countries. Organized crime groups may not operate in the open, but their presence is felt. A business may be connected to an organized crime group simply because the owner has been forced to pay protection money to the local group; if he does not pay, then his business will suffer, possibly via vandalism or lack of protection against smaller organized crime factions. Thus, this business is technically connected with organized crime, but it is not directly involved in its activities.

Organized crime groups are also intricately involved in certain industries throughout Asia. Some of them are more obvious—for instance, pachinko parlors in Japan would most likely have some sort of organized crime backing, however discreet. The same may be said of the gaming industry in Macau. There are others that may not be so obvious. For instance, organized crime groups are starting to infiltrate the Southeast Asian shipping industry, as they rely on this means of transport to move luxury vehicles stolen from Western countries to sell in places throughout Asia and Africa.

In Japan, "sokaiya" are "corporate extortionists" who are often linked with organized crime groups who threaten to disrupt a corporation's operations unless he is offered payment. Sokaiya may infiltrate any entity, regardless of industry, and may even be present at shareholders' meetings. Should a company extend payments to a sokaiya, it may be held liable for such actions. In the late 1990s, 31 executives with some of Japan's leading financial institutions, including the top five companies, were indicted for paying off just one sokaiya. One of the toughest penalties was handed down to the former chairman of Dai-Ichi Kangyo Bank, who received a suspended prison sentence of nine months. It would be wise for any foreign investor to investigate whether a potential Japanese business partner may be offering payments to sokaiya. Whether it is doing so willingly or unwillingly makes no difference in the eyes of the law.

The 21st century promises to be an exciting and promising time to do business in Asia and with Asian entities. In addition to the above, to understand some of the basic mannerisms of the Asian people—for instance, use both hands when presenting / accepting business cards or other items and do not give clocks as gifts to the Chinese (the character for clock is pronounced the same as one of the characters for "death") —goes a long way in paving the path for successful business ventures. However, in order to provide additional assurance for guaranteed success, proper due diligence should be conducted into the background and practices of a potential business partner. If one does not seek the answer, how will one be certain that he/she has all the information needed to make the correct decision? As the Chinese proverb notes: "Deep doubts, deep wisdom; small doubts, little wisdom."

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