

Chinese Outbound Investment: Navigating the Regulatory Framework and Preventing Risks

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China's economy has definitely matured and the past few years have seen a growing trend of Chinese companies joining the international stage as foreign investors.

In the midst of the current economic downturn many opportunities have emerged for investors, with a sharp drop in the price of overseas assets. For Chinese companies, it is a "going out" time. However, along with this enthusiasm, another key element for the success of an outbound investment is a reasonable dose of prudence and awareness to ensure that no major obstacles arise either at home or in your destination country.

Know Your Rules at Home

Under the current Chinese legal framework, Chinese companies which contemplate an outbound investment must secure a set of regulatory approvals beforehand. This is done by submitting their project to the following administrations: the National Development and Reform Commission ("NDRC"), the Ministry of Commerce ("MOFCOM"), the State Administration of Foreign Exchange ("SAFE"), and, if the would-be investor is a State-owned enterprise, the State-Owned Assets Supervision and Administration Commission ("SASAC"). These precautionary procedures whereby the government will study the merits of an investment project abroad, though burdensome and time-consuming, are designed to protect Chinese businesses from venturing unconsciously into the risks of investing overseas.

Recently, the Chinese government has implemented a series of measures to encourage domestic enterprises to dive into international waters. These are:

- The Measures on Overseas Investment Management by the MOFCOM (16 March 2009) which is designed to provide support to the investing candidates, by delegating the approval authority to its provincial branches and streamlining the approval process.

- The SAFE Regulations on Foreign Exchanges Administration in Relation to Direct Overseas Investment by Domestic Entities (Hui Fa [2009] No. 30) which further simplify the procedures (i.e. the review of sources of investment funding and remittance of the funds now only requires a filing submission, as opposed to a prior approval), expand the opportunities to use foreign currency funding for investment overseas, and implement financial support for overseas direct investments.

- A set of Measures on Foreign Economic and Technical Cooperation Funds (Cai Qi [2005] No. 255 and Cai Qi [2009] No. 95) which were jointly issued by the MOFCOM and the Ministry of Finance ("MOF"). They provide financial support to domestic enterprises investing abroad, including partial reimbursement of legal counsel, financial advisor, technical investigation and feasibility study fees, insurance fees for mining resources shipped back to China and patent registration fees, as well as subsidise loans obtained from domestic banks in order to finance the operation of projects abroad.

- NDRC and the Export-Import Bank of China jointly set up credit support mechanisms granting preferential loans to encourage five types of overseas investments. While the NDRC has the authority to approve a project,

the Export-Import Bank of China has the final decision regarding the granting of any loans.

Meanwhile, local governments have also enacted similar measures with a view to encouraging domestic enterprises to "go global".

Know the Rules Abroad

For Chinese companies which are profitable and expanding, investing abroad is an exciting prospect. But, as always when swimming in new waters, caution should be exercised as language barriers, cultural differences and an unfamiliar legal environment may turn your venture abroad into a nightmare. There are ways around the obstacles, though, and a reasonable amount of preparation and sensible judgement will better ensure success. Set out below are a few recommendations to avoid the most typical mistakes, gathered during the course of our time as legal advisors for Chinese enterprises on overseas M&A projects:

Prepare for your arrival

Once the investment scheme is carried out, your resources will be focused on reacting to the myriad of urgent problems of daily management, with very little time for analysis and planning. So, use the time before investing to study the business and legal environment in which you are about to land. Find out about the tax, corporate governance, contractual, labour, environmental and IP applicable rules and the local constraints on foreign investment and exchange. Also, consider your exit options: in certain countries, winding-up

an unsuccessful company can be a long and cumbersome process.

For an outbound acquisition, study the target carefully by conducting a thorough due-diligence. As this step is common practice in many western countries, both the seller and the management of the target will normally accept to share information about the company with you, so you should take advantage. This cautious approach will help you to become acquainted with the legal standing, compliance, material defects of the target and strengthen your bargaining power during the negotiations while at the same time allowing you to make well informed decisions once you are in charge of the local company.

Do not neglect the transaction scheme

Many Chinese enterprises with only a recent experience in cross-border investments tend to overlook the transaction or investment framework while they investigate the target company and market.

However, proper structuring - or, in some cases, restructuring - at the time of the investment can be instrumental in laying the foundations for good business operations and tax planning. Similarly, achieving the optimum financing scheme will require that you explore all tax, foreign exchange and operational aspects beforehand. Examine all investment options with your professional advisors, and compare the various schemes for shaping the transaction with a view to maximizing your profits and minimising the legal and financial risks.

Secure proper legal advice

The local laws will determine your rights and influence your daily decisions for many years to come, so you should know them in order to avoid unpleasant surprises. Reliable, comprehensive, tailor-made legal advice that really fits your needs and situation can only be provided by a professional counsel, so it is advisable to hire a lawyer early in the process.

As we found out, Chinese in-house teams are sometimes reluctant to work hand-in-hand with their outside consultants, a combination of cost-saving considerations and distrust resulting in last-minute instructions for a limited scope of assignment. This will almost always result in inconsistencies in the contractual documentation, as the master and the ancillary agreements are

prepared separately, which in turn makes their enforcement more difficult. Also, we would warn against a do-it-yourself approach that substitutes the application of self-taught legal practice for a professional adviser. Relying solely on information gathered on the internet or at some local administration is risky as the information supplied may be incomplete or outdated. Even the best formulated and codified laws come with a practical interpretation which is uneasy to find for non-professionals.

Your lawyer is there to help, and can only do so efficiently if he knows what you want and where you are going. Explain your expectations and provide a comprehensive picture, both in terms of the transaction itself and of the future business model. Keep your lawyer involved so that he knows how the situation unfolds and can track the issues. This will help keep the costs low by identifying and avoiding problems early, create a cooperative climate for negotiations and ensure quality and consistency in the legal documentation.

Prevention works better than remedy

Even successful investments face problems. In our experience, it is a common mistake for young Chinese international investors to wait until a problem has materialised to take action. They often incur significant costs in order to remedy a situation in which anticipation would have saved much time and energy.

Anticipation involves proactive, timely communication with the local teams, and discussing the options with the professional advisors at early stages of the investment to identify potential risks.

When in Rome, do as the Romans do

Adapt to the business ways of your host country. It is important that your local partners know what to expect from you. This will prove valuable in the long-term, both in managing the enterprise and in dealing with overseas competitors. However, always remember that an easy-going approach towards corporate and business rules, especially in the case of individual enterprises, will prove a recipe for fiasco if exported. Make sure that while you adapt to local expectations, your standards of adhering to the applicable legal rules both at home and abroad remain high.

Think long-term, and communicate accordingly

Model your investment structure and attitude according to your plans in the long-term. Your first approach of the country is a crucial moment, and the first impression you make on the local players will determine your market position, legal protection and reputation for many years to come.

Communicate regularly with your local contacts so that they have a clear understanding of what your strategy is. During the preliminary negotiations, explain to them about your constraints at home to ensure that they do not wrongly attribute delays to a lack of goodwill on your part due to their unawareness of the Chinese regulations on overseas investments. Understand and respect your local partners as well as their negotiating practice. Western or African negotiators will usually not expect a contract to be re-discussed, once finalised and signed. This can be to your advantage as a comprehensive set of warranties in a partnership agreement, coupled with efficient judicial enforcement of such contractual provisions, offers serious guarantee against future disappointment. Reassure the personnel of the target as to what your business orientation and direction will be after you take over. Managing the company will be easier in the long run if the local management team trusts you and is willing to come forward with information on the status of the company and the on-going issues, as well as support your business decisions.

Conclusion

Chinese enterprises which opt for "going out" with their business interests will encounter ample opportunities and also inevitably face challenges. But fortune favours the brave and so they should take their chance and go for attractive opportunities. The deciding factors will be how well they learn from their mistakes and use the full extent of legal tools available in China and abroad to secure their investments. By doing this, Chinese investors will gradually refine and improve their investment strategies and develop an acute sense of international competition and investment practice that just stand the tests of time for years to come. 