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China trade -- it's vital to understanding the terrain

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China is a wonderful and awe-inspiring place to do business. It is also fraught with obstacles and danger.

First and foremost, doing business in China requires time, patience, flexibility and open-mindedness -- as well as a clear focus on end goals as opposed to a "win quickly" philosophy.

China trade is not for the faint of heart. Americans expecting clear application of U.S. law and business principles will be disappointed -- or worse. For example, the Chinese consider that the formation of a "contract" means only that the parties are ready to begin serious negotiations -- not that they have reached a final understanding of terms.

U.S. companies, likewise, will be dismayed to learn that their hard-earned profits may not be so easily repatriated to the U.S. or that their U.S. patents, copyrights and trademarks are not enforceable for sales within China. To succeed they must understand that doing business in China is simply different. Here are some things to understand to make it easier, however.

Selecting the right partners

Probably the greatest area of caution and the most important decision a U.S. company must make when entering China is the selection of its Chinese "partners." These are manufacturers of products to be exported to the U.S. or the domestic distributors for goods we send to China. For that reason, it is important to understand the different types of Chinese companies and their roles in modern China trade. Basically, there are four types of Chinese business enterprises:

- State-owned Enterprises (SOEs): China's SOEs are a dying breed created under the Communist rule and socialist economics of the past 50 years, and which were supported throughout that time by forced loans from China's State-owned banks. During the past five years, as China's entry into the World Trade Organization has forced it to revise its failing banking system, those SOEs, for the most part, have been forced to survive or fail on their own merits. However, the SOEs -- with the political and financial support of the Communist government -- still firmly control China's banking, transportation, communications, media and military industries. If you wish to do business in those industries, you must still partner with those SOEs.

- Sino-Western Joint Ventures: During China's early development of capitalistic enterprise (China prefers to call this a "socialist market economy"), which began in 1992, most U.S. and other Western companies entered the China market via the formation of joint ventures with Chinese SOEs or other Chinese trading companies formed specifically for that purpose. Gradually those joint ventures expanded to include ventures with privately owned Chinese companies, which are often still financed through the local or provincial government. These joint ventures typically required the U.S. company to provide money, technology and management to the JV while the China side supplied cheap labor and government support. This JV structure worked reasonably well during China's transition phase, but more recently has fallen out of favor with U.S. companies which have sensed loss of control over their technology, management practices and U.S. customer base.

- Wholly Foreign-Owned Enterprises (WFOEs). More recently -- with the impact of the WTO -- U.S. companies setting up China operations have opted to form their own subsidiary companies. Under Chinese law, these are labeled wholly foreign-owned enterprises ("WFOEs"). These companies are created much like any subsidiary company is formed in the U.S. -- with some important distinctions and limitations. Minimum investment levels, currency restrictions, employment regulations and China domestic market restrictions still apply. But with a WFOE the U.S. company can more tightly control and monitor its production, IP, marketing and management practices, while also obtaining greater freedom to repatriate profits.

- Chinese-Owned Private Companies. Certainly the most common form of U.S.-China trade is the direct trade between the U.S. customer and the Chinese privately owned manufacturer or trading company. Most U.S. buyers are not large enough or otherwise interested in forming WFOEs or JVs, when all they want is to buy goods already manufactured in China. As a result, during the past 15 years China has experienced a virtual explosion of privately owned companies -- typically factories -- which have developed into world-class producers of many consumer, industrial and specialty products. Over just the past five years, the scope and rate of change has been astonishing. Companies which already were doing brisk business with Western customers have since added newer, larger, more modern factories with state-of-art equipment and dramatically improved production processes.

Cautious optimism

Given China's enormous, and still growing, manufacturing capabilities, cheap work force, vastly improved logistics, and gradual opening of its domestic market to foreign goods and services, U.S. companies understandably become excited and energized by the potential they see when visiting China. But there remain serious issues for resolution by its government and business community, and grounds for caution by U.S. newcomers. China has been slow to resolve IP infringement, foreign currency exchange, public corruption, violation of labor laws, adoption of western legal principles and environmental cleanup. In addition, persistent problems with quality control, product defects and cultural differences can create pitfalls for the unwary.

Nonetheless, if they are properly prepared and have the right assistance, and especially by selecting the right partners in China, U.S. companies can create and expand new business opportunities in the world's largest market.

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