ESTABLISHING A MANUFACTURING PLANT IN ASIA

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Today’s discussion focuses on issues relevant to the establishment of a manufacturing plant in Asia. The issues pertinent to a new investor seeking to establish a facility for the first time are very different from what they might be in some of the other major world economic centres. Asia is very different from Europe or the United States for example, and although the Association of Southeast Asian Nations encourages cooperation between the countries of this region, we are still a very long way from a United States of Asia, or even an Asian Union. Within Asia there is a huge range of jurisdictions for investors to consider. Some, such as Hong Kong and Singapore are extremely wealthy whilst the others such as Laos, Cambodia and Vietnam rank among the poorest nations in the world. There are also a large variety of political and legal systems. Many other factors also need to be taken into account when looking at the alternatives.

Notwithstanding the recent Asian financial crisis, Asia has become a very important manufacturing base and market. Some 50% of the world’s population live in Asia and many countries such as India and Vietnam have fast expanding populations. With China set to emerge as a major economic power, we can be certain that in this new century Asia will remain an important part of the world economy and central to global manufacturers plans.

A new investor in Asia is going to have to first consider what sort of jurisdiction is going to be right for them. Many regional governments are making significant efforts to entice investors. On the surface, Cambodia, for example, is a very attractive place to invest in. The Government of Cambodia passed a Foreign Investment Law in 1994 that offers, amongst other things, low taxation, possibly as low as 9% with complete exemption from tax for 8 years. However, Cambodia is not yet recognised as a significant magnet for new investments in Asia. The fact is that jurisdictions compete with one another to attract investment monies and some need to compete a little more than others. New laws designed to attract foreign investors tend to be indicative of the fact that a jurisdiction is not receiving the level of investment that it would like. Countries like Vietnam, Laos and Cambodia are all worthy of consideration and Vietnam has attracted a very significant number of investors based on its long term potential. These jurisdictions do offer investors a package of incentives and low cost labour. However, with these jurisdictions come:-

- developing and often difficult business environments;
- undeveloped legal systems with frequent changes in applicable laws and the interpretation thereof;
- foreign exchange concerns;
- unclear tax regimes;
- the fact that short term and perhaps medium term profits will be low or non-existent.
In contrast, countries such as Thailand and Malaysia offer a much more stable business environment with more mature banking and legal systems. The economic difficulties in recent years in these countries has encouraged some of these nations to enhance their attractiveness to foreign investors as a way of speeding their emergence from the recent financial crisis. Thailand, for example, has passed a new Alien Business Law and in recent years has introduced other new legislation which has attempted to improve the overall business environment and has significantly transformed major areas of law from what they were, say, five years ago.

China is an example of a different sort of market. Although China is developing quickly and business enterprises do encounter many hurdles, investors are attracted to China, at least in part, because of the size of the market and the huge potential that there is for the future. A population of 1.2 billion and an economy that has been expanding for well over a decade, often with double-digit growth, offers exciting opportunities. Yet investors in China still have to put up with an uncertain and developing legal system and difficult business environment.

Thus early issues for an investor to consider might include:

Is the objective of investment to maximise opportunities in the domestic market of a particular country, or is it to establish a base in a low cost jurisdiction with the objective of exporting (for example as Nike is doing with its sports shoe facility in Vietnam). Is the objective to establish a foothold in a developing economy with the long term in mind or are short term profits necessary.

**What kind of business vehicle is available?**

This is quite an important issue. In some jurisdictions, a foreign investor business may be granted a licence for a fixed number of years. For example in Vietnam, one will generally obtain a limited duration licence for a particular project. This has certain disadvantages as the scope for diversification is limited. It also means that the life of the project may only be 20 years and, while this provides a way to enter the Vietnamese market, it clearly limits the return that an investor can expect to achieve from its investment. This is particularly relevant at a time when it is difficult to make profits in Vietnam.

Related to this is the issue of whether or not a wholly foreign owned enterprise will be permitted or whether some form of joint venture arrangement with a local entity will be required. Obviously, there are advantages to a joint venture as a local partner can often assist with licences, consents and the general relationships that need to be established with government authorities. However, disruption is sometimes caused to management and in some cases foreign investors find joint venture arrangements extremely frustrating, particularly in emerging markets. One example is Coca Cola in Vietnam, who some years ago established a joint venture arrangement and after much negotiation succeeded in buying out their local partner and converting the joint venture into a wholly foreign owned enterprise.

If a joint venture is required, a foreign investor should consider what meaningful contribution can be made by a local partner. This is quite important as legal requirements might mean that a local partner will have a significant share in a joint venture company (under many jurisdictions this would be 30% or more), often this ends up being advantageous should they have little else to contribute.
In many joint ventures, the local partner may not be familiar with modern business practices (for example, the need for high tech communications or even the need to spend money on advertising or legal advice) and may be interested only in short term profits rather than long term investment - all of which can delay and frustrate a foreign investor's plans. It is likely that these sorts of difficulties will be encountered more often in the less developed jurisdictions which have only recently started to experiment with foreign investment and market economies. In more developed jurisdictions such as Taiwan or Korea, a joint venture will often be a union of equal partners (both in terms of expertise and financial resources).

Often when entering into joint venture arrangements in less developed jurisdictions, investors make the mistake of thinking that simple documentation is all that is required. In countries such as Vietnam this would often be suggested by local partners who often would prefer to see, for example, joint venture documentation on 3 or 4 sheets of papers. It is, however, usually worth insisting on long form documents in order to ensure that there is agreement from the beginning as to how decisions are to be made and what investment planning is envisaged by the parties. It may take longer to reach agreement, but joint venture arrangements based on well drafted documentation will often last longer than arrangements concluded in haste.

**What Sort of Legal System?**

Asia has a variety of legal systems. Countries such as India, Malaysia, Singapore, Burma and Hong Kong all retain English law style common law legal systems which generally work to their advantage. Laos and Cambodia, which were French possessions, have abandoned the old legal framework that was in place during colonial times and have essentially had to start again. These latter legal systems are generally much weaker and less clear cut and often a cause of concern for foreign investors.

The legal system will, of course, matter a great deal to any business that may wish to borrow money. Banks are generally relaxed about lending in jurisdictions where good security is available. If mortgages over land, plant and machinery can be legally granted and easily enforced, the ability to raise funds by way of bank loans is much easier. The position in Laos or Cambodia is more difficult.

Clearly, in addition to financing issues, a small manufacturer will often be concerned about his ability to collect debts and this will be a significant concern for any enterprise operating in a domestic market.

**One Stop Shops**

Many jurisdictions around Asia seek to provide foreign investors with a “one stop shop”. The idea is essentially that, a new investor will need to deal with only one government body. The procedure should thus be easier and the time involved in the establishment of the business should, in theory at least, be much shorter. Unfortunately this is not always the case. I have already mentioned that Cambodia established a new Foreign Investment regime in 1994 and as part of that process established the Council for the Development of Cambodia which promised licences within 45 days. Unfortunately this has not always worked as smoothly as envisaged, particularly in respect of controversial projects. Other ministries are often reluctant to give up power to such a one stop
shop and it is often worthwhile that an investor ensures that the right contacts are made in a range of
government ministries. Although, in a particular country there may be one licence issuing body,
discussions and concerns expressed behind the scenes can easily cause delay. I have recently been
involved in a number of power station negotiations in Vietnam, and although there is one authorised
state body required to negotiate documentation and one government ministry required to issue the
main project licence, a whole range of other ministries are relevant to such projects including:–

(i) the State Bank who are concerned with foreign exchange issues and the manner in which
foreign loans and government guarantees are arranged;

(ii) the Ministry of Justice who are concerned with issues such as governing law and often seek
a role in reviewing government related documentation generally (for example, on BOT
Projects);

(iii) the Ministry of Finance who is concerned with matters of taxation;

(iv) Electricity of Vietnam which is the state controlled utility that is required to purchase
electricity and their views on a range of issues are crucial;

(v) PetroVietnam which is the State owned enterprise responsible for the supply of gas who
have a central role in the negotiation of a number of power projects now under discussion in
Vietnam.

One Stop Shops are good ideas but rarely work as well as governments intend in their early
years of activity. More developed investment centres which have had many years of experience in
dealing with foreign investors will usually have clear and well established procedures. In Vietnam,
foreign investment has only been encouraged for a little over a decade and the country is in a state of
transition from a centrally planned economy to a market economy. There are thus many more
issues which are novel to and likely to be of concern to government bodies which can cause
difficulty and delay.

Secondary Issues

Once a jurisdiction has been selected there are often further matters to consider. Often
manufacturing businesses would prefer to set themselves up in large population centres in order to
take advantage of a concentration of consumers and ready local labour market. However, many
jurisdictions apply different levels of support by way of incentives and tax advantages depending
upon location. In Thailand for example, the Board of Investment has for some years had three
zones with different privileges applicable to each.

If the attraction of a jurisdiction is the investment incentives on offer from the government, a
potential investor must look at all details early in its evaluation.

Manufacturing ventures may also wish to consider Special Industrial Zones. A number of
Asian jurisdictions have established separate legislation providing for special conditions to apply to
such zones. These may include favourable tax treatment, a quicker licensing procedure (in Vietnam,
for example, it is possible to get a licence within 15 days of application) and much better infrastructure.

**What can be done to make investment in a manufacturing plant easier?**

There are of course a lot of things that one can say about the approach that investors should take to new projects in Asian jurisdictions. It goes without saying that careful planning and thorough research are essential.

However, there are a few areas relevant to the role of lawyers that may be worth highlighting.

**Language** – In many jurisdictions English is used in the negotiation room and is the language in which deals are documented. English is the language of business and this is likely to remain so. However there are some jurisdictions where the local language is preferred. In such countries, it is often worth ensuring that all correspondence to government entities and local project participants is produced in both English and the relevant local language. Good interpreters should also be available at meetings (it is often advantageous for a foreign investor to have their own language capability and not rely on other parties to provide this). Although an added cost it is worth ensuring that documentation is properly translated. This will not only ensure that local participants are more comfortable but should also help identify issues of concern early in a business relationship that might otherwise have been missed.

**Negotiation Team** – Foreign investors will usually involve advisors from their home jurisdiction. It is, however, usually beneficial to have part of a negotiation team made up of people based in and familiar with the jurisdiction being invested in (preferably people of the same nationality as the local participants). This demonstrates respect for local laws and business practices and assists in crucial relationship building.

I hope what I have said this morning has been of interest although I have been unable to cover all Asian jurisdictions. I am sure that many of you will have comments to make about your own experiences across Asia. I would like to close by stating that the role of lawyers extends to assisting clients in assessing investment alternatives and I hope our discussions today will illustrate that, as lawyers, we should not be limited to advising only on the basics of foreign investment law and tax regimes.

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