



DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

How to Manage Risks in Your China Joint Venture

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Dezan Shira & Associates

8 July, 2021



Numbers

1992 Dezan Shira's establishment

300+ Our team of legal, tax, accounting and audit professionals

2000+ Multinational clients that have already chosen us

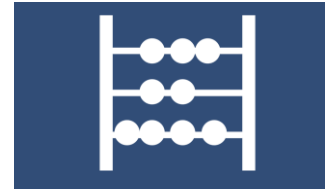
80+ Countries served by our professional services

24 Our offices in **China, India, Vietnam, Singapore**, liaison offices in **Italy, the United States and Germany**, and alliance offices in **Indonesia, Malaysia, the Philippines, and Thailand.**

DSA Service Suite



Pre-Investment and Entry
Strategy Advisory



Accounting, Payroll, and
Treasury



Corporate and Tax
Structuring



Tax and Compliance



Cross-border
Transactional Support



Employment law and HR



Audit Financial Review,
Due Diligence



ERP and Financial
System Advisory

INTRODUCTION

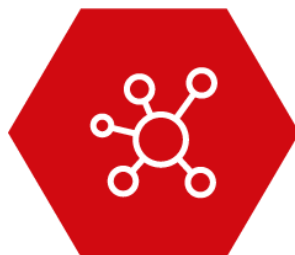
WHERE WE MAKE THE DIFFERENCE

CBBC is the leading organisation helping UK companies develop and grow their business with China, and Chinese companies expand and invest in the UK. For more than 65 years we have offered unrivalled experience and insight into the ever changing opportunities for growth between the UK and China.



OUR EXPERIENCE

We have an established track record and are uniquely positioned to provide clear, impartial advice to help companies thrive in the rapidly evolving Chinese market.



OUR NETWORK

Our China network has extensive coverage both regionally and sectorally with offices in 10 locations, and a team of experienced in-market specialists dedicated to guiding British companies towards commercial success in China.



OUR INSIGHTS

Providing you with the latest local market intelligence and contacts is at the heart of any successful market entry or expansion strategy. Our objective is to help you make informed decisions to enable your business to grow in China.

MEMBERSHIP

JOIN THE UK'S LEADING CHINA BUSINESS NETWORK



ADVICE

Our experience, built over 65 years of supporting thousands of organisations to enter, grow and succeed in China, leaves us expertly positioned to advise you on every step of your China journey.



ANALYSIS

From bespoke reports and policy updates to market insights across eight core sectors, we provide our members with the tools to help them prepare, plan ahead with confidence, and grow.



ACCESS

Access and engagement at the highest levels of influence in the UK and China, and to an unparalleled network of your peers, suppliers, stakeholders and competitors across all sectors. This includes events, roundtables, delegations and VIP visits.



500 Members

10 Offices in China

8 Sector Teams

100+ China Experts (China & UK)



abrdn



Arup



AstraZeneca



Atkins



BP



Clifford Chance



Diageo PLC



DLA Piper



Hawksford



Jaguar Land Rov...



Jardine Matheson



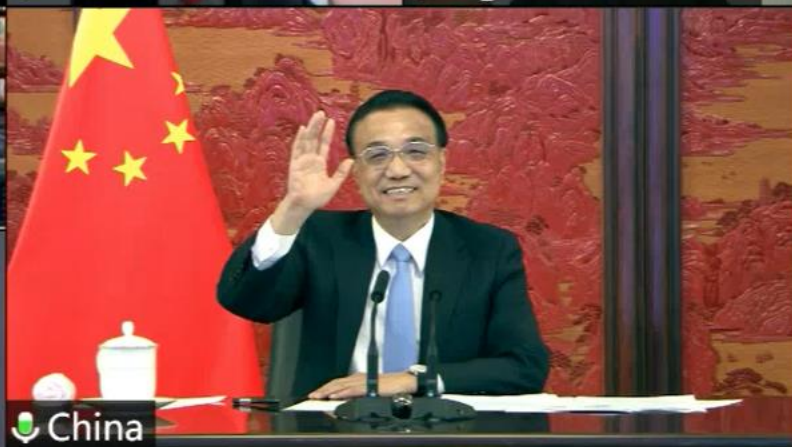
Ambassador Zh...



Prudential



Lord James Sass...



China



Sir Sherard Cow...



PwC



Reckitt Benckiser



Rio Tinto



China



Schroders



Smith+Nephew



Standard Char...



The 48 Group...



The Weir Group



UCL



Walgreens Bo...



Wood



WPP



CBBC VC 3



CBBC VC 2



HSBC



CBBC VC 1



CBBC Chief Ex...

OUR CLIENT SERVICES

IN-DEPTH CHINA EXPERIENCE & KNOWLEDGE

Our advisory teams in the UK and China have in-depth experience and knowledge of guiding British companies towards commercial success in China across multiple sectors. They understand the sectoral, geographical and cultural aspects of business success, as well as the main business challenges that UK companies face when working in and with China and that Chinese companies face when exporting to the UK. We pride ourselves on the impartial advice we provide to our members and clients.



GATEWAY



NAVIGATOR



LAUNCHPAD®

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Section 1

Common Risks and Issues for Joint Venture – case study

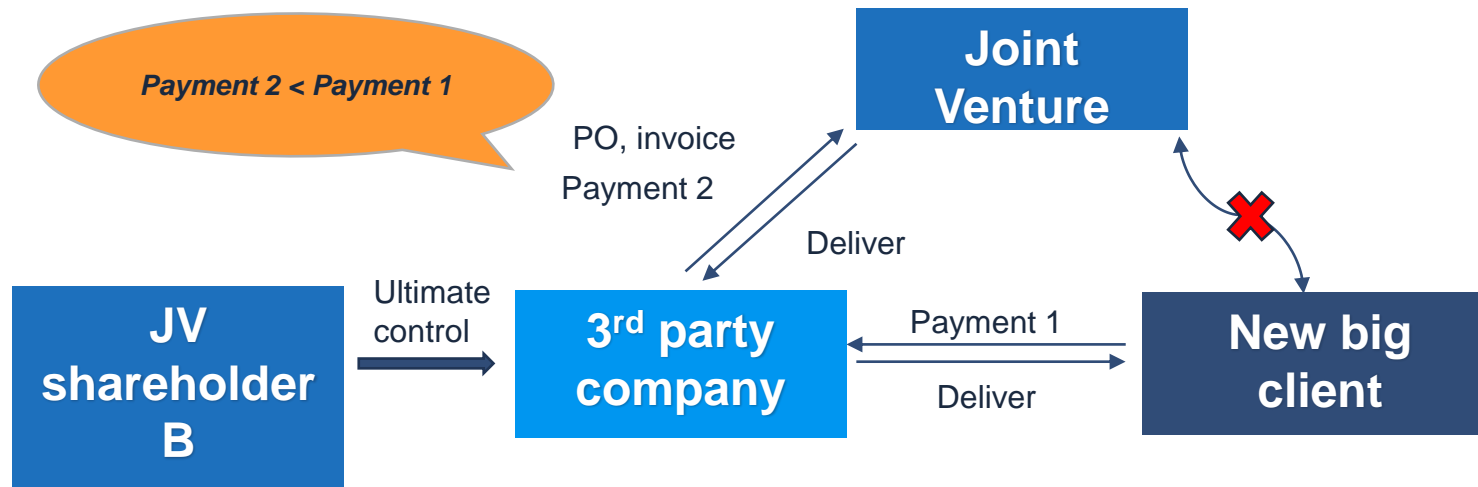
Case I: Suspected Profit Shifting from JV to one of Shareholders' own company

Background:

- One JV manufacturer was invested by two shareholders, shareholder A and shareholder B
- The JV's main product used shareholder A's branding and name
- Periodical financial review performed by DSA

Signal:

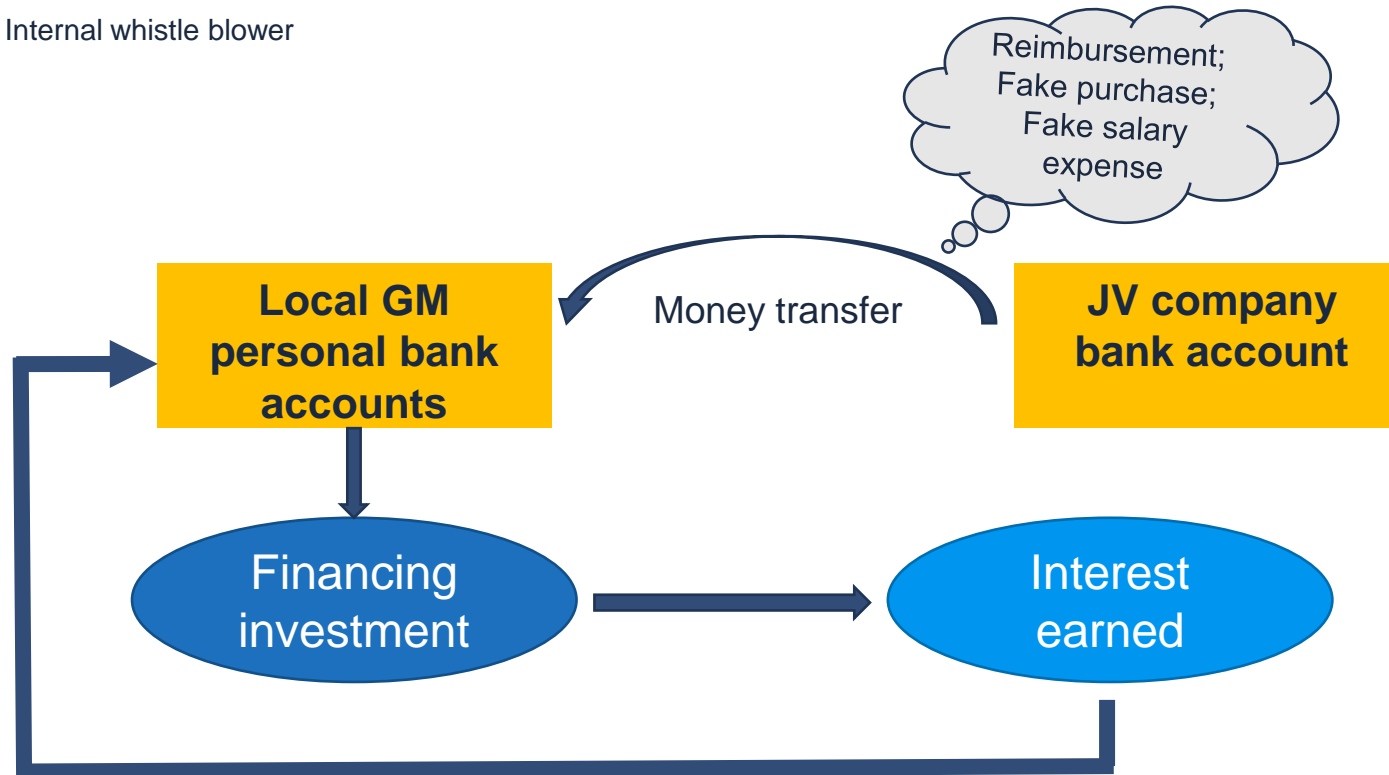
- New big local client created
- Profit margin for this new client transaction was much lower than JV's general profit margin
- Unusual transaction flow arrangement



Case II – Key Chops and Company Certificates Abused by Local Management

Background:

- JV management created by managers assigned by both parties
- Shareholder A managers were stuck outside of China due to the COVID-19 in year 2020.
- The JV's key chops and certificates were held by Shareholder B for easy daily operation use.
- Internal whistle blower



Seal management



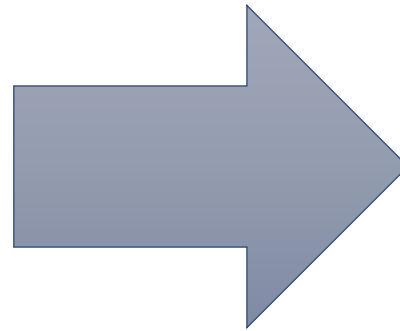
Common Risks and Issues for Joint Venture

Potential signal from finance view

Unusual fluctuation of key financial ratios (e.g., gross profit margin,

Key customer or supplier change

Key business model change



Prevention

Internal control design and implementation

Trademark control

Seal management

Detection

Internal supervision

Outside finance supervision

Common Risks and Issues for Joint Venture



Lose Control of JV



Random Distribution of Powers
and Personnel Arrangement



“Contribution” of Intellectual Property
Rights



Abuse of Seals and Certificates



Section 2

How to Control Risks in Your China JV

- Choose a reliable business partner

How to Control Risks in your China JV

Background Check

- Basic corporate registration information;
- Corporate history and any amendments to the official registration records;
- Shareholders information;
- Management team structure and main leaders;
- Bank relationships;
- Business relationships;
- Business affiliates;
- Lawsuits records and public filings; and
- Financial statements.

- Design of voting rights and dividend rights

How to Control Risks in your China JV

PRC Company Law

- **Art. 42 – Voting Rights**

The voting rights exercisable by shareholders at a shareholders' meeting shall be based on the ratio of capital contribution, **unless otherwise provided in the articles of association of the company.**

Art. 34 – Dividend Rights

Shareholders shall be entitled to dividend sharing in accordance with the ratio of capital contribution, **unless all the shareholders agreed that dividend sharing shall not be in accordance with the ratio of capital contribution.**

- Control of JV

How to Control Risks in your China JV

Absolute Control – 66.7%

Relative Control – 51%

PRC Company Law

- **Art. 43**

Resolutions passed by a shareholders' meeting on amendment to the articles of association of the company, increase or reduction of registered capital, and company merger, division, dissolution or change of company structure **shall be passed by shareholders holding two-thirds or more of the voting rights.**

Key positions

- Legal Representative
- Chairman of the BOD or Executive Director
- General Manager
- Supervisor
- Finance Manager
- Procurement Manager
- Sales Manager

Authorization

- Execution of shareholders' resolution
- Decision on the business plan and investment scheme
- Decision on the profit distribution plan and loss recovery plan
- Decision on appointment and dismissal of senior executive

Qualification and Obligation

- Fiduciary duty
- Shall not abuse duties and rights to receive bribes or other illegal income
- Shall not convert company assets, etc.

Choose Reliable Personnel for Management

Safe Custody of Seals and Certificates

- Assign a third party to safekeep all the seals and certificates;
- Design internal approval procedures

IP rights and Trade Secrets Protection

- Pay attention to the method of contribution;
- License agreement;
- Confidentiality agreement;
- Non-use, non-disclosure and non-circumvention agreement (NNN agreement)
- Non-competition clause/agreement;

Equity Transfer

- The shareholders may transfer all or part of their equity interests among themselves;
- A shareholder proposing to transfer its equity interests to a non-shareholder shall obtain the consent of more than half of the other shareholders;
- Other shareholders shall have pre-emptive right to acquire such equity interests on similar terms.

Termination and Liquidation

- Specific circumstances for termination and liquidation – general dissolution;
- Mandatory dissolution of JV – Art. 182

Exit Mechanism

Equity Transfer, Termination and Liquidation

Better Prepare all the Legal Documents

- Shareholder Agreement
- Articles of Association
- Equity Transfer Agreement
- Intercompany Service Agreement
- License Agreement
- NDA Agreement and NNN Agreement
- Non-competition Agreement
- POA for senior executive
- Usage Guidance of Various Company Seals



Section 3

Relevant Legal Requirements under PRC Foreign Investment Law

- ❑ Law of PRC on Sino-foreign Equity Joint Ventures (EJV law)
- ❑ Law of PRC on Sino-foreign Cooperative Joint Ventures (CJV law)

2020



Foreign Investment Law

Applicable Law

Comparisons: Corporate Governance

Taking the example of limited liability company to show the key differences

Subjects	The EJV Law	The CJV Law	The Company Law
Highest Authority	Board of Directors	Board of Directors/Joint Management Committee	Shareholders Meeting/Shareholder
Minimum Numbers of Board Composition	At least three directors	At least three directors or members of the joint management committee	1 Executive Director Or Board of Directors
Quorum	2/3 of all the directors	2/3 of all directors or the joint management committee	No limit
Terms of Director	4 Years	Up to 3 years	Up to 3 years
Legal Representative	Chairman of the Board	Chairman of the Board or head of joint management committee	Chairman of the Board, executive director or general manager

Comparisons: Corporate Governance

Taking the example of limited liability company to show the key differences-**Continued**

Subjects	The EJV Law	The CJV Law	The Company Law
Transfer of Shares	Unanimously agreed by other shareholders	Unanimously agreed by other cooperatives	Passed by a simple majority of votes casted by shareholders, unless otherwise agreed by shareholders
Voting Mechanism	Unanimous consent of directors attending the meeting	Unanimous consent of directors attending the meeting or the joint management committee	Passed by shareholders representing two-thirds of votes shares
Distribution of Profits	In proportion to capital contributions	In accordance with CJV contracts	In proportion to actual capital contributions, unless otherwise agreed by all the shareholders
Register Capital Decrease	Generally prohibited Exception: approval from competent authority for capital decrease due to change of total investment or scale of production and business operation	Generally prohibited Exception: approval from competent authority for capital decrease due to change of total investment or scale of production and business operation	No limitation as long as the creditor notification procedure is duly completed

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based on our on-the-ground experience.

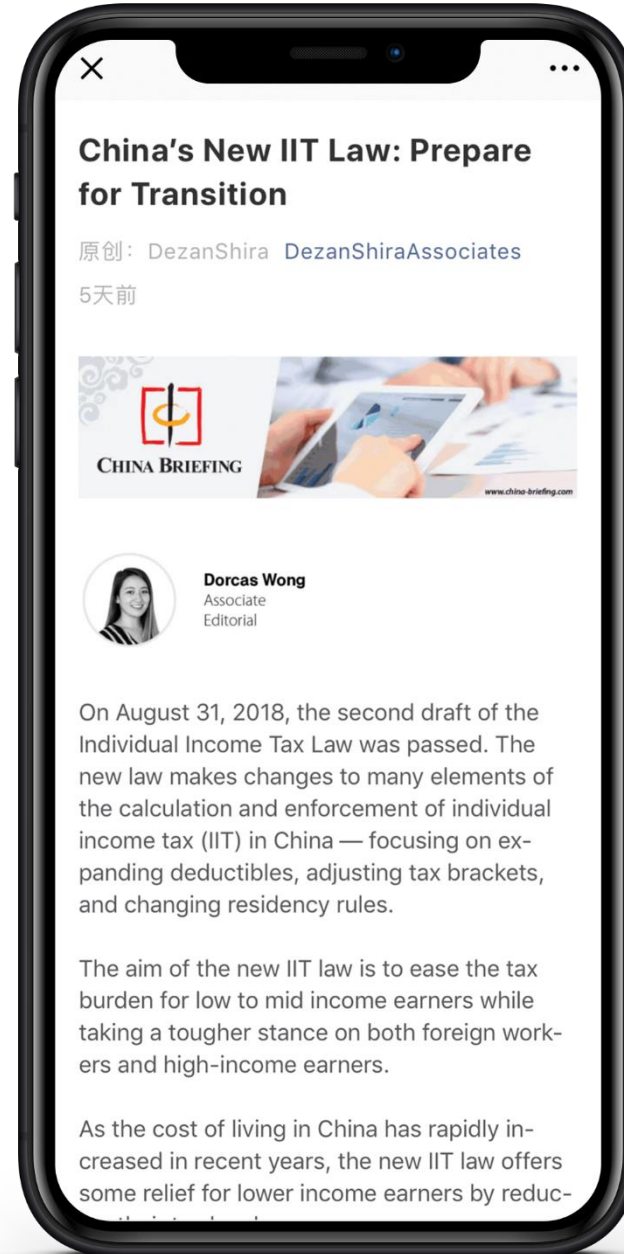


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