

Credit Management and China – The Do's and Don'ts

What is important when dealing with Chinese?

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Nowadays China is on the lips of at least every third person doing business. No surprise when one takes a closer look at the GDP's of the USA, Europe and China. The economical scale and importance of China is evident.

The likelihood that an international operating company has to deal with a Chinese entity, on the sales and/or sourcing side of business, is large. The international operating credit manager therefore has to know the do's and don'ts to facilitate the business process and protect the company's bottom-line.

Before addressing the more critical items, I need to emphasize an important aspect of the Chinese culture, they way they do business.

CULTURAL DIFFERENCES

That there are cultural differences between China and the West is clear. To better understand these differences and the role they play in transacting business, here is a brief 'West versus East' comparison.

- the West bases its view on economics, the East relates matters to sociology.
- the West bases developments on facts; the East focuses on people.
- the West has the tendency to judge and make decisions based on the future; the East gives greater consideration to the past.
- the West focuses on financial capability; the East focuses on security.
- the West generally exhibits dynamic behavior; the East tends to value static characteristics.
- in the West business decisions are based on available financial information and contracts; in the East' these decisions rely more heavily on trusting a relationship.



The term often used to express the cultural differences that affect doing business in China is 'guanxi'. Guanxi describes the interplay of a complex network of personal and social relationships. It can be understood in terms of it not being just what you know, but also who you know. This is still a central concept in Chinese society. Doing

business internationally, however, is very different. It is less about trust and more about assessment and legally binding agreements.

This concept of guanxi, however, is not completely foreign to the western mind. When we look into our history, the time before one could buy credit information, it was that credit only would be given to people from their network, people they know.

It should be stressed that one culture is not better than the other, just different in their history, economic circumstances and specific characteristics. These characteristics, however, will become more universal given the continuing process of globalization. Certain differences will, of course, always remain.

CREDIT PRACTICES

In previous written articles I mentioned that Credit management in China still is in its early days and although a lot has happened over the last couple of years, this still is the case. It will take at least another 2 generations before one can start comparing this with Europe whereas it might take longer to compare it with the USA.

The organizational structure of Chinese entities is still very 'flat', meaning that the decision power lies with a few. It is not uncommon to see entities of approx. 100 employees managed by a single person, who is also the company president. It therefore requires many changes, changes new generations will bring, as globalizing business does enforce.

On top, China understands that, when one wants to compete in a highly competitive environment, one has to be able to offer more than just cheap prices. With its objective to grow its national products/services, one truly recognizes that one obstacle is the high level of securitization involved in doing business (i.e. letters of credit, bank guarantees etc.). This complicates free trade.



This drive is furthermore supported by the constant rising of the Yuan, which is expected to continue gradually.

On the other side do Chinese entities slowly start to understand that transparency, in international business, is an important feature as it creates confidence and trust but they are still far from managing their 'order-to-cash' process on a level as we are used to in the West.

The real large Chinese entities, which are trading internationally for a while now, have understood all of the before mentioned and therefore have adjusted their organization and do have a proper credit management in place. Some of them even have an exemplary status within the country.

On the other hand, and in number by far the largest, do see credit as a pure admin function and still have to adjust their operation. That is not an easy task as there is virtually no credit education in the country.

CREDIT INFORMATION

The reader will agree that it is essential to gather credit information about any potential business partner but we are surprised to see how many cases we have in our law firm, which proves that many still do business on vague promises and ultimately are tricked.

There are several suppliers of credit information active in the market, although these also range from poor to excellent. I therefore only can recommend sticking to the few top providers, as one of their goals is to provide accurate information instead of just supplying data; they are interested in re-occurring customers whereas others are only interested in the short-term gain.

Acquiring data from any so-called intermediary is only driven by price and the seller is only interested in turning data into cash, whatever the quality. It therefore should be an important criterion whether the provider also is the one who compiled the report!



For all providers it is not easy to get reliable information and on top it is considerably more expensive than one is used to in Europe or even the USA, but your provider should be able to do a good job.

Contrary to one might expect, in China most company data is not centrally managed and a provider is required to contact many different sources in order to be able to compile a proper report. It therefore is recommended to only use those that provide information, originating from the Chinese

authorities. Your credit information partner should be able to tell you wherefrom they get the data from.

There though is a huge difference in B2B (business-to-business) and B2C (business-to-consumer)! In the latter segment there is not much of information available. In fact the Chinese law is very strict here, obviously trying to protect the interest of the Chinese citizen.

The demand for reliable credit information in China is not yet as great as it is in the West. This is largely due to the cultural differences outlined at the beginning of this article. Business in China remains heavily related to personal relationships. Chinese companies however do realize themselves more and more that doing business in today's global economy carries more risk than in the past. Step by step also in China one is adopting the credit management principles.

Another reason motivating Chinese companies to implement a credit management policy is the need for cash. Also in China the banks are not as easy anymore providing loans and companies are forced to better manage their assets.

COLLECTION

In the West, there is a systematic, more aggressive approach towards collections. As soon as an account becomes delinquent a predetermined routine of follow up starts, designed to capture the past due payment. The approach is more assertive and carries implications for future dealings with that specific customer.

In China one takes a more passive attitude. In fact, most people are not comfortable addressing overdue accounts. As a result, businesses have no established policies or

systems for dealing with delinquencies. Their tendency towards avoiding confrontation results in poor follow up, with an adverse effect on cash flow. One prefers to wait, hoping that the matter will resolve itself. One thinks often that, as long as the delinquent account is on the balance sheet, there is hope.

Using specialised (third party) collection companies is relatively new to the Chinese. This strategy is gaining popularity, however, as using a third party prevents them from losing face. Unfortunately, being new to third party collections, they lack the experience of selecting the better firms, and tend to go for the cheapest offering rather than the most effective. One though has to keep in mind that, once an account is placed with a third party, a Chinese entity still might intervene.

Thus when one has placed an account for collection in China, one has to bear in mind that the process might take longer than one is used to in the West. First one needs to establish a direct contact with the debtor, not only creating a channel for communication but also is addressing the debt with the right person. Apart from checking whether the debt still is open in their books, the collector needs to establish who actually is in charge and who decides on making the payment. That might be a very different person, one whom might be difficult to get hold of. After that the actions are pretty comparable to what we are used to, apart from them taking somewhat more time.

When one thinks about the process we are used to in the West, the sending of reminders is by the Chinese more seen as a confirmation. To effectively collect, one needs to call (establish a personal contact).

With regard to the overall process there though is an important difference and that is that a collection agency legally only is allowed to mediate! They are not authorized to take any other steps. That means that only a law firm can take any proper steps to enforce the payment of a debt. Best therefore is to look for a legal partner who is specialized in debt collection.

LEGAL

With regard to litigation, the Chinese law and court system is reasonably adequate. That does not mean, though, that taking the step towards litigation is easy. Chinese, in general, are afraid of lawsuits, as they don't fully understand the legal process and possible consequences.

In the West, an attorney is selected based on his or her specific skills. In the East, the selection is based on the relationship one has with an attorney, regardless of any specialized knowledge of the matter to be brought to court.

The 'in-house' process also differs. Whereas in the West is about being practical and willing to settle, in the East one tends to be reluctant to make a decision, trusting the 'system' to solve issues, and thus is not looking for a settlement.

The post-judgment remedy is relatively effective and arbitration is seen as a popular alternative dispute resolution mechanism. This is encouraging, but one should not forget that there is an overall lack of sufficient professional legal services, and local protectionism still exists.



As for court cost, these are still low in comparison and certainly not an argument to avoid the Chinese litigation. It though is up to the judge to determine who ultimately will pay the litigation cost.

A more problematic issue is our conditions of sales! In most contracts one still refers to a court in the subject's home country, thinking it is the easiest and safest way to manage risks. Almost on a daily basis we notice how wrong one is! A verdict of a foreign court is not enforceable in China. That means that, when one would like to execute a verdict, one still has to turn the Chinese court and, in fact, needs to do the whole procedure again. In the end a lot of money spend and this to no effect. So when one knows this, it is far easier to adjust the conditions of sale and make Chinese law applicable.

Apart from choosing Chinese law, it is also important to mention the jurisdiction of a city like Shanghai. This to be able to avoid cities (mostly inland) where there might be larger effects of protectionism.

In those cases we handled on behalf of a growing number of clients, they were surprised how efficient the litigation procedure was and the comparable short time needed to get a verdict. On top, execution of the verdict is not that difficult anymore and once payment has been received, it is relatively easy for the attorney to get the needed permission by SAFE (State Administration of Foreign Exchange) to transfer the funds abroad.

As for choice of a law firm, once more I can only stress to choose one of those firms who have made debt collection business part of their main stream. After all one does not want to spend money for the attorney to find their way in this particular area of the Chinese law. The right firm will mediate, perform amicable collection as well as pursue litigation.

One last item I would like to mention here is that a lawyer in China is held personally responsible for all he or she does. In case of any wrongdoing it might quickly end the attorney's career and put him or her out of business forever. Out of the view in the West it actually is comforting.

CONCLUSION

Wrapping up this article I would like to summarize some of the major do's and don'ts in doing business in or with China (out of credit perspective) below.

Be prepared

Companies in China are more focused on developing a relationship based on trust then we actually believe. It though takes years to develop this. It nevertheless is one of the most important elements when one is building a liaison. While doing, make sure you know who has the power in the subject company to be most effective. A proper credit report actually will, next to information about their creditability, show who the decision takers are. So one can be prepared!

Patience

Patience is a true virtue in China. It requires time to build a relationship and to come to a mutual understanding. Be prepared to invest in this and, in time, one will achieve the needed trust. Turning to China to make some quick money nowadays only can be

found in tales.

As English to them is a foreign language, they might express things differently from what you initially understand. Therefore to double check and re-confirm surely is advisable. On the other hand, do not just wait but act when things are unclear. The Chinese will not have the drive to deal with the unknown.

Currency

Seen the rise of the Chinese currency (Yuan) and more and more banks nowadays allow their clients to keep an account in Yuan, it is recommended to keep trading in USD or EURO as it is expected that the Yuan will continue to rise in the coming years. Having agreed to invoice in Yuan in the end would mean that one has to pay more and more in ones local currency.

Sales conditions

Make sure that the essence of your sales conditions are understood. Don't make them too complicated, as one would not understand thus adhere to them. The same counts for product descriptions or payment terms, them to be clear and precise. There should be no room for a different interpretation as that might lead to complications later on.

Law

Although companies might shiver thinking about applying Chinese law in their conditions of sale, it is the only proper way to secure one position in the Chinese market. With that one also should predetermine a city like Shanghai as the chosen jurisdiction. Any other steps only lead to loss of time and money.



Partners

Choose the right partners in business, meaning that one should make a proper selection of those who can deliver and this not based on promises. This counts for your credit information supplier as well as the firm supporting your collection activities. I hope that the reader finds the above mentioned of help in establishing a relationship with Chinese entities. In trade the world is becoming one but a cultural differences, I would say luckily, do remain.

Creditreform China is a leading provider of credit services in China; with its largest actual database of companies in China and in-house law firm it supports companies doing business with and in China.

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He has over 30 years of experience in credit and held roles as Global Credit Risk Manager with a Chemical multinational, as well as Director Global Markets with an American company in Receivables Management. He was for over 12 years member of FCIB's Board, their first non-US Chairman, and one of the founding Board members of ICTF, where he still is active.

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