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## UNDERSTANDING THE “ELEPHANTS IN THE ROOM:” A ROADMAP TO PREPARE FOR BUSINESS NEGOTIATIONS IN CHINA AND INDIA

*Wa Yang\**

*Corporate Counsel Guides: Understanding Asia. By Dennis Unkovic. American Bar Association 2011.*

### INTRODUCTION

China and India “will define Asia in the 21<sup>st</sup> Century” (p.9). Back in 1980, China and India were replete with “large populations living in poor, technologically backward conditions.” Few experts predicted that China and India “were destined to dominate the world’s economy” thirty years later (*Id.*). Trade between China and the U.S. did not take off until the countries formally established diplomatic relations in 1980s.<sup>1</sup> In 2011, bilateral trade has reached \$446.7 billion, an increase of over 180 times the trade taking place at the beginning of diplomatic relations.<sup>2</sup> Also, China and the U.S. have become the second largest trading partners for each other.<sup>3</sup> Similarly, the trade between the U.S. and India is relatively small, it has risen sharply since 1990.<sup>4</sup> From a modest \$5.6 billion in 1990, the bilateral trade in merchandise goods has increased to \$63.7 billion in 2013, with growth of 1,037.5% in a span of 23 years.<sup>5</sup> By 2012, India has surpassed Japan and become the third largest economy, behind China and the U.S.<sup>6</sup>

In *Corporate Counsel Guides: Understanding Asia*, Dennis Unkovic condenses twenty-five years of experience advising American clients conducting business in Asia into a 200-page guide. The book introduces Unkovic’s viewpoints of the legal concerns associated with conducting business in twenty-two major Asian countries. This review, however, focuses on conducting business negotiations in China and India due to the rapid rise of the economies in these countries.

Ninety percent of the book is devoted to analyzing the prospects and challenges of doing business in each individual country. The introductory chapters provide in-house legal counsels and private firms a high level, yet vital, understanding of Asia. For example, the author initially calls attention to, and subsequently corrects, a common misconception - there

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<sup>1</sup> Ben Baden, *40 Years of US-China Commercial Relations*, CHINA BUSINESS REVIEW, Jan. 1, 2013, <http://www.chinabusinessreview.com/40-years-of-us-china-commercial-relations/>.

<sup>2</sup> *China-U.S. Relations*, Embassy of the People’s Republic of China in the United States of America, <http://www.china-embassy.org/eng/zmgxs/ocusr/> (last visited Dec. 17, 2014).

<sup>3</sup> *Id.*

<sup>4</sup> *Indo-USA Trade Relation, Recent Development In India USA Trade Relations, Economy Of USA, World Economy*, ECONOMY WATCH, (June 29, 2010), [http://www.economywatch.com/world\\_economy/usa/indo-usa-trade-relation.html](http://www.economywatch.com/world_economy/usa/indo-usa-trade-relation.html).

<sup>5</sup> *India-US Bilateral Trade*, Embassy of India, <https://www.indianembassy.org/pages.php?id=42> (last visited Dec. 17, 2014).

<sup>6</sup> Arvind Subramanian, PIIE & CGD, *Deepening US-India Trade Relations*, EAST ASIA FORUM (Apr. 10, 2013), <http://www.eastasiaforum.org/2013/04/10/deepening-us-india-trade-relations/>.

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are no such thing Asians. “Asia is merely the name of the Earth’s largest continent,” so a business cannot devise a commercial strategy targeting an Asian population any more than a business can devise a strategy targeting North Americans. Each country in Asia has its own unique characteristics; therefore people wishing to have dealings with Asian countries must appreciate those differences. Although there are common themes that in-house counsels and lawyers should be aware of, such as “negotiating techniques, use or avoidance of local court systems, and the scope of intellectual property protection,” the author decided to dedicate each chapter to presenting “the intricacies, complexities, and unique aspects of doing business in the particular country addressed.”

**CHINA AND INDIA: ELEPHANTS IN THE ROOM**

Admitting the four most dominant players in the region to be China, India, Japan and Korea, the author believes that China and India will “collectively dictate what direction Asia will move in the future” and named the second chapter “China and India: The Elephants in the Room” (p.7). The second chapter begins with the author citing an Indian Proverb: “[w]here does the sacred elephant walk? Anywhere it desires.” Whereas “elephant in the room” is an English metaphorical idiom for “an obvious major problem or issue that people avoid discussing or acknowledging,”<sup>7</sup> in Indian culture the elephant has special meaning. Hindus have worshiped the elephant for many centuries.<sup>8</sup> For them, the elephant represents “obedience to the dharma (the master’s call), ability not to repeat past mistakes, and respect and care towards their peers.”<sup>9</sup> Hindus represent their philosophical/theological concept through images. The image of the elephant was used to demonstrate all the attributes and characteristics that a perfect disciple should have. The author may use the image of elephant to represent the development of China and India. He is alluding that not only has such development been largely underestimated by the Westerners, but the development model may be used as an exemplar for other Asian countries. In the chapters that follow, the author used one-third of his book to discuss the developments in these two countries and give his suggestions for in-house counsel and lawyers doing business on the Asian Continent.

**INDIA**

Although it is home to 1.1 billion people and the world’s largest democracy, India remains one of the world’s least understood societies (p. 41). Now that India is growing as an attractive destination for Western-based companies looking to expand in Asia throughout the next decade, attorneys working as in-house legal counsels should be cognizant of how to conduct themselves when transacting with Indians (*Id.*). The author provides nine points that lawyers need to understand if they are asked to advise on possible projects or investments in India.

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<sup>7</sup> *Elephant in the Room*, MERRIAM-WEBSTER, [http://www.merriam-webster.com/dictionary/elephant% 20in% 20the%20room](http://www.merriam-webster.com/dictionary/elephant%20in%20the%20room) (last visited Dec. 17, 2014).

<sup>8</sup> Thais Campos, *Meaning and Symbolism of the Elephant Worship in India*, SUITE, <https://suite.io/thais-campos/51q222t> (last updated Feb. 8, 2011).

<sup>9</sup> *Id.*

## UNDERSTANDING THE ELEPHANTS IN THE ROOM

First, the foreign direct investment ("FDI")<sup>10</sup> was not welcomed by the Indian government until a decade ago, but the prospects for future FDI are very good (p. 37). From 1980 to 2000, which the author referred to as the "crucial 20 years," the central government of India opposed "unwanted" foreign incursions into India's economy. India's government began to alter its traditional opposition to FDI after viewing how the Chinese government aggressively sought out FDI from the U.S. and Europe - resulting in a spectacular 9% to 10% annual growth. Presently, Indian bureaucracy is slowly beginning to dismantle the protectionist barriers it erected over the past few decades, aiming to create a more responsive environment for foreign investors. Foreign investors typically choose to establish business entities in India as joint ventures (encouraged by India government), subsidiaries, liaison offices, branch offices, or project offices.

Second, adequately protecting intellectual property ("IP") in India can be a major issue because enforcement under Indian IP law remains a challenge. Conversely, foreigners get substantial protection in trademarks. The newly passed trademark law provides for a ten-year term and broadened coverage for trademarks in a number of key areas. An attorney working as an in-house counsel should carefully review what IP assets their company owns or licenses, and evaluate whether India's IP laws pose a serious barrier to any potential investment plans. While still a concern, the company's trademark is less of an impediment.

Third, India is made up of diverse economic regions, each with different strengths and weaknesses that must be considered prior to foreign investment. For example, local government officials' views on FDI can be strongly influenced by regional political sentiments. Therefore, in-house counsel should research the micro economics of potential investment locations before advising their companies on a suitable business location. This diligence often includes intra-brand analyses, such as where other foreign companies in similar industries have already put down roots and any successes attained.

Fourth, due diligence should be exercised when evaluating Indian service providers or joint partners. Inquiries should include the financial background of the Indian company, previous trading experience with foreign companies in the particular area, the location of the Indian company, and the adaptability of its employees to work with foreigners.

Fifth, when outsourcing to an Indian entity the key conceptual issues are as follows (p.54; listed in no particular order):

- Defining Services
- Best Efforts
- Invoice Disputes

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<sup>10</sup> The OECD defines foreign direct investment as "a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries." OECD, *Glossary of Foreign Direct Investment Terms and Definitions*, at 7, <http://www.oecd.org/investment/investmentfordevelopment/2487495.pdf>.

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- Guarantees of Performance
- Onsite and Offsite Supervision
- Confidentiality
- Force Majeure
- Termination of the Indian Supplier by the U.S. Company
- Deconversion
- Indemnification
- Limitations of Liability
- Dispute Resolution
- Change in Control
- Termination by Election of the Indian Company

Sixth, Indian people are extremely proud, sensitive, and have a desire to be valued. The author pointed out that Indians are more emotional than Chinese, and consequently more likely to take offense to a perceived wrong while keeping their frustration a secret. Their emotional reactions to perceived slights are immediate and direct (p. 59). To prevent a minor problem from escalating into a major crisis, the author suggests that information be presented in the form of written data and hard facts in business dealings, while emotion should rarely be injected into business discussions. Furthermore, due to India's diverse religious culture caution should be exercised as not to inadvertently slight any religious group.

Seventh, since India's court system is very slow to render final and binding decisions in commercial cases. In-house legal counsels should demand that the parties adopt arbitration as the way to resolve commercial disputes when drafting commercial contracts in India or with Indian parties. If arbitration in the U.S. or Western Europe is refused by the Indians, the American party can propose the use of Asian-based alternative tribunals: the Hong Kong International Arbitration Center (HKIAC) or the Singapore International Arbitration Center (SIAC) (p. 57). Either option is typically more acceptable to the Indian supplier than a Western venue.

Eighth, Indian management styles, which have a hierarchical structure and impose decision-making power on the management level, are strongly encouraged in a joint venture or a foreign investment. Individual employees and managers are anxious to share their ideas, so praise is the best approach to inspire a willingness to participate. One valuable suggestion for working with an Indian team is that supervisors should be encouraged to provide details on "the type of project and how and when it is to be accomplished, and why it should be done a specific way." This tactic ensures that the work can be done in a timely and correct manner. Unkovic notes that as accomplished and hardworking as Indians worker are, they lack at filling-in and interpreting in the gaps between supervisory instruction and task completion(p. 61).

Ninth, the best approach for foreign investors to do business in India is to hire established Indian law firms. However, thoroughly vetting local counsel before hiring is strongly recommended to evaluate their credentials and abilities.

Lastly, the author summarizes the main challenges that India faces to reach its full potential. India's inefficient agricultural production, inadequate infrastructure, and insufficiently educated managers and business people may impede its development. Also, its relatively slow governmental decision-making process, its religious and ethnic strife, and its rapidly growing population may have a negative impact on foreign investors' decision to do business in India.

## UNDERSTANDING THE ELEPHANTS IN THE ROOM

### CHINA

Regarding China as the opposite of “transparency”, the author found China and the Chinese people elusive and full of surprise. Being originally from China, I agree with this opinion. Since China is so vast, diverse and complex, even Chinese natives cannot truly understand it all. In light of this, the author lists multiple issues in-house attorneys should pay attention to when advising foreign companies seeking to do business in China.

First, the Chinese government plays a key role in business transactions. Individuals who hold high corporate positions within Chinese enterprises are also often closely aligned with the Chinese Communist Party - which may determine the ultimate outcome of a business negotiation. Therefore, the author recommends in-house legal counsel investigating the corporation’s current financial strength and ability to provide services, as well as its background and ownership interest of the Chinese party. Ask questions such as “where did it originally begin? Was it at one time wholly owned by a local or provincial government? Is there any equity that the government may have retained within the enterprise?” Answers to these questions may ultimately make or break a deal, so in-house counsels should explore them at an early stage of the diligence process. Even when a Chinese enterprise may appear to have no government ownership, in-house counsel should check banks or other financial institutions that have a history of lending money to the target Chinese enterprise. Many Chinese banks are heavily controlled or influenced by Chinese government officials, similar to the structure found in Chinese enterprises. By controlling to whom a local or regional bank can issue loans, the Chinese government may indirectly and effectively have the power to control a Chinese enterprise. Therefore, it is important for counsels to carefully examine the web of financial relationships existing between the Chinese enterprise and its sources of financing within China. The author suggests starting with the assumption that there is a direct or indirect connection between local Chinese officials in the Chinese enterprise. This will help counsels to adequately prepare for problems that may be encountered in the final stages of a negotiation.

Second, foreign companies must strongly resist all requests for illegal payment. China, known to have significant institutional corruption, is taking serious steps to “root out corruption” at every level under Present Hu Jintao’s leadership (p 71). Unknown to a significant number of foreign lawyers, China prohibits bribery or improper payments to government officials by implementing local laws (p. 71). Actually, a number of high-level officials have been sentenced to death by Chinese central government for significant corruption (*Id.*). It is safe to draw the conclusion that foreign investors do not need to act illegally in order to successfully conduct business in China (p. 78). To the contrary, once foreign investors make illegal payments at the very beginning, they are forced to do it forever (*Id.*)

Third, foreign investors should consider China’s vast economic and geographic diversity when considering the geographic area in which to conduct their businesses. Besides taxes, factors worth considering include the existence of appropriate infrastructure, transportation links, and basic resources (p. 73).

Fourth, the two most common business forms for American investors to conduct businesses are forming a joint venture with a Chinese company or establishing a formal wholly owned operation in China (p.73). A subsidiary in China is most often called a wholly owned foreign enterprise (“WOFE”) (p.74). From the 1970s to the early 1990s, most investments in China required some type of joint venture (p.75). Starting in the early 1990s,

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the Chinese governments allowed foreign companies to form WOFEs under certain circumstances (*Id.*). Now foreign investors are able to ship goods to China’s mainland without the requirement of utilizing a Chinese-owned and controlled trading company (*Id.*). Also, the minimum capital requirement to set up commercial enterprise in China has been reduced, which will be attractive to smaller foreign investors (p. 76).

Currently, the WOFE appears to be the most popular business form that foreign investors choose to establish in China (p. 75). While joint ventures and WOFEs have their pros and cons, foreign investors need to consider different factors when choosing the ideal business form their venture in China should take. The most important factor to consider is how government bodies will influence or regulate the business activities (p. 76). This relationship is of paramount concern, and its importance to a successful venture cannot be overstated. Foreign investors can begin considering this by investigating how central and provincial government will regulate their anticipated activities in China (*Id.*) Other issues include tax, accounting, employee and labor relations, as well as banking and financial concerns.

Fifth, a Chinese executive may be a better choice to run a Chinese operation, compared with a foreign expatriate (p. 82). This recommendation is helpful because of the difficult language and the complex, subtle culture that China possesses. Most of these things can only be learned through extended exposure within the Country. (p.83).

Sixth, the Chinese negotiation approach is significantly varied from Western or Japanese approach. While Westerners believe “time is of the essence,” the Chinese will never follow a set schedule (p. 84). In listing the strategies Chinese utilize in business negotiation, the author also provides foreign in-house legal counsels with solutions.

Chinese strategies	Solutions
Assembling unnecessarily large, intimidating negotiating teams	Mirroring the Chinese team’s levels of specializations.
Not identifying a chief negotiator for their team, and replacing the negotiator with little explanation when things do not go the way they had hoped.	Designating your primary negotiator and not switching negotiators. Also, tell the Chinese in the beginning that each party must agree to use the same lead negotiator throughout.
Not following a set schedule	Going slowly and never try to artificially accelerate the negotiation process
	Excluding your CEO in the negotiation team, so that you have a reason not to make an on-the-spot decision
Trying to renegotiate a settled point or introduce a new issue	Summarizing in writing the agreed terms before adjournment and reading the list aloud before the negotiation resumed

Lastly, intellectual property is not as vigorously protected in China as in the U.S. or Europe. As a result, in-house legal counsels must carefully judge the kinds of technologies that will be licensed, sold, or used in China and then do a cost-benefit analysis on situations where those rights are infringed (p. 89).

India and China are each potential targets for foreign investors. While both have undergone different processes to stand out among all the Asian countries, they share common

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characteristics and face similar problems on their path to reform. The following two charts compare and contrast the problem encountered in each of these two countries.

**Problems that attorneys may encounter<sup>11</sup>**

	India	China
Uneven development within the country	√	√
Inadequate infrastructure	√	√
Undeveloped protection for intellectual property	√	√
Rapidly growing population	√	
Lack of business managers	√	
Religious and ethnic strife	√	
Corruption		√
Non-convertible currency		√

**Suggestions for in-house lawyers**

	India	China
Hiring local people as executives	√	√
Choosing arbitration rather than local court system	√	√
Forms to choose: joint venture & wholly owned subsidiary	√	√
Government control	May need to get approval from the Reserved Bank of India	Do background check in advance
Tips on negotiation	Emotionally detached, careful not to demonstrate slight related to any religious group	Create a team of specialists mirroring the Chinese team's level of specialization; use a primary negotiator and go slowly.

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<sup>11</sup> This chart is made based on the information in the book. See generally Dennis Unkovic, ABA, UNDERSTANDING ASIA WINNING STRATEGIES FOR BUSINESS SUCCESS (2011).

## CONCLUSION

While this book serves as a comprehensive general handbook for in-house legal counsels advising investors wishing to engage in business in Asia, it can only be used as a primer for guiding future due diligence efforts. It is valuable as it offers practical, directional suggestions for lawyers initially facing the decision of whether to invest in Asia in fewer than 200 pages. However, while it sets a broad scope, the book did not provide adequate detailed information for in-house legal counsels to confront surprises that may throw them off.

This book highlights the utility of building relationships with Korean and Chinese counterparts off the table, though it only gives a vague and general overview of this process. Lawyers will be surprised to find how drinking and eating rituals affect the final result of a business negotiation. The current scholarship on contract negotiation and formation in China reveal that in many ways China's black letter law is almost identical to Western contract law.<sup>12</sup> Of course the actual practice varies significantly.<sup>13</sup> In China, "the law as observed depends much more on custom and culture..."<sup>14</sup> Guanxi, defined the development of relationships "based on reciprocal respect, friendship, effort, and continued contribution," as the key for contract negotiation success.<sup>15</sup> It leads to a flexible understanding of contracts. One Chinese party stated, "[w]e Chinese are very flexible. We can change to suit the situation...After the contract, you can still ask for amendments, to change this and that."<sup>16</sup> This sort of flexibility comes from Confucian ideology that "relationships form the basis of society as well as interaction with each other."<sup>17</sup> "Inasmuch as contracts form a legal relationship, this relationship must be based on a pre-existing social relationship determined by one's role in ...Confucian society."<sup>18</sup> Therefore, it is no surprise that Chinese people regard it important to build a relationship with the party, instead of focusing merely on the four corners of the contract.

In China, business involves elaborate meals or banquets, where excessive drinking plays an important role.<sup>19</sup> Contract negotiation breakthroughs occur during excessive drinking.<sup>20</sup> Parties may even sign a letter of intent during drinking rounds, although a prudent attorney advises his client never sign anything at a banquet.<sup>21</sup> Therefore, a successful

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<sup>12</sup> Mary Szto, *Contract in my Soup: Chinese Contract Formation and Ritual Eating and Drunkenness*, 25 PACE INT'L L. REV. 1, 11(2013).

<sup>13</sup> *Id.*

<sup>14</sup> John H. Matheson, *Convergence, Culture and Contract Law in China*, 15 MINN. J. INT'L L. 329, 382 (2006).

<sup>15</sup> Yunxia Zhu & Allee Mengzi Zhang, *Understanding Guanxi (Connections) From Business Leaders' Perspective*, BUS. COMM. Q., Sept. 2007, at 385, 386; Thomas Leung & L.L. Yeung, *Negotiation In The People's Republic Of China: Results Of A Survey Of Small Businesses In Hong Kong*, 33 J. SMALL BUS. MGMT. 70, 76 (1995).

<sup>16</sup> Tong Chee Kiong & Yong Pit Kee, *Xinyong and Chinese Business Networks*, 49 BRIT. J. SOC. 75, 76 (1998).

<sup>17</sup> Patricia Pattison & Daniel Herron, *The Mountains Are High And The Emperor Is Far Away: Sanctity Of Contract In China*, 40 AM. BUS. L.J. 459, 478 (2003).

<sup>18</sup> *Id.*

<sup>19</sup> E.N. Anderson, *Food*, in HANDBOOK OF CHINESE POPULAR CULTURE 35, 45 (Wu Dingbo & Patrick D. Murphy, eds. 1994).

<sup>20</sup> Szto, *supra* note 12.

<sup>21</sup> *Id.* at 25.

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businessperson or negotiator is expected to drink heavily.<sup>22</sup> Foreigners, unfortunately, are also expected to drink heavily.<sup>23</sup> When a contract is at stake, a negotiating party may state; “[I]f you drink this cup, we’ll increase our contract order.”<sup>24</sup> Only by becoming aware of all these customs, will a foreign investor not be shocked to be pulled in front of a feast after negotiations, and be persuaded to drink excessively.

In all, Unkovic’s work is an excellent introduction to the complexities of doing business in India and China; however, it should only be regarded as a first step in a long and complicated due diligence process prior to launching an Asian venture.

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<sup>22</sup> *Id.* at 11.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 25

