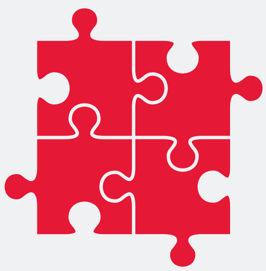
Chinese Companies Transacting in Canada — Deal's Closed: Now What?

By Michael Laffin, Robert Kwauk, Zaichi Hu, Chris Flood and Roger Song



When Chinese and Canadian companies come together, whether it's through a merger, joint venture or another arrangement where cultures will be meshed, tackling the cultural differences is critical. Culture isn't about comparing the mission statement and vision of the two companies, which can often appear very similar; it is a sense that you share the same values.

The essence of culture is reflected in a company's management and daily practices. For instance, are decisions made locally or offshore? Are they made by a senior person or by consensus? If merging cultures is not properly addressed, challenges in cultural integration can lead to frustration among employees and result in reduced productivity.

Chinese companies have made significant investments in Canada over the past several years. While the value proposition was appealing to both buyer and seller/target, less certain was how the parties should fuse their commercial philosophies and corporate cultures once the transaction closed.

Ensuring that companies are successfully integrated should be entrenched in the objectives of the deal. Bringing together different cultures, setting the right performance goals and attracting the best talent are often among the top challenges facing merged companies.

The following articles highlight a number of different integration issues Chinese companies often face — and will likely continue to face — following their entry into the Canadian market, as well as how these issues may be anticipated and addressed.

RETAINING AND ATTRACTING SKILLED MANAGEMENT, EMPLOYEES

When a Chinese company enters a foreign market, its objectives are varied but foremost among them is obtaining a reasonable return on investment, and protecting and increasing the value of its newly acquired overseas company. This is no different from any company in North America. To ensure these objectives are achieved, retaining and attracting effective management and employees is critical.

While companies accept that an increase in employee attrition may, for a variety of reasons, follow a target's acquisition, Chinese buyers face additional challenges in respect of such attrition, given that Canadian personnel are not usually familiar with Chinese corporate culture.

When Chinese companies consider entering the Canadian market, they should make it a priority to address these issues from the onset of the acquisition process. There are many common strategies to retain and attract talented management and employees, however, a number of these pose challenges to Chinese acquirers given certain cultural and economic differences, namely leadership, compensation and corporate social responsibility.

Leadership

Skilled staff in Canada expect bona fide leadership, be it local or foreign. In Canada, as in most western countries, corporate leadership is considered to include: (1) setting a direction for the company and having the discipline to implement it; (2) establishing a clear set of corporate values and goals; and (3) inspiring trust and confidence. If any of these criteria are lacking, Canadian management and employees often begin to question a company's future, as well as their own.

Leadership may come from local management supported by China or directly from Chinese management. The leadership must have the Chinese shareholder's full support and this support must be obvious to Canadian management and employees. It may be displayed in many ways, including integration of the Canadian operations in the Chinese parent, and the Chinese parent contributing in a meaningful way to the local and national economy. It is also critical to communicate with Canadian management and employees through meaningful town hall, group or one-on-one meetings given the importance of Canadian employees feeling connected to and valued by their leaders. Any communication should address how the corporation envisions being successful in Canada, including articulating any plans to grow the Canadian entity. Communication should be consistent and supported through action.

When fostering the dedication of local personnel, Chinese companies should consider removing any perceived or actual restrictions on management performance or promotion within the Canadian subsidiary and the parent corporation. While having senior Chinese management has many positive impacts, it may limit the upward mobility of local Canadians, and therefore talent retention and attraction of skilled management and employees becomes challenging. Towards this end, Chinese companies should consider the contributions Canadian managers may make not only to the Canadian entity but also by contributing to the international growth and competitiveness of the larger Chinese parent and network.

Compensation

While compensation is not the sole issue of importance to Canadian management and employees, it constitutes a principal element of job satisfaction. On the other hand, compensation can be a delicate issue with Chinese shareholders given that salaries in Canada are typically higher than in China.

Nevertheless, implementing a competitive Canadian compensation plan is manageable and, when used with retention strategies, can provide a Chinese shareholder with sufficient time to understand its new Canadian subsidiary and formulate a compensation plan acceptable to both the shareholder and the subsidiary's management and employees. Many of the compensation schemes typically used in a western environment (e.g., options, warrants, restricted share units, etc.) are not available to a company controlled by a Chinese state-owned entity (SOE). However, a plethora of options exist — retention agreements, bonus plans based on mutually agreed key performance indicators, etc. — to ensure that employees of a Chinese parent are not disadvantaged when compared to their Canadian colleagues employed by a Canadian corporation.

In setting the key performance indicators, a Chinese company should consider including a subjective assessment when determining performance for the purpose of compensation. Performance may include consideration relating to positioning the company's brand in Canada and management supporting the Chinese company's global goals and efforts. Also, the retention component of a long-term incentive plan (LTIP) may attract a greater weighting in the LTIP than other non-Chinese companies, due to the fact that until the Chinese company is well established retention may be a challenge.

For a Chinese company operating in a capital market economy, a compensation plan typically has three components: a base salary, short-term incentive award and LTIP. The base salary component is relatively straightforward and, depending on where the Chinese company wants to be placed in the market, it can readily ascertain what it should be paying from human resources firms. Although the indices may vary from company to company, short-term incentive awards can normally be restricted to four or five metrics, including net profit, operating costs, etc. A key component in the compensation plan is the LTIP and it often poses the greatest challenge to a Chinese company in setting compensation. Typically, LTIPs consist of two components: "performance" and "retention." The indices and weighting factoring into each component may vary.

Corporate Social Responsibility

The last several decades have witnessed a marked growth in Canadian companies and their employees of a sense of obligation to contribute to social and community causes. This obligation, often referred to as "corporate social responsibility" (CSR), should be embraced by Chinese companies that acquire Canadian or western companies, since employees often view a company's CSR commitment important to their job satisfaction. Also, through CSR activities, corporations are seen by Canadians to contribute to the well-being of society by building strong communities. Any Chinese company wishing to invest or operate in the country should therefore be prepared to develop and implement CSR programs as part of its talent retention efforts, as well as to effectively integrate into the Canadian marketplace.

It is also noteworthy that many Chinese companies, including SOEs, are bound by similar obligations under Chinese law and regulation. For example, the State-owned Assets Supervision and Administration Commission (SASAC) guidelines state that SOEs have the responsibility to "earnestly fulfill CSR so as to realize coordinated and sustainable development of enterprises, society and environment in all respects." The SASAC guidelines also establish a number of related mandates, including that "fulfilling CSR is an overall social requirement for SOEs" and that "fulfilling CSR is not only their mission and responsibility but also an ardent expectation and requirement from the public." Furthermore, the SASAC guidelines instruct that "CSR should be integrated into corporate governance and business strategy, and implemented on all levels of their daily operations."

Chinese SOEs operating in Canada can therefore approach the fulfilment of these mandates in tandem with their satisfaction of the CSR expectations of their Canadian workforce. That said, Chinese companies should recognize that — unlike Chinese CSR guidelines — the corporate norms of CSR in Canada cannot be found in any formal documentation and instead remain dynamic and subject to continuous evolution.

CORPORATE GOVERNANCE

There is concern in Canada and the western world regarding the governance of Chinese corporations that invest in or acquire Canadian companies. Of particular concern is the perception that such companies: (1) lack the rigorous corporate governance principles and processes necessary to operate effectively and (2) do not operate on the same free market principles embraced by Canadian and other western corporations. Absent these accountability mechanisms, potential partners and bankers of such companies may be without safeguards from suspect activity by management or majority shareholders.

It is encouraging to see that China's top decision-makers appreciate the importance of corporate governance. The recent Decision on Major Issues Concerning Comprehensively Deepening Reforms (Decision) provides that China's SOEs must adapt to a modern enterprise system that reflects operating in a free market environment. The reform of China's SOEs should also focus on streamlining the process of their operation and decision-making, maintaining and increasing their asset value, increasing efficiency and the vitality of their operations, and embracing social responsibilities. While the Chinese government and its leaders recognize the importance of implementing good corporate governance in not only their home country but where their subsidiaries are located, they need to make it happen in tangible ways, while working within the constraints of the Chinese system.

Towards this end, good corporate governance includes making commitments to transparency and disclosure, appointing independent members to the board of directors, and establishing independent audit committees.

A salient aspect of corporate governance is the appointment of qualified directors. In this regard, Chinese companies are advised to obtain quality local candidates to become directors of an ongoing Chinese-controlled entity.

The presence of independent Canadian directors on a Chinese-controlled company is an effort to ensure that Canadian best practices are followed. Ensuring laws and policies are followed and rigorous processes are implemented regarding human resources; health, safety and the environment; and corporate governance are key attributes of a successful and responsible Canadian company. In addition, qualified Canadian directors can be of great assistance to a Chinese company in assessing opportunities, facilitating the integration of a local company into a Chinese company's global network and educating a Chinese company's head office about Canadian norms.

ENVIRONMENTAL, HEALTH AND SAFETY MATTERS

Resource and mining companies are under constant scrutiny from regulators and the public with respect to environmental, health and safety matters. Due to China's domestic environmental issues, it is likely that a Chinese company will be subject to additional scrutiny by those who believe that safeguarding the environment is not a priority for Chinese companies.

As a result, in order for Chinese companies to successfully combat any misperceptions, they should adopt strict environmental policies and procedures that exceed legislated environmental requirements, similar to what is done by the vast majority of Canadian and international companies.

As is the case with CSR policies and practices, Chinese companies operating in Canada may approach compliance with Canadian environmental regulation in tandem with similar obligations under Chinese law. As of February 18, 2013, the Ministry of Commerce and the Ministry of Environmental Protection of the People's Republic of China issued Guidelines for Environmental Protection in Foreign Investment and Cooperation. Included among the standards that Chinese enterprises should follow is a requirement that "enterprises shall understand and observe provisions of laws and regulations of the host country concerning environmental protection."

DECISION-MAKING

Successful business operations often require that decisions be made in an expeditious manner. To expedite the decision-making process in a Canadian subsidiary and avoid competitive disadvantage, effective communication between the Chinese shareholder and Canadian subsidiary should be coupled with an appropriate delegation of power. When it comes to more locally focused decisions regarding day-to-day operations or approved budgets of the Canadian subsidiary, a certain amount of delegation to Canadian management is required.

Strong lines of communication should be established between Canadian and Chinese operations regarding all matters of long-term strategic importance, as well as matters that touch on aspects of the Canadian subsidiary's operations, such as setting capital expenditures and budgets. This will protect against unexpected surprises when big-picture decisions are made and facilitate long-term planning.

While any Canadian subsidiary of a Chinese parent recognizes the need for local decision-making, it is incumbent on local management to appreciate that while SOEs are global players, they are subject to Chinese laws and regulations regarding the management of state-owned assets, and local management must ensure its decision-making takes these requirements into consideration. Local management should also appreciate that decision-making processes differ between Chinese SOEs and privately held Chinese corporations; the former being subject to administrative considerations from which the latter are generally free.

SECONDMENT OF EMPLOYEES

An effective and efficient method for a Chinese shareholder to become directly involved in the management of its Canadian subsidiaries is through the secondment of Chinese employees to Canada. This is an effective method of advancing communication between employees in the two countries, and helps Canadian employees to understand the intricacies and reporting requirements of a China-based company.

Chinese/Canadian secondments should be executed tactfully to maximize benefits. Canadian subsidiaries should welcome Chinese secondees as employees or members of management. Secondees should be competent and understand their role in facilitating the development of the Canadian subsidiary, including ensuring that foreign cultural concepts — whether Chinese or Canadian — are communicated early and effectively. They should also strive to gain exposure to the wider Canadian market rather than concentrating solely on assimilation into the subsidiary's corporate culture.

Likewise, it may also be desirable to second Canadian employees and managers to China, especially in cases where the Chinese shareholder is interested in transferring the Canadian technical and management expertise to its Chinese operations.

CONCLUSION

Many factors are required for a successful transaction, including structuring (be it tax or corporate), identifying correct assets/targets, negotiating a suitable price, finalizing the appropriate documentation, etc. Without the foregoing, a transaction may not be as fruitful as envisioned. Nevertheless, even where the aforementioned transactional matters are successfully addressed, the buyer's efforts may be undermined if it has not anticipated and implemented a strategic plan to enable the management and employees of the target to be successfully integrated into the resulting entity. To this end, Chinese companies are advised to address the various challenges they will face once closing occurs. While these challenges are manageable, they require planning and effort to ensure the merged entity is positioned to move forward in a profitable manner.

CONTACT US

Michael Laffin
Chair, Asia Region
403-260-9692
michael.laffin@blakes.com

Robert Kwauk
Managing Partner, Beijing
+86-10-6530-9001
robert.kwauk@blakes.com

Zaichi Hu
604-631-3349
zaichi.hu@blakes.com

Chris Flood
416-863-4293
chris.flood@blakes.com

Roger Song
403-260-9729
roger.song@blakes.com