Issues Faced by US Companies when Entering into Distribution Arrangements in Southeast Asia

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Background on ASEAN

- ASEAN was originally formed in 1967. Cooperation amongst Southeast Asian nations has grown in terms of number of members, strength and objectives ever since.
- The Association of Southeast Asian Nations ("ASEAN") as it is today consists of 10 member States : Malaysia, Singapore, Indonesia, Thailand, Philippines, Brunei, Vietnam, Laos, Cambodia and Myanmar, with a combined population of almost 600 million.
- ASEAN is gradually becoming a strong economic bloc. Movements for ASEAN + 3 (China, South Korea and Japan) being discussed (EAEG).

Why Southeast Asia?

- **Rich in resources**
- **Inexpensive and educated work force**
- **Good infrastructure and transport systems**
- **Large market (population of almost 600 million)**
- **Many forms of incentives (e.g., tax relief, pioneer status, grants and subsidies)**
- **US combined two-way trade with ASEAN countries amounted to US107 billion in 2001 (for the first 11 months of 2001). Third largest U.S. overseas export market after Japan and EU.**

Trade Relations between US and ASEAN

- **Distinctive US products and services are seen in almost every ASEAN country (e.g., McDonald's, Coke, Pepsi, Levi's, Warner Bros, Amway, Tupperware, DKNY, Microsoft, Nike)**
- **Various vehicles were used to introduce these products and services (e.g., partnerships, JV companies, distributorship agreements, licensing agreements, franchise agreements, OEM, VAR)**
- **Issues do surface from time to time, but as is evidenced from the successes of the various relationships, they can be overcome. Important that these issues are identified at an early stage.**

Some issues faced by US companies in distribution relationships

- Equity restrictions
- Government approvals - specific industries
- Delays
- IP Issues
- Tax issues
- Management and commercial issues
- Governing law and dispute resolution clauses

Equity Restrictions

- **Where distribution is by way of direct participation in the target country - the level of equity participation allowed may be controlled.**

- In Malaysia, the FIC will usually allow up to 30% foreign equity. For manufacturing or high tech related industries, equity can be held up to 100%.

- In Philippines, foreign ownership and the extent thereof would depend on whether the proposed industry falls within one of the subjects listed in the Foreign Investments Negative List.

Equity Restrictions

- In Thailand, foreign participation is governed by the Foreign Business Act 1999, replacing the earlier Alien Business Law. It restricts participation in certain industries. American-owned enterprises, however, may invoke the the Treaty of Amity and Economic Relations between Thailand and US to claim exemption(i.e., national treatment to be granted to persons of each country).
- In Indonesia, the Capital Investment Coordinating Boards (BKPM) must approve most foreign investment proposals. Some sectors, especially technical sectors, are covered by specific laws and regulations. Fiscal and political deregulation has enabled provincial investment boards to assume a greater role in approving foreign investments within the region.

Government Approvals – Specific Industries

- **Depending on the industry, trade or business, government approval may be required, regardless of equity structure.**
- **In Malaysia**, all wholesale and retail trade with foreign involvement must obtain prior approval of the Committee on Wholesale and Retail Trade. Direct selling and franchising are regulated by the Direct Sales Act 1993 and the Franchise Act 1998.
- Certain products will require approval permits or import licenses (e.g., import of electrical switches - Dept of Supply of Electric; Import of motor vehicles - Ministry of International Trade and Industry)
- Labeling laws - name & address of manufacturer, importer, producer or wholesaler, the name of the country where the goods were manufactured (e.g., Made in the USA)

Government Approvals – Specific Industries

- Usual to provide that the agreement is subject to procurement of necessary approvals (i.e., a condition precedent and that contracting party will comply with all applicable laws).

- Failure to obtain important approvals should be made a ground to terminate and to obtain damages or costs.

Delays

- Bureaucracy will inevitably cause delays. Delays are not uncommon in ASEAN countries.
- Should include provisions for delays (e.g., right to terminate; who bears the costs).
- Depends on the country’s reputation for bureaucratic expediency and the government department concerned (some departments are more efficient than others).

IP ISSUES

- **Most members of ASEAN have been placed on the Special "301" provisions of the Trade Act 1974. They include 'Priority Watch List' countries: Indonesia and Philippines and 'Watch list' countries: Malaysia, Thailand and Vietnam.**
- **Most infringements relate to optical media piracy, software piracy and counterfeit products.**
- **Most ASEAN countries have adequate IP laws in place. The complaints have mostly been directed towards enforcement, which have been stepped up lately (e.g., Malaysia - successive raids on illegal VCDs)**

IP ISSUES

- Important to conduct a search in the country whenever seeking distributors/franchisees/licensees, or when approached by one. Quite common that the IP has already been registered or applied for by a related party. May hold the IP owner for ransom later.
- Important to register the user of the mark as a registered user; otherwise you may find the mark susceptible to expungement for non-use.
- Important to check on OEM ocassionaly - check the books and any evidence of excess productions.
- IP may be your only recourse as restraint of trade clauses may be void.
- Parallel Imports - can be a problem

Tax Issues

- Withholding tax on royalty income and interest payments levied on gross amount (e.g., 10% and 15%, respectively, in Malaysia)
- Not all ASEAN countries have double taxation agreements with US.
- Parties should provide for withholding tax in the agreement. Who should bear it? Local company or US company?

Management and Commercial Issues

- Differing expectations between parties
- Distributor becomes too proud and confident - wishes to disengage from distributor and sets up rival company
- Language barriers in some ASEAN countries
- Targets are set too high and profit margins become too low (some countries control the amount of royalties payable)
- Disputes arise as to transfer of knowledge or technology
- Problems with using local nominees to circumvent foreign participation guidelines - may be illegal. Local company uses this to argue that agreement is void.

Governing Law and Dispute Resolution Clauses

- US companies wish to choose US laws and US courts. May not be possible in some instances (e.g., for manufacturing agreements (with more than RM2.5m shareholders’ funds or more than 75 employees) the Ministry of International Trade and Industry requires that the governing law and courts be Malaysian)
- The local company would normally object - costs considerations to engage advice on US law, place of business, remoteness of connection etc.
- US companies are normally wary of the transparency involved in proceedings instituted locally.
- Middle ground - arbitration clause. Malaysia and Singapore appear at the moment to be the popular neutral locations for arbitration and choice of law in the region.

Conclusion

- Expansion is important, especially now in the move towards globalization. Many companies have had to pay the price for their delays in moving into the ASEAN region.
- One must understand the mindset of the target country. Most developing countries are interested in transfer of skills, knowledge and technology, as well as economic growth. They no longer want a depletion of resources for short term gains. They are sensitive to certain sectors, and tend to protect them.
- Find out what is the best way to make your presence in the target country, and aim to create a win-win situation.
- In this regard, HSBC's strategy may be useful - "the world's largest local bank."

Thank you

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