China, a market too big to ignore

By Peter Zeughauser

China could be the legal industry’s salve for the economic malaise it has suffered for the better part of a decade. Or it could be the sieve that drains firms of more money than many can afford to lose at a time when every firm should be minding its pennies.

The second largest economy in the world, the International Monetary Fund predicts that China will eclipse the U.S. as the world’s largest economy in 2016, just over two years from now. According to McKinsey, in the last 30 years 600 million Chinese people have been lifted from poverty into a still rapidly growing middle class of consumers.

Between 2010 and 2025, around the world a billion people will move into cities. Over 200 million of them will live in 20 megacities of over 10 million in population each; the lion’s share of them will be in China. Six hundred million of them will live in 400 cities with populations between 200,000 and 10 million people each. Over 230 of those cities will be in China.

Big cities — centers of commerce — are uniquely the province of Big Law and the many firms that feed off their spoils. If Big Law thrives in big cities, then whether and how to enter and penetrate the Chinese market is the single most vexing strategic issue facing America’s Big Law firms.

For American Big Law, the challenges of realizing on their investments in China are many and great. China proudly regards itself as the vast military-industrial complex that Eisenhower warned the American people to guard against becoming. Working seamlessly with industry, the Chinese government erects impenetrable barriers to entry to enable state-owned industries and other sectors vital to maintaining a hold on all things economic and related to maintaining social stability, including law firms, to dominate their sectors.

A decade ago, many China watchers believed the prohibitions against non-Chinese lawyers practicing law in China would soon fall. No longer. The Chinese Ministry of Justice is acting to create some of the largest law firms in the world before lifting the restrictions on practice by foreigners, simultaneously with China’s next huge economic expansion: the announcement just last month of the creation of a new, bigger, first-of-its-kind in China “free trade zone” (FTZ) in Shanghai that will mirror Hong Kong’s “second system” (yes, that’s right, Western rule of law, possibly a more independent judiciary, and allowing non-Chinese lawyers to practice transactional law) and likely is a prelude to the relocation of Asia’s financial center from Hong Kong to Shanghai.

Even if the creation of the Shanghai FTZ provides Big Law with long-awaited revenue, the pervasive corruption on which a vast network of government and private monopolists feast will still present possibly insurmountable competitive challenges for anyone subject to the constraints of the Foreign Corrupt Practices Act. Indeed, Big Law’s only hope for prosperity in China will be to become a force for change much as it is in the U.S., testing Beijing’s latest crackdown on bad actors in its badlands economy. This won’t be easy in a country that has no free press and persecutes and tortures pro bono lawyers.

In the face of many challenges, there are signs that the Chinese government recognizes that its path to greatness may require acceptance of Western law and lawyers. As far back as 2007 the Ministry of Justice allowed the creation of MWE China Law Offices, a combination of two Big Law firms: King & Wood, one of China’s largest firms, and Mallesons, a prominent Shanghainese firm, to create a prototype for the Ministry of Justice to experiment with Westerners practicing in the same law offices as Chinese lawyers, it was no doubt a success. MWE paved the way for the combination of two Big Law firms: King & Wood, one of China’s largest firms, and Mallesons, a preeminent Australian firm, to create a top 25 global brand. The KWM deal took the form of a Swiss verein, with the Chinese mainland and Australian offices remaining separate financially, but with financial integration in Hong Kong. MWE and KWM have become the poster children for success in penetrating the Chinese market, and will thrive still more with the creation of the FTZ (particularly if KWM chooses to expand its financial integration to include its Shanghai office).

If MWE and KWM are the template for successful penetration of the Chinese market by foreign law firms, we can likely expect to see a wave of similar deals between U.S. and Chinese firms. Indeed, I write this piece while in Shanghai working with the Ministry of Justice to spur a transformation among Shanghai firms that will undoubtedly lead to their internationalization, including more combinations akin to MWE China Law Offices and KWM. The path they trod may well turn out to be Big Law’s Silk Road.

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