

Reflections



Managing Risk and Business Disputes in China

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A majority of international companies in China are successful with good profitability. Nonetheless, this market offers many challenges that can blow companies off course, impacting operations and reputation.

In this edition, there is a review of the rapid market changes that generate risks, coupled with the internal factors that make companies susceptible.

Trade issues, whether as WTO or anti-dumping cases, can affect companies directly or indirectly. Another

article addresses increasing instances of commercial disputes and litigations.

In an upcoming edition, we will continue the theme of risk, looking at the rise of civil society in China, NGOs and community groups.

Reflections will also survey trends of media and the prevalence of social media to act as safety valves and barometers of consumer attitudes for driving crises.

Overview

While Europe languishes and the jury is still out on the trajectory of the U.S. economy, China enjoys relatively high growth rates and business profitability. Anxieties

here of a slowing to about 8 to 8.5% growth pale in comparison with the challenges of developed markets. U.S. studies indicate that American companies in China have 40% higher profits than their overall global operations. Yet as the old business adage goes, "higher profits bring higher risks."

Internal Risk Factors

China has many inherent risks. Many are internal to companies resulting from years of high growth and turnover rates. Internal systems and processes are often not solidified. Conditions are such where management and staff alignment is difficult. Working through joint ventures is common, loosening control while introducing added complexity.

For many corporations, China is formally categorized as a high-risk market leading to more onerous governance and compliance procedures. While these give safeguards, they introduce operational and management rigidities, so lowering competitiveness. Entrepreneurs on the Forbes richest list and business leaders often cite that Chinese companies are more nimble and flexible exploiting rapidly evolving market trends.

Given China's size by population, geography and unconsolidated markets, corporate models used elsewhere for supply and, especially, distribution cannot be applied and need to be reconfigured. Organizational structures based on global business units (GBU) are particularly prone to setback.

External Risk Factors

The role of government at central, provincial and local levels for activist industrial policies has coupled with the proliferation over past years of more detailed regulation for product safety, environmental conformity and governance. This ensures that there are many more "touch points" where governments intersect with companies' operations and their continued licences to operate.

For over a decade, much of the established media has been starved of government subsidies. Print and broadcast media are subsequently struggling under commercial pressures, particularly in tier two and three cities. Many are drifting towards nationalism or blurring the separation of editorial content and advertising revenues in order to sustain themselves.

Social media provides useful safety valves for consumer opinions, but are raucous, undisciplined and susceptible to manipulation by competitive interests. Lastly, with increasing prosperity, there is the rise of community and middle class activism and interest groups that are able to mount "Not in My Back Yard" (NIMBY) campaigns or seek compensation.

With this rapid external market churn and internal inertia, many companies find themselves in a crisis prone environment with a growing prevalence of labour unrest, product safety issues, disputes arising from JVs that are "failing marriages," environmental

pollution or plant closures.

This potent mix puts great pressure on managements in China. With a series of incidents, relationships with corporate headquarters can be fraught. For those in Europe and North America, facing low or flat growth attitudes are invariably more risk averse. Conversely, for those in China, the headquarters can seem remote and out of touch with the realities of the market. This gulf can lead to mistrust, which often proves the biggest hurdle to timely resolutions of crises in China.

Conclusions

While "relationships (guanxi)" are the traditional cornerstone of doing business in China, rapid change means that such "remain necessary but no longer sufficient for success." For government relations, there are simply too many ministries, agencies and levels of government involved with the greater complexity of regulations to give the assurance of years past. Media under stress from commercialization, and the vibrant social media are more challenging to manage.

In this era of profitability, regulatory change and market consolidation, corporations are reassessing their paradigms of managing risk. Key trends include:

- Tolerating some risks, especially with Chinese collaborations
- Broadening relationships and strengthening JV operations
- Enhancing government affairs activities
- Accelerating localization of the business value chain and
- Where possible, enhancing R&D capabilities in China and foregoing repatriation of some IPR.



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Risks of Trade or Trading Risk

Rash of anti-dumping and countervailing duties cases against China disruptive to mutual interests ?

On 20 December 2011, the U.S. Court of Appeals ruled that U.S. law does not allow the Commerce Department to impose countervailing duties on products from non-market economies such as China, reinforcing a March 2011 WTO ruling on four Chinese imports: standard steel pipes, rectangular steel pipes, off-road tires and laminated woven sacks. Since bowing to pressure from certain industry groups in 2007, the Commerce Department had allowed companies to seek countervailing as well as anti-dumping duties against Chinese imports.

While Chinese media have taken this court action as a small victory, the reality is that this issue has yet to run its course. Trade cases are the prime territory of interest group politics and this presidential election year offers many opportunities for populists at the expense of China. The U.S. Congress may seek to introduce legislation to allow countervailing duties imposed against "non-market economies" such as China.

Since China entered the WTO ten years ago, this is another small milestone in the tortuous trade relations between the U.S. and China. The last five years have been especially active with an acceleration of the number of cases to thwart entry of Chinese companies and their gaining market share in the U.S. This trend towards ready use of anti-dumping, countervailing duties or WTO dispute settlement for remedies has been duplicated in Europe, Australia and elsewhere.

China learns to retaliate !

U.S. and European companies operating in China cannot escape from the effects of these trade disputes whether directly or indirectly impacted. It is not uncommon that corporate headquarters or business units decide to initiate a dumping case or become a co-petitioner for competitive reasons in the U.S. or Europe, while having operations in China.

For disputes regarding automotive parts in Europe in 2008 and paper products in the U.S., Australia and the EU from 2009 to 2011, this was the situation. Affected companies in China risk a chilling of their relations with governments at all levels, even suspension of contacts and curtailment of business development plans. Regulatory approvals related to products, facilities or expansions can take longer time. Relationships with JV partners become strained.

But it is not just those initiating cases that can be adversely affected. In the 1990s, the U.S. and the EU traded not only goods and services, but a protracted series of trade cases and counter cases (on bananas, beef hormones, Foreign Sales Corporations (FSC) et al.) While the WTO is touted as being a rules based system, the U.S. and the EU have set

the roadmap of dispute settlement for mature trade relations within the WTO system. It is driven by a "quid pro quo" mentality. China has progressively learnt this lesson and in recent years initiated cases itself as retaliation (see Box 1). Automotive parts, tires and tariffs against American auto imports with large engines are examples of such cases to achieve balance with respect to trade disputes. Alternatively, product categories can be chosen that have no relation to previous cases, but are chosen for political impact.

Global companies vulnerable

For globalized economies, it can often be difficult to determine where national interests lie. On behalf of Italy, France and Belgium, the EU may bring against imports of foot ware from China, but then is buffeted by complaints from



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1 Trade Cases on the Rise: EU & U.S. vs. China

- China faced **67 trade remedy investigations in 2011**, involving US\$ 5.9 billion (most originating in the EU and U.S.)
- China has been most targeted for **anti-dumping for 16 years (1995-2010) and anti-subsidy for 5 years (2006-2010)**
- Since 2002 (when China joined the WTO), **the country has been subject to 692 trade remedy investigations** (610 anti-dumping, 106 safeguard measure, 43 anti-subsidy, 33 special safeguard measures)

Total Disputes Launched: November 2010 - present

EU vs. China

Anti-dumping: 19
Countervailing duties: 1
WTO cases: 2

China vs. EU

Countervailing duties: 1
WTO cases: 2

EU / China Fast facts:

- The total number of on-going disputes was almost **40 percent higher in 2010 than 2009**; the number of on-going disputes peaked at 23 during the summer of 2010
- In 2010, the number of WTO consultation requests went up from 2009. **The 17 requests made in 2010 were slightly above the annual average of the previous 5 years**

U.S. vs. China

Anti-dumping: 8
Countervailing duties: 1
WTO cases: 1

China vs. U.S.

Anti-dumping: 8
Countervailing duties: 6
WTO cases: 4

U.S. / China Fast facts:

- The United States currently has countervailing duty orders against **23 Chinese products, including tires, lightweight thermal paper and a variety of steel pipe**; the U.S. also has ongoing countervailing duty investigations against China involving steel wheels, galvanized steel wheels, high-pressure steel cylinders and solar cells. Many were initiated in 2009.
- To have **five dual investigations** against Chinese products in less than a year was unprecedented in the history of world trade, according to Gao Hucheng, a MOFCOM official
- U.S. anti-dumping and anti-subsidy investigations into Chinese coated paper and steel tubes in 2010 and 2011 **involved 635 Chinese enterprises with 70,000 employees and goods worth \$860 million**. China has quickened the pace of retaliation in 2011.

importers, retailers and consumer organizations throughout Europe.

For multinational corporations with vertical supply and distribution chains crisscrossing continents trade cases can be disruptive or entail costs to operations. An example of interwoven industries is the recent spate of cases between the U.S. and China over solar energy. Some MNCs find themselves seemingly pitted against their own suppliers, distributors and customers! More details of the solar cases are given below (see Box 2).

Rising tensions

If trade tensions rise further then multinational companies potentially face greater disruptions to their operations in China by what is known as carousel trade sanctions. Again, this is a controversial policy initiated by the U.S. in the 1990's for WTO disputes, and then also adopted by the EU.

The motivation was frustration in the U.S. that while it had won WTO decisions against the EU on bananas, beef hormones and GMOs, the EU was prepared to forgo abiding by the decisions to open up those respective markets and to endure ongoing trade sanctions. The U.S. decided that



customs codes of products for retaliation would change each six months, so magnifying the punitive impact of WTO sanctions. The EU retaliated where it was later authorised to

levy sanctions for U.S. delays on FSC, or as WTO terminology "suspension of concessions." Both the U.S. and the EU included invariably products with political significance.

So far carousel sanctions have not been used on or by China, but if so, they would constitute an escalation. For companies with globalised supply and distribution chains, this would add significant risk to existing operations.

Trade is the lifeblood of the global economy, but it also carries risk. If companies find themselves caught in trade disputes, then they should engage in proactive programs to defend the integrity of their operations and their reputations.

2 U.S. against Chinese solar cells

Endangering the future of solar power in the U.S.

Background:

On December 2, the U.S. International Trade Commission (ITC) voted unanimously to move forward on a full investigation of China's solar exports to the U.S., following from a dumping complaint made by the **Coalition of American Solar Manufacturers**, led by Solar-World and six unnamed companies.

Case Details:

- Plans to create a tariff endangers the creation of vital solar infrastructure, including projects worth between \$11 and \$60 billion

- U.S. had well over \$1.5 billion in solar exports to China, with net exports to China of some \$400 million and argue that retaliatory Chinese tariffs "could devastate the many American-owned companies exporting solar products to China and cause thousands more American jobs to be lost."

- Solar-World represents an industry segment that creates only 2-3% of our solar industry jobs.

Analysis: An Own Goal?

While the Coalition and its members worried about their market share, they stand to endanger possibly the progress of solar energy expansion in the U.S. and China.

3 Asia Trade Watch: your trade reference –

www.AsiaTradeWatch.com

Produced by North Head, *Asia Trade Watch* acts as a compendium and reference source of trade relations between the dynamic emerging markets of Asia and the developed markets of North America, Europe and Australia.

Key features of the site include:

- Trade cases of **six major economies** of the region: China, India, Korea, Indonesia, Thailand and Vietnam

- A database of approximately **550 anti-dumping and countervailing duties cases**
- Regular news updates of trade and investment issues, involving WTO, regional and bilateral developments
- A trade news database containing over 4,000 links to relevant news sources
- Detailed **analysis of cases** that are either high profile, act as precedents or have particularly adverse effects on bilateral relations
- **Editorials from renown experts** on trade and investment to give Asian

perspectives, complementing those from the West

- **Comment forums** for discussion about specific cases and trade issues

Features: Most trade disputes, especially anti-dumping cases, are the result of pressure from interest groups. Competitive issues, defense of the status quo and local politics are normally at their core.

In the name of greater transparency Asia Trade Watch's mission is to peel back the layers shrouding high-profile cases showing who are the true players and interests promoting these cases, analyzing their details and implications.

North Head has a history of providing public affairs services to companies with trade cases in Washington D.C., Brussels and Canberra, involving China and other Asian countries.

Commercial Disputes and Litigation

Managing disputes as a foreign company can be very sensitive at the best of times. In China, there is a litany of foreign companies, finding themselves in public disputes with Chinese competitors and, subsequently, seeing their operations badly suffer. Danone, Schneider Electric and ConocoPhillips, just to name a few, have all experienced very public disputes in past years.

The basis of such disputes and litigation are many and various, most driven by competitive pressures, though IPR and breakdown of working relationships within joint ventures (JV) are also common.



In addition to the courts in China, and the U.S. or Europe, the battlegrounds of these suits and counter-suits are in the media, traditional and on-line, government agencies, employees, and especially business customers, suppliers and distributors.

Nationalist appeals and arguments are typically cornerstones of the opponents' campaigns.

Yet, a number of multinationals have weathered these experiences successfully, including the Israeli technology company Siano.

Planning and Co-ordination

It goes without saying that an effective public communications strategy must be coordinated with the legal strategy, sensitive to the concerns of in-house and outside counsel, developing communications strategies that support and enhance the company's legal strategy.

Principally, management wants an outcome whereby it is free to continue unfettered business operations in China. It may or may not be prepared to reach an accommodation out of court.

Accordingly, in addition to the direct support of the litigations themselves, there are invariably requirements for communications, neutralizing the attacks of the other parties and positive reputation building for the corporate brand.

It is a specialty of translating the confusing and complicated elements of legal arguments into messages that are heard, understood and remembered outside the courtroom.

In China, it is often wise for messaging to remain nonaggressive. Balancing the adversarial American legal and communications cultures with the more conflict-avoiding style of China requires astute and precise planning. Managements in China are often challenged by corporate headquarters for soft-pedaling and lacking focus.

Campaign Implementation

External timings are factors for campaigns that require careful coordination for media interest and external outreach. Legal cases have their own dates for initial hearings, preliminary judgments and so on. Meanwhile, the rhythm of a hectic business schedule continues, and business relationships need to be maintained with customers and partners. Thirdly, for

building reputation, it is important to use pre-programmed conferences and trade fairs.

In addition to accepted processes for media relations, government affairs and customer outreach, other notable elements of litigation or dispute campaigns include:

- Given time limitations of litigation, a rigorous prioritization of stakeholders among the government, industry associations, business partners/customers and media.
- Activating a business intelligence early warning system via daily alerts and periodic analysis reports, updates of competitors, customers, government and media. Perception audits are especially useful for examining opinion leaders' attitudes and then calibrating messaging and tactics.
- A series of briefings for managements in China and the headquarters bringing nuanced political and cultural details to the attention of executives, so building cohesion and rapid decision-making systems. Third-parties can so assist in lowering tensions and building trust.
- The establishment of an advocacy group of influencers drawn from associations, academia, influential journalists, customers and current and former government officials is an important tactic. They provide third party endorsement and advocacy with stronger credibility.
- Speaking opportunities should be sought and delivered at industry forums. These, coupled with high-level media interviews, are platforms to publicize to broader audiences thought leadership, commitment and success.

About Us

North Head is a strategic communications and public affairs consultancy with a clear China focus. It specializes in partnering with multinational companies operating in this dynamic but challenging market, and supporting Chinese companies extending their reach globally. To receive future issues of *China Reflections*, please send an email to info@northheadcomms.com