

# Managing China Risk in a Changed Business Ecosystem



**Savvy international executives are fully capable of planning, structuring, building, operating and growing businesses. But few CXOs are trained to protect an enterprise against a predatory business environment in which regulators and partners alike are gaming the system.**

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Cartoonist David Horsey earlier this year created an image of an anxious Uncle Sam asking a fortune teller, "Can you tell me about my future?" She responds: "Hmm ... I would, but I can't read Chinese."

The fortune teller's words are relevant to every executive of a multinational company or a small or medium enterprise. The re-emergence and convergence of the mainland and Taiwan have transformed the world's economy and delivered decades of growth and profit. Delivering reliable collaborations with partners from Greater China is the critical responsibility of every executive seeking to secure their company's future.

Private-sector businesses all have one common goal: finding safe ways to create successful partnerships while reducing risk. But they pursue this goal in a rapidly changing and increasingly corrupt business ecosystem. The metastasizing ethical confidence crisis in China is glaringly apparent even in the declining air, water and food quality. The ability of the chief "X" officer (CXO) to manage the trust deficit is the difference between success and failure in China, with potentially global implications.

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to protect an enterprise against a predatory business environment in which regulators and partners alike are gaming the system.

All international companies operating in China face the following corruption threats:

- Corruption eroding supply chain (sales and procurement) integrity.
- Corrosive temptations threatening senior management cohesion and reliability.
- Irregular governmental discretion when seeking regulatory permits, licenses or approvals with limited avenues of redress.
- "Structural transformation" issues, to quote Premier Li Keqiang, including discriminatory market access and local protectionism, even 12 years after accession to the World Trade Organization.
- Theft of intellectual property, trade secrets and know-how.
- Predatory practices targeting key personnel that threaten enterprise competitiveness and viability.

Four decades after the opening of the mainland, "doing business in China" for all CXOs has become "how to protect a China business".

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of failure is high. Global headlines throughout 2011 about more than 50 China-based companies being delisted on international exchanges, and of the associated torrent of class-action lawsuits, should make every CXO take pause. Each of these disastrous cases happened despite some of the world's largest and most prestigious foreign accounting, investment banking and law firms applying time-tested Western methodologies. So what went wrong?

Western-style due diligence focuses on verifying documents related to past events based on a standard checklist. But effective China due diligence requires verifying facts in the context of a complex, rapidly changing society and business culture to ensure trust is properly placed in a management team and in business systems that will successfully and ethically overcome the corruption challenges that every business in China inevitably faces. Applying familiar Western "business as usual" paradigms will not be enough to navigate this changing landscape successfully. Winners in China will master this basic reality.

China's economy this year is decelerating to 7.5 per cent growth in gross domestic product, its lowest in 14 years. The leadership has just changed. The government will detail sharp policy changes in November that will include a free-trade regime in Shanghai and throwback rectification campaigns. The state-owned enterprise's societal role and aspects of the social contract will change.

Successful CXOs will seek locally grounded, globally aware advisers with deep China connections to develop and implement strategies and procedures that can be constantly refreshed to face the ever-changing Chinese context. In this

way, wise CXOs can enhance the probability of success and reduce the chance of becoming another "China roadkill" news story.

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