TRUST AND TRANSPARENCY REPORT

- How Swedish SMEs in China handle political and legislative challenges
TIGHTENING CONTROL BUT A MORE TRANSPARENT AND EFFICIENT ADMINISTRATION: SWEDISH SMEs’ OPINION ON BUSINESS CLIMATE AND TRUST AND TRANSPARENCY IN CHINA

The 19th Party Congress in October of 2017 saw the leadership of the Chinese Communist Party declare their ambitions for how the political and economic influence of China will develop over the coming years. Most foreign observers agree that the tightening of the political control will continue. For many, the development is worrying. Hopes that China would slowly adapt to Western democratic principles, as international trade and exchange increased have proven false. China continues down its own path, in its ambition to create a unique socialist market economic system.

As often is the case with China, the development however is not all black or all white. Many foreign companies are thriving in the country and are experiencing a more effective and market oriented administration. Within many areas the Chinese authorities are perceived to be more open and transparent than ever before.

Against this background, questions of trust and transparency are becoming increasingly important for international companies with operations in China. The challenges of navigating in an environment with a multitude of values, cultures, traditions and political considerations are becoming increasingly complex. This report aims to investigate the regulatory and legislative challenges that Swedish small- and medium-enterprises with operations in China are facing. Seven qualitative interviews have been performed with key individuals from a wide-ranging selection of industries to understand how they experience matters such as corruption, discretionary enforcement of regulations, Chinese business culture and censorship.

The report paints a picture of a China that is developing in what from a western perspective can seem like polar directions. An increasingly ideologic and political society, but with a bureaucracy that better serves market needs. Developments within the legal framework that govern an open and transparent market, but nationalistic tendencies to favor local Chinese companies. A China emerging as a world leader, while simultaneously enforcing even tighter control over all forms of communication between companies and individuals and the outside world.

We would like to extend our gratitude to all the respondents and a special mention to the Swedish Chamber of Commerce in China and their CEO Martin Vercouter who made writing this report possible.

Stockholm, 18 June 2018

Pär Uhlin, Managing Partner, Six Year Plan
EXECUTIVE SUMMARY

- Representatives of Swedish SMEs operating in China are noticing tightening political control and a more ideologic society.
- As a foreign SME operating in China, regulations and legislative framework concerning censorship and control of communications have a negative impact on the efficiency and financial performance of the company.
- The Chinese Government and its authorities have become significantly more efficient with substantially decreased lead times and a lighter bureaucracy.
- Over the past few years corrupt methods have seen a significant decrease in engagements with the Chinese government and authorities, but still prevail in business.
- Despite continued modernization, China’s legal system is still seen as challenging to rely on with many grey areas and local exceptions for interpretation and execution.
- Swedish SMEs are experiencing an uneven playing field where they are being more strictly scrutinized whilst their Chinese counterparts are being favored by the Chinese administration.
- Swedish SMEs believe they are too small to directly influence policy and regulations. The preferred approach is to work through industry organization such as the European Chamber of Commerce or Swedish Chamber of Commerce in China.
- Guanxi is still a central part of doing business in China but representation and the infamous Baijiu culture has decreased.
Context and method

This report has been done against the background of a study performed by The European Chamber of Commerce in China. The Chamber annually publish a Business Confidence Survey that brings together the input of over 500 senior representatives of the Chamber’s member companies and provides an overview of the companies’ performance and outlook within the Chinese market.

What stands out in the results from the 2017 survey is that among the top 5 challenges facing European companies in China, three are regulatory or related to policy. Financially, the respondents of the survey reported an overall improved performance compared to the previous year, but also stated that conducting business in China comes with many difficulties. Moreover, European companies have their doubts regarding China’s true commitment in creating a simplified administrative environment whilst guaranteeing a level playing field. The survey states that the Chamber’s members are doing well within industries that have a degree of freedom to operate within, while others experience an unclear legislative framework, often subject to arbitrary interpretation and burdensome bureaucracy. Furthermore, the survey states that European companies are suffering heavily from regulatory difficulties in China and feel less welcome in China compared to when they entered the market.

In this report, Six Year Plan investigate whether Swedish small and medium-sized enterprises (with a global turnover of less than SEK 250 million) are experiencing the same challenges and difficulties as the companies included in the European Chamber of Commerce’s survey. We also wanted to understand how Swedish SMEs handle trust and transparency issues in China. The hypothesis was that companies within the SME-category are likely to be subjected to these kinds of challenges to an even greater extent than larger actors, with fewer resources to spare for legal and government relations work.

This report is based on seven qualitative interviews conducted by Six Year Plan between February and May 2018 with the Managing Directors or representatives in similar positions at Swedish SMEs operating in China. The companies are active within diverse industries, ranging from strategic consultancy to manufacturing of heavy machinery. The size of the interviewed companies also varied with the number of employees ranging between 4-120. All company names and names of individuals have been anonymized in the report due to the sensitive topics discussed and by request of the interviewees.

”When in a situation that could be deemed as controversial, one should always ask oneself that if a tabloid calls you in the morning and asks you about your dealings last night and you are not able to tell them the whole truth, you should probably reconsider”
Results

The results from the interviews are presented below within the categories of Current affairs, Political climate, Legislation and regulation, Communications and Chinese business climate.

Current Affairs - Business is good but staff retention is a challenge

The Swedish companies interviewed are doing well in China. Despite threats of a trade war between USA and China, increased costs for personnel, rents and increased competition from Chinese actors, business is good. With one exception, made a healthy profit in China last year and most were experiencing substantial growth this year. The interviewees were unable to pin their strong business performance to any specific Chinese circumstances, rather stating it was due to a combination of factors including the positive trend in the world economy. Some of the interviewees had their main clientele in Western markets while others had their main customer base in China.

The companies were fully owned foreign companies with either a WOFE in China or a Chinese branch office. All companies described themselves to maintain a Swedish culture within their Chinese organization, including a flat organizational structure, few ceremonial activities, a feedback culture and employee benefits more generous than what is normal in China. Still, many of the interviewed companies reported difficulties with hiring and retaining staff. It has become increasingly difficult to attract Swedes to China, and even though the talent pool in China is increasing, finding the right candidates is a laborious and arduous task. Moreover all actors interviewed mentioned that the changed system for retaining visas had had affected their operations.

The Political Climate – Worrisome overall development but reforms are so far having a positive impact on business

Following the 19th Party Congress in 2017 and the 13th CPPCC in March 2018, it seems evident that the Chinese Communist Party will continue its tightening of political control. The party is reaffirming its grip on the Chinese society and tensions remain between ambitious market reforms, continued strong support of state ownership and leadership in the economy. In general, the respondents thought that China’s political climate is hardening.

"China is going from an authoritarian to a totalitarian society”

All respondents had monitored China’s political development closely, but the overall agenda of the Chinese government had so far had little negative impact on the businesses themselves, rather the opposite. Several respondents argued that they had seen crucial reforms being implemented over the past years, including China’s war on corruption, that had made it easier to conduct business in the country in line with Western customs and policies. Moreover, many had seen a more agile administrative framework that simplified the engagements with local authorities.

All respondents did however believe that the long-term political direction that China is currently taking will eventually have an impact on their business. Some were already seeing both the benefits and disadvantages of the current administrations priorities. Respondents operating within the ICT industry were experiencing favourable policy changes directly improving the bottom line result, including subsidies thanks to the Chinese leadership supporting the development of IT services.
Others had recently experienced extreme difficulties due to new regulations and policies. Chinese suppliers are raising their prices significantly due to new production methods required to adhere to stricter environmental standards implemented by the Chinese government. One company experienced difficulties in the wake of the anticorruption campaign. Their entire network at a large Chinese authority had recently been removed, and since the authority in question was crucial to their undertakings in China, this meant they had to start over from the beginning with their relationship building efforts.

”We lost all our contacts in a key authority in one day”

No company had any direct contact with the national government in China and none of the companies believed they would be able to influence policy on their own, be it on a national or local level. They argued unanimously that they were simply too small to do so. If they wanted to raise a policy question or try to influence the Chinese governing bodies, they went through a larger cooperative organization or institution such as the European Chamber of Commerce in China, The Swedish Chamber of Commerce in China or the Swedish Embassy.

Legislation and Regulation - Increased efficiency but an uneven playing field

China’s legislative system is perceived as complicated with regulations that are often difficult to interpret. The state apparatus is however becoming increasingly efficient. The majority of respondents pointed out that the Chinese administration’s efficiency has improved over the past couple of years. Lead times have decreased considerably and almost all dealings with both the Chinese government or other authorities have become more efficient.

Furthermore, several respondents pointed out that the way the administration operate has changed. Formerly, one could simply let a third-party handle all the contacts with local authorities, but now the foreign companies have to do it directly themselves.

”Things have become much smoother in China, what used to take six months now take only one”

Even though an increase in the authorities’ and governments’ efficiency had been detected by most of the respondents, there were still other areas where discrepancies existed compared to what they were used to operating under Western laws and regulations.

Several respondents raised concerns regarding an often ambiguous Chinese legal code. They stated that Chinese law often contains grey areas where it is not clear how the legislation or regulation should be interpreted. Judicial precedents are not enforceable in China, and this opens for arbitrary interpretations that often comes down to your personal relationship with the authority or institution that is supposed to uphold a certain legal code.

Moreover, several respondents had witnessed discretionary enforcements of laws and regulations aimed against Western companies, albeit never directed towards any of the interviewed companies.

Several respondents had also seen discretionary treatment in other areas. In recent years, the respondents had seen a rise in the Chinese administrations’ will to actively support their Chinese competitors which has skewed the competitive landscape in China.
Quick questions to the respondents summarized

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<thead>
<tr>
<th>Question</th>
<th>YES</th>
<th>NO</th>
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<tbody>
<tr>
<td>Do you think the political climate in China has worsened over the past year?</td>
<td>7</td>
<td>0</td>
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<tr>
<td>Has the governments’ efficiency increased over the past three years?</td>
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<td>1</td>
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<td>Are you comfortable in storing sensitive information in China?</td>
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<td>5</td>
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<tr>
<td>Do you have access to political decision makers on a national/regional level?</td>
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<td>7</td>
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<td>Have you experienced discretionary enforcements of laws aimed at foreign actors?</td>
<td>7</td>
<td>0</td>
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<tr>
<td>Do you think your Swedish HQ fully understand the challenges you face?</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Have you come across situations where corrupt methods were used?</td>
<td>7</td>
<td>0</td>
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Communications - Censorship and stricter control on the rise

The Great Firewall of China is most certainly impacting Swedish SMEs operating inside the country. All companies that were interviewed were currently using a virtual private network (VPN) to communicate with their headquarters in Sweden, often to get around the firewall, and access sites and digital services that are blocked on the Chinese mainland. Some respondents expressed that VPNs often function poorly and that internet speeds were hampering their overall business performance. Simple tasks like accessing document servers, downloading large files and accessing virtual meetings are becoming increasingly difficult. New regulations introduced in 2017 banned VPNs that are not government approved, but it is still not clear how strictly these rules will be enforced.

Most of the respondents also mentioned that they had seen a worsening situation over the past couple of years in terms of the ability to communicate internally. The Chinese government is tightening its control over how people communicate digitally and this influenced many of the investigated companies. Examples given include Swedish companies often communicating via social networking sites that are not accessible in China and a general worry that all communication is being supervised.

"That fact that we don’t have perfect access to the entire digital sphere is definitely having an effect on our result”

In terms of storing sensitive information in China, the interviews had mixed results. Some of the companies saw no issues in storing, for example, intellectual property in the country, while others had strong policies against this.

Chinese Business Climate – A general lack of confidence in the system persists

Chinese business culture is difficult even for the well established. All investigated companies expressed that their overall level of trust in Chinese business culture had decreased or remained the same over the past year. As a foreign SME in China, it is hardly uncommon to come across situations where bribes or other forms of corrupt methods are used. Not by Chinese officials, but in business-to-business contexts. Huikou, a term used for commission paid to a middle man or facilitator, is still common in China, especially in more rural areas. All investigated companies had strict policies against bribes or similar activities. However, many explained that Guanxi, a central idea in Chinese society that loosely translates to networking, is the only way of doing business in China. Everything is built on personal relationships, and those relationships are best cultivated by showing your appreciation with gifts. The fine line between a bribe and a gift is something that has to be taken into consideration when doing business in China.

All respondents had seen the infamous “Baiju culture” (Baiju being a liquor) disappear over recent years as a result of Xi’s anticorruption campaign. Previously, it was almost required by representatives of foreign companies to drink with their Chinese counterparts or business partners (both in the private and the public sector) as a way to cultivate the business relationship. This type of behaviour has almost come to a complete halt over the past years and had rarely been observed in recent times by the respondents.
CONCLUSIONS

This report has investigated the views of seven Swedish SMEs operating in China through qualitative interviews regarding the Chinese business climate and trust and transparency issues. The companies are noticing the increasing political control exercised by the Chinese government. While the administration has become increasingly efficient, general productivity is being affected by regulations that decreases the companies’ access to communicational infrastructure.

Chinese companies are benefitted by the Chinese government while foreign companies are being subjected to discretionary enforcements of regulations that often are open to interpretation. For foreign actors that have China as their main market, it is becoming increasingly evident that they are operating in an uneven playing field.

The general level of trust among the interviewed companies in the Chinese business climate is very low, and even though corruption within the Chinese administration has decreased substantially corrupt methods still persists in business-to-business situations.

Swedish SMEs feel that they have little to no means of influencing policy relevant to their operations themselves, if they wish to do so, they have to go through a bigger collaborative organization such as the Sweden-China Trade Council in Sweden and the Swedish Chamber of Commerce in China.
Six Year Plan is a business development agency. We help our clients build robust businesses, geared to the challenge of political headwinds and changing customer preferences. We specialise in business development, communications, public affairs and management, helping clients reposition themselves, transform their businesses and enter new markets.

Six Year Plan has offices in Stockholm, Beijing, Shanghai, New Delhi and is the Swedish representative of FIPRA, the leading and most extensive global public affairs consultancy network, advising clients on a range of government relations and regulatory policy issues.