CHINA SIGNPOSTS:

A PRACTICAL GUIDE FOR MULTINATIONALS IN 2022

APCO worldwide®

CONTENTS

China Signposts is an annual guide by APCO Worldwide for executives of multinational companies (MNC) that have significant China interests, whether as a key market for sales, as a critical supplier, or as a source of innovation and competition.

This guide identifies seven issues that will be critical for MNCs to navigate in 2022 and offers global viewpoints from several of APCO's senior advisors.

GLOBAL VIEWPOINTS

ISSUES THAT WILL DEFINE THE OPERATING ENVIRONMENT

GLOBAL VIEWPOINTS

U.S.-China Relations

James McGregor

APCO Greater China Chairman and bestselling author

A New Normal for Business:

The first year of the Biden administration revealed that the Trump era of confrontation was not an anomaly. In 2022, the United States will continue to pressure China on allegations of unfair economic practices and human rights abuses, particularly ahead of the U.S. midterm elections and in the wake of the Beijing Winter Olympics. China and the United States will pressure companies to speak out against their counterparts' most assertive policies. The United States also seeks greater policy coordination with its allies in Europe, the Quad and AUKUS.

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Fraying Links Between HQ and China:

COVID-19 travel restrictions are widening the disconnect between headquarters and China management teams. There are ample opportunities for foreign enterprises to continue growing their China businesses in 2022, but global executives will need to entrust this growth to their on-the-ground leadership teams and strengthen mechanisms to foster corporate cohesion, culture and connection. Corporate leaders must prioritize direct engagement with their China teams to better understand their interpretations of sensitive issues and on-the-ground operating dynamics.

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The Era of Quiet Compliance:

Despite impulses to speak out on topics of social justice and ESG, businesses with a China presence must exercise caution. Compliance with regulations and interactions with public officials in Washington, Brussels or Beijing should be executed without fanfare to avoid inadvertently provoking nationalist reactions and risking reputational and operational challenges.

EU-China Relations

Declan Kelleher

Former Ambassador of Ireland to the People's Republic of China and Permanent Representative of Ireland to the European Union

Nuance in Geopolitics:

Geopolitical uncertainties, the pandemic, fears for the health of the liberal rules-based international order and concerns that the EU should be less vulnerable and more realistic on trade, have led the EU to fashion a more multifaceted and rigorous approach to engagement with China without necessarily containing it. While the EU will undoubtedly seek to work closely with the Biden administration on certain aspects of China policy, the evolving concept of EU "strategic autonomy" will influence the shape of this cooperation. In 2022, whether the EU can manage political and values-based differences with China will determine the scope of defrosting the EU-China Comprehensive Agreement on Investment (CAI). The European Parliament will play a significant role in dictating whether this thaw will occur.

Businesses should keenly track the views of influential member states...

Working with the Grain:

The EU legislative process involves three parties: the Commission, the Council (the member states) and the European Parliament. Some areas, such as trade policy, are the exclusive competence of the Commission, while national authorities have a stronger say in areas such as health, industrial and foreign policy. Businesses should keenly track the views of influential member states and of coalitions of member states on key issues. While EU member states may sometimes have differing opinions on China-related issues, the legal force and influence of agreed EU regulation (the "Brussels effect") need to be factored in by European and non-EU businesses.

Top-down Guidance:

In the sensitive period before the 20th National Communist Party Congress in November, headquarters executives need to be particularly aware of top-down political guidance within China. Evolving policy prescriptions and regulations on economic, social, and environ-mental issues, as well as re-castings of core Party ideology and policy—such as the Common Prosperity agenda—present both challenges and opportunities for business. EU businesses should be mindful of potential challenges to resolving divergent compliance requirements of China on the one hand, and EU and national authorities on the other.

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GLOBAL VIEWPOINTS

UK-China Relations

Richard Burn

Former HM Trade Commissioner for China and HM Trade Commissioner for Europe

Stabilizing the Decline:

While the UK-China relationship has deteriorated from its "golden era," it remains fundamentally stable. The UK government simultaneously shares the concern of the United States, the EU and others on human rights, while also recognizing that a constructive relationship with China is pivotal for trade and investment. While businesses can categorically rule out a return to free trade negotiations in 2022, MNCs may witness the long overdue return of the UK-China Economic & Financial Dialogue (EFD) and the Joint Economic and Trade Committee (JETCO), which has not been held since 2018.

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Managing Vocal Opposition:

Boris Johnson has been the driving force behind a delicate balancing act, but he has been constrained by COVID-19, his own political

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weaknesses and the need to appease a small yet important group of Conservative Party backbench parliamentarians pushing for a more hawkish position towards Beijing. The saga of Chinese interference in UK politics is illustrative of a growing sensitivity and hostility towards China among UK Members of Parliament.

Transparency Is Key:

Businesses involved in critical infrastructure are most at risk of the reporting and investigation requirements under the UK's new National Security and Investment (NSI) Act, though the vast majority of businesses need not worry. But all businesses should expect a greater emphasis on transparency: Chinese businesses on their activities in the UK and British MNCs on their business in China.

Global Trade and Technology Competition

Pamela Passman

Chair of Corporate and Managing Director, New York, and former Deputy General Counsel at Microsoft

The "Decoupling" Dilemma:

Strategic competition between the United States and China over global technology dominance will increase pressure for businesses to "decouple," particularly in areas that are perceived as critical to national security such as data. Multinationals require access to cloud services, interoperable technologies and critical business information across markets to innovate and operate efficiently. Creating artificial walls and data friction is inherently counterproductive to innovation, trade, and growth. In 2022, it will be incumbent upon global companies to work with policymakers to help them understand the practical implications and costs of decoupling.

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Diversifying and De-risking Global Supply Chains:

In 2022, growing pressures to decouple combined with rising expectations for businesses to act on contentious social and climate issues and disruptions caused by COVID-19 require multinationals to reassess and reconfigure their global supply chain. Cost-efficiency should no longer be the leading factor for how companies source or locate their manufacturing. Multinationals need to think about diversifying supply chain risks—whether through "multi-shoring" or building a "plug and play" manufacturing model—depending on whether and what they will sell in China, the United States or third markets. This will help enhance their overall supply chain resilience against headwinds while allowing them to maintain a strong presence in China—fundamental for businesses that want to remain competitive globally.

SIGNPOSTS FOR 2022:

ISSUES THAT WILL DEFINE THE OPERATING ENVIRONMENT

SECURITY & DATA:

DRIVING FORCES BEHIND POLICYMAKING

MNCs must audit themselves to avoid crosscutting national security hotspots—whether political, ideological, economic or technological.

- Security will dominate China's 2022 political agenda ahead of the forthcoming 20th National Communist Party Congress. Ensuring Xi Jinping's unquestioned reappointment as Party Secretary will be the Party's utmost priority.
- MNCs should keep a low profile and focus on compliance with a raft of new laws and regulations, including the Data Security Law and the Personal Information Protection Law, which aim to protect citizens and bring stability to markets.
- Equally, MNCs should not make bold or dramatic moves ahead of the Party Congress and should not anticipate significant new policies related to opening and deregulation in 2022.
- In strategically important sectors, government industrial policy will support and offer subsidies to domestic champions.

Ongoing geopolitical tensions and the upcoming 20th National Communist Party Congress make 2022 a critical year for China. This period of acute political sensitivity is cementing a risk-averse mindset within government to mitigate economic instability. From addressing the risk of food and resource shortages to ensuring control over strategic sectors, all policy decisions will have strategic significance in 2022. Within this environment, MNCs should exercise extreme caution when deciding how to handle sensitive matters that could intersect with China's long-term interests.

MNCs must prepare for a greater emphasis on cybersecurity and data issues in 2022. Enforcing the privacy-oriented Personal Information Protection Law (PIPL) and the national security-oriented Data Security Law (DSL) is already underway. If not already completed, MNCs should compare their compliance with the EU GDPR in developing mechanisms to adhere to the PIPL. MNCs operating in sensitive areas, including e-commerce, healthcare and automotive sectors, should anticipate increased government scrutiny under the DSL.

MNCs should mind China's long-term focus on "technology self-reliance"—a central pillar of China's national security strategy. Increasing state support for domestic competitors is an irreversible trend; MNCs hoping to grow in China will need to demonstrate how they support China's global competitiveness.

DUAL CIRCULATION:

UPGRADING "IN CHINA, FOR CHINA"

Businesses that double down on their commitments to China, while creating strategic separation from their parent entities, will be most resilient and best placed for growth.

- Chinese economic and industrial policies reinforce the need for self-reliance, but Dual Circulation still requires MNC innovation, expertise and export markets.
- Building more resilient corporate structures should be a priority for 2022. This will include reviewing local partnerships, investments, procurement relationships and product development arrangements.
- Such a review should help accelerate China market growth, insulate global and local operations against geopolitical risks and protect against other external shocks.

One of Beijing's responses to geopolitical friction is to take actions that make China less dependent on the world, but make the world more dependent on China. This "Dual Circulation" strategy seeks to insulate China from the unstable ebbs and flows of the global economy and place its own economic destiny firmly in its own hands.

This strategy seeks to elevate the Chinese consumer to become the bedrock of its economy, empowering domestic companies and enhancing local supply chain resilience. Beijing also wants to reduce dependence on export markets and limit the impact of U.S. and foreign government actions to stymie access to the critical technologies essential to China's development.

While this undoubtedly means greater support for domestic entities, especially Chinese companies in critical sectors, this does not mean foreign companies are unwelcome in China. Instead, Beijing wants foreign businesses to occupy specific roles within the market and contribute to "Dual Circulation."

Regardless of past experience, MNCs need a thorough rethink of what it means to be "in China, for China." Treating China as a "client" for products or a "source" for global markets is no longer enough. Those with market access are increasingly expected to demonstrate how their presence empowers domestic innovation, strengthens domestic supply chains and adheres to social and political priorities. This can be done through value chain partnerships, investments or localizing R&D to develop products for global markets, or "in China for the world."

This will have profound implications for the structure of MNCs. While some are localizing data to ensure compliance and build trust, others already treat China as a second home market—complete with parallel operations and a full value chain. Creating this firewall may protect MNCs from geopolitical turbulence and contradictory orders issued by different national governments.

COMMON PROSPERITY:

EXPANDING THE PIE

MNCs should look for areas of alignment and intersection with the Common Prosperity agenda, a set of long-term goals which aim to address China's socioeconomic inequality and establish a more sustainable socialist development model.

- China's growing middle class is demanding higher quality products and services and pushing back against systemic economic injustices.
- MNCs that employ and serve the needs of underdeveloped regions and underserved populations in China are uniquely poised to secure new opportunities.
- Common prosperity is consistent with decades of Party doctrine and articulates an expectation that all companies—foreign and domestic—increase their commitments to give back to society and encourage CSR, philanthropy and stakeholder capitalism.

While Common Prosperity has been framed as a new initiative, it is merely a new label for a set of long-term goals. It is closely aligned with the Chinese government's other long-standing priorities, such as transitioning from high quantity to high-quality growth, expanding the middle class through poverty alleviation and rural revitalization and promoting social and economic fairness.

Despite misconceptions, Common Prosperity does not discourage businesses and individuals from getting rich. Instead, the government expects the wealthy to inspire and play a greater role in supporting marginalized groups through corporate social responsibility and philanthropic efforts.

The government will adopt a wide range of measures to achieve Common Prosperity. In the short-term, businesses should expect the introduction of new regulations and increased scrutiny in certain sectors—such as technology, real estate and education—to ensure more fair market practices and equal market access for all.

In the medium and long-term, central and local authorities will focus initiatives on ensuring access to basic social welfare such as education and healthcare for low-income groups, particularly in rural and underdeveloped areas. The government is also toying with tax reform—including piloting property tax schemes in certain areas—to facilitate a more equal income distribution. The government may also increase personal income and consumption taxes that will mainly affect high-income groups.

REGULATORY REFORM:

REMOVING BARRIERS TO ACHIEVE ECONOMIC REBALANCING

Beijing's efforts to mitigate near-term financial risks present an opportunity for foreign MNCs, particularly if they can align with the Party's long sought economic restructuring.

- Domestic reforms to promote China's economic stability will create short-term volatility for businesses.
- MNCs with Chinese partners or investments in the internet sector, real estate and other high-risk industries should be alert to potential regulatory spillover into their operations.
- MNCs can continue to find opportunities in critical sectors where China still requires global expertise and knowledge—particularly in financial services, advanced manufacturing and technology.

The focus on maintaining Chinese economic stability means regulatory decisions will be highly surgical in 2022. As a result, measures will focus on stabilizing the real economy while also creating a more robust economy needed in the long-term. MNCs should therefore expect a two-pronged approach: a regulatory tightening in areas considered as "social ills," and a targeted opening-up in sectors in need of a structural economic shift.

The government's scrutiny of monopolistic behavior, especially surrounding data and algorithms, will continue at pace. Reforms are likely to continue in China's financial and capital markets. In light of China's latest property sector crisis, Beijing faces immense pressure to contain systematic financial risk by curbing debt and excessively risky offshore investments, and targeting illicit cross-border transactions.

The need to improve the efficiency of the Chinese financial sector is also pushing Beijing to look outward. Officials seek trusted players that can provide the jolt (and capital) required to not only establish a well-functioning financial system, but also underwrite the critical industries needed for its long-term development goals. Foreign financial institutions may find significant opportunities to deepen their participation in China. These opportunities, however, may also present new risks for MNCs, such as a potential "spillover effect" of a Chinese regulatory crackdown for foreign firms.

TRADE & SUPPLY CHAINS:

CAUGHT IN THE CROSSFIRE

As MNCs navigate the consequences of geopolitical and trade issues, home nation governments and the Chinese government will both increasingly expect extraterritorial compliance—for companies to uphold their own country's values in every jurisdiction where they operate.

- Trade is an increasingly important tool in the geopolitical toolboxes of Western countries as they address allegations against China's human rights practices. Beijing will also use coercive economic measures in response to foreign actions on issues it views as key to China's sovereignty.
- Western countries will not subordinate human rights allegations in China to economic or trade interests. While the Beijing Winter Olympics will be a flashpoint, policymaking in this area will continue throughout 2022.
- MNCs will increasingly be expected to have visibility into their entire supply chain. All companies should already be focused on auditing, diversifying and de-risking.

China's bids for bilateral trade agreements have stalled. Two years after the U.S.-China Phase I Agreement, bilateral trade relations remain poor as China has failed to meet purchasing commitments and the Biden administration maintained or upgraded several Trump-era enforcement actions. Just one year after the EU-China Comprehensive Agreement on Investment (CAI), ratification is on ice aafter China implemented sanctions against EU officials due to their stance on Xinjiang. Chinese coercive economic measures against smaller EU states over Taiwan further complicate its resuscitation in 2022.

As brute force proves less effective in shaping international affairs, countries are increasingly defaulting to wielding their markets and economic influence to encourage strategic rivals to change their behavior.

MNCs will continue to face greater compliance requirements as trade policy and domestic agendas align on human rights. In Washington, the new Uyghur Forced Labor Prevention Act entering into force in mid-2022 will require companies to prove imports from Xinjiang are free from forced labor. While the EU Commission may have postponed the release of its proposed human rights and environmental due diligence directive, some EU member states, such as Germany and the Netherlands, are forging ahead with mandatory due diligence requirements of their own.

Chinese officials will likely balance projections of domestic strength with economic stability. MNCs need to watch for Chinese countermeasures deployed in response to Western government actions on human rights. As these may single out specific industries or companies, headquarters should be in lockstep with in-country leadership to ensure alignment. Establishing and maintaining good working relationships with local officials and regulators where companies have a significant presence is more essential than ever.

COVID-19:

SMALL GLIMMERS OF HOPE

Border restrictions and other COVID measures will frustrate MNCs that operate inside and outside of China, demanding new strategies for coordination between headquarters and local management.

- The political significance of this year for the Party lowers the chance that COVID-19 restrictions will be completely lifted in 2022.
- Headquarters will need to rely more than ever on their in-country presence or local partnerships to run their businesses and supply chains.
- Maintaining trust and managing through the opacity caused by the physical and information divide will become increasingly essential for business and supply chain continuity.

With the Winter Olympics and the 20th National Communist Party Congress taking place in Beijing this year, China is very likely to maintain its zero-COVID-19 policy and impose local lockdowns whenever needed.

This zero-tolerance strategy may chafe against the government's urgent need to reverse slowing economic growth caused by sudden restrictions. The sole silver lining is in manufacturing, where government efforts to preserve economic growth will result in minimizing disruptions to production as much as possible.

In-person engagement with government officials will only be possible for those based in China. MNCs with a strong in-country presence should take advantage of this, empowering local teams to make their presence felt and commitment to China known. Those lacking boots on the ground will need to maintain and refresh alternative strategies and intermediaries, whether finding a reliable partner or investing in relationships virtually where possible.

The ability to move staff in and out of China will remain severely limited in 2022, meaning the ability of MNCs to execute mission-critical business decisions may be delayed. In the absence of details on an upgraded fast track for U.S.-China business travelers and continued uncertainty in China on the Omicron variant, companies will be challenged to strengthen their communication channels to minimize the widening information gaps between China and headquarters. This will prove critical in responding quickly to emergency situations, such as the impact of localized lockdowns, to maintain business continuity and ensure employee well-being.

ENVIRONMENT & ENERGY:

STARTING THE LONG MARCH TOWARDS DECARBONIZATION

Businesses need to assess the resilience of their long-term sustainability plans, stay ahead of a raft of new compliance requirements and seize opportunities which align with Beijing's climate and environmental objectives.

- Heightened environmental compliance pressures and regulatory change require MNCs to closely monitor policies and trends to enable well-informed business decisions.
- Companies should anticipate and proactively adapt to forthcoming changes to minimize business disruption.
- Green development creates business transformation and reputation-building opportunities for MNCs who can bring innovative technical solutions and practices to China.

President Xi Jinping's announcement of China's decarbonization goals casts a long shadow over future environmental policymaking. The emergence of a long-term national framework to oversee decarbonization in the coming decades is instructive of China's ambitious time-lines, and is already being matched by a wave of supportive policies at the central and local levels.

In some parts of Eastern China and areas surrounding Beijing, pollution standards are now higher than similar regulations in Western Europe and North America. While resource constraints caused by global shortages and the transition away from coal may temporarily relax some emissions standards in 2022, the overall trend will move towards stricter standards in the near future. MNCs will need to consider whether their transition plans are future proof to withstand long-term compliance rather than piecemeal investments to meet current standards.

China's sustainable transition also creates opportunities for foreign companies to improve their sustainability performance in China and demonstrate value. Techno-logical innovation will be essential to minimizing the economic impact of this transition and achieving China's long-term environmental objectives.

While the government will likely turn to stimulus to incentivize the green transition, a lack of domestic expertise remains a major barrier. MNCs with a strong sustainability commitment are well positioned to introduce global standards and advanced practices in key areas, such as supply chain management, sustainable consumption, renewable energy, green infrastructure and smart transportation. These contributions can demonstrate commitment to development goals and provide a platform to institutionalize engagement with key stakeholders and industry partners.

ABOUT APCO WORLDWIDE

APCO Worldwide is an advisory and advocacy communications consultancy. We partner with public and private sector organizations to help them catalyze progress, act with agility and build reputations, relationships and solutions that enable success. APCO is an independent and majority women-owned business.

APCO'S GLOBAL CHINA PRACTICE

APCO's Global China Team advises leaders on their China market strategies and supports leading Chinese enterprises as they expand globally. The team includes consultants throughout Europe, the United States and Asia and is part of APCO's trailblazing Geo-Commerce offering, which guides clients whose interests intersect geopolitics and commerce. The Global China Practice complements APCO's strong onshore business in China, which boasts more than 25 years of experience supporting multinational clients on the ground in China from offices in Beijing, Shanghai and Hong Kong.

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