Cultural Norms That Complicate Compliance in China

By Jaclyn Jaeger

China is emerging not just as a massive and powerful economy, but for the companies that do business there, as a huge compliance risk.

China's anti-bribery enforcement, in particular, has grown significantly stronger over the last year, forcing U.S. companies that operate there to consider not just compliance with the U.S. Foreign Corrupt Practices Act, but local Chinese anti-bribery laws. "Businesses seem to be recognizing, rightly so, a culture of greater enforcement by China on anti-bribery and corruption issues," says Randy Stephens, vice president of advisory services at Navex Global.

As a result, U.S. companies have no choice but to understand and respect the cultural differences, and obstacles, that come along with doing business in China in order to reduce their corruption and bribery risks.

1. Tight-knit personal networks

The old expression, "It's not what you know, it's who you know," is far from cliché in Chinese culture. Familism has great influence on business decisions, "particularly since many of China's companies are family-based," says Violet Ho, senior managing director in the Greater China practice at risk consultancy firm Kroll.

"Foreign management may find it hard to penetrate this family circle of trust and secure loyalty, making it challenging to enforce their decisions," explains Ho. "Familism may cause compliance concerns and make it all too easy for management at the China branch to circumvent anti-corruption measures put in place by the head office."

Most Chinese companies also possess tightly-knit networks of informal interpersonal ties and relationships, including those with the Chinese government, known in Chinese culture as *guanxi*, which is a "central idea in Chinese society," Ho adds. "Guanxi for some companies may mean they are more likely than their competitors to be approved for loans, or they may receive relevant licenses sooner rather than later."

"There is still very much an overriding culture of 'us' and 'them' in China, and the 'them' doesn't necessarily have to be non-Chinese," says Louise Kern, managing director of consulting firm GloBIS, which helps companies entering the China market.

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"Chinese companies can still be very focused on just doing business within their own known networks," Kern adds. "If a company is not within their circle of acquaintance, anything is fair game."

Such relationships make it especially challenging for foreign companies to do business in China if they're not part of these networks. "Any personal relationship you can build is hugely important for your business relationship with a Chinese company," says Kern.

Because many relationships in Chinese culture are built on mutual trust and respect, any sort of conflict can pose a threat. A U.S. company coming into the country to investigate potential violations of the FCPA, for example, is never an easy process.

"Americans want to put an issue on the table, have a thoughtful discussion about it, provide facts of both sides, and hope to reach a common understanding and way forth," explains Brian Wilson, a managing director with KPMG's advisory services. "In China, it's very difficult to put issues on the table culturally, because you could be causing the counterparty to lose face."

This can be particularly frustrating for a U.S. company, "especially when you're trying to move fast and trying to get information out of an operating company on exactly what happened, and when," says Wilson. A conflict can be resolved a lot faster by having a local team who understands these cultural differences, he advises.

2. Pro-employee rights

Employee rights are extremely favorable in Chinese culture, making it incredibly difficult to terminate an employee who has engaged in fraud or corruption. "You have to really prove a pattern of misconduct over time," says Wilson.

In addition, even if the employee has engaged in one or two acts of egregious wrongdoing, "that won't be enough to prove intentional misconduct," Wilson says. If a decision is made to terminate an employee, you need to have a robust story and be prepared to defend that story to China's labor bureau if the employee files a termination lawsuit, he says.

3. Widespread collusion

Conflicts of interest, fraud and corruption, embezzlement, and kickbacks are all common practice in China, and "all occur outside the four walls of Chinese companies," says John MacPherson, a director, Control Risks for the Greater China region. "Generally, U.S. companies don't have that depth of understanding to know how to respond to that sort of external environment."

It's not atypical in China for there to be an "elaborate tribe of sales people who are very loyal to each other, and not loyal to the multinational company that they work for," says MacPherson. "They actively collude to set up their own distribution network to achieve personal gain."

Bribes and money laundering paid through marketing agents or travel companies, for example, often are "completely off the books," and often are missed by auditing and compliance programs, MacPherson adds. "It's forcing a lot of companies to have to reevaluate their compliance and audit programs."

Wilson says that means having to do more face-to-face interviews with third parties, as well as potential joint venture partners, to get a better understanding of where revenues are coming from, and going to.

4. Restricted access to corporate information

The ability of U.S. companies to obtain information about domestic Chinese companies from government corporate registration agencies is often very difficult, due to a lack of publicly available information. "Sometimes it depends on what level of access regulators want to give you," says Wilson.

China's State Administration for Industry and Commerce, for example, maintains the official corporate files and corporate information on companies incorporated in China. Such information typically includes a company's name, date of establishment, business address, the names of its shareholders, among other details. "That information today is generally not available in most of the jurisdictions in China," says Wilson.

U.S. companies are finding it "increasingly challenging" to establish a straight line of sight on their third-party business partners, which is forcing them to come up with alternative solutions to their due diligence practices, says Wilson. If a U.S. company wants to do a joint venture with a Chinese company, for example, it may be more effective to obtain information directly from the company itself, whereas in the past such information would have been obtained by a third party, or the proper government agency, he says.

5. Conflicts with compliance directives

For foreign companies operating in China, a common practice is to import their anti-corruption policies and procedures from their developed home markets, and then expect that those standards will be followed without really understanding or appreciating the external operating environment.

"They assume that the Chinese workforce will be able to exercise the same level of judgment that we expect of employees outside of China," MacPherson says. "That's consistently proven to not be the case."

Employees in the local market are stuck balancing between meeting the cultural expectations of the company versus that of the [country's] culture, says Wilson. "There ends up being this disconnect of actual compliance in a local market versus the program's true design," he says.

Most well-established anti-corruption programs, for example, carry out due diligence on third-party partners—such as distributors, deal-brokers or suppliers—where the potential for fraud is high, Ho says. In China, however, "it is necessary to widen the scope of due diligence on third-party relationships to also include advertising agencies, travel agents, or event organizers, which would typically be considered low-risk in most developed markets," she says.

Wilson recommends creating policies and procedures that are conducive to the local employees in that country. That means using "practical examples that are communicated in the local language to local sales force," he says.

"You have to educate your workforce and third parties on the nuances," adds Stephens. "What is acceptable and legal in that country may be something that is contrary to the code of conduct of a U.S.-based company."

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Much of the premise for effectively doing business in China lies in knowing how to adapt to their culture, experts say, rather than relying on them adapting to you. ■

DOING BUSINESS IN CHINA

Foreign companies operating in China can take several steps to mitigate bribery and corruption, while doing business in the country. Violet Ho, senior managing director in the Greater China practice at risk consultancy firm Kroll, offers the following advice:

1. Look carefully at any potential local partner's track record on compliance and ethical conduct. When hiring a local manager, do not assume that strong local expertise negates the need for thorough due diligence.
2. When putting in place anti-corruption measures locally, these will only be of value if managed by a local team put in place by the head office.
3. It's important for someone from U.S. headquarters to visit the local China site regularly rather than relying on a quarterly report from your subsidiary. Sometimes these visits should be done with little advance warning.
4. Build and maintain your own relationships with government regulators and don't just rely on local senior management

—Violet Ho