

# CHINA FOCUS

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## A New Era in Compliance

**A**ll companies have felt the global winds of change when it comes to compliance, with cross-border reporting regulations becoming increasingly stringent. Now, this topic is coming to the forefront, as the government in China cracks down on officials and companies engaging in corrupt practices. While there will be an uncertain period of transition, in the long-run these changes will yield a transparent and fair business environment, beneficial to foreign companies.

Since our inception over 30 years ago, we have advocated clean business practices for ourselves and our clients alike. In this issue of China Focus, we share with you how you can do the same, by introducing you to some of the most important recent reporting changes and giving you some practical tips that will help you avoid damaging situations in the future.



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### Compliance: the Fine Line Between Appreciation, Favours, and Bribes

*Due to the Chinese government's recent efforts to strengthen transparency, compliance is becoming an increasingly important topic for international companies operating in China. China Focus interviews Dr. Richard Zhang, President of Heraeus' Greater China Regional Headquarter on his experiences with compliance in China.*

#### How has the compliance mindset evolved in China?

In the late 80s and early 90s, when international companies first came to China, they had to learn to adjust to the so-called “Chinese way of doing business”. While building up their local organisations, they were confronted with a variety of people coming from many different backgrounds, which inevitably influenced the way they did business. For a long time, foreign companies were testing the waters, realising that anti-corruption laws in China were nowhere near as comprehensive as those they were used to at home. In some cases the laws even left significant room for interpretation!

The two major wakeup calls were the Siemens case in 2006 and the Glaxo Smith Kline case in 2014. The Chinese government started cracking down on corruption, and foreign companies were not exempt. Multinationals realised that not only their global reputation was on the line, but there were also substantial

legal consequences, such as hefty fines and even imprisonment of foreign senior managers.

#### What has been the short-term impact of the anti-corruption drive?

From a business perspective, a major side effect has been that many people in authority have been scared or reluctant to make decisions. A major contributing factor to this is that compliance regulations and their legal consequences are unclear and inconsistent. As a result, it has taken longer to, for example, receive approvals for projects, or issue new licenses, which in turn could potentially hold back investment. In the short term and from a business perspective, this has been a negative consequence of the anti-corruption drive.

With all new policy guidelines, there will be winners and losers. Those who benefit less will try to come up with countermeasures to slow down the implementation of new

policies. This is a significant challenge for China because it is a big country and there is no real federal system for policies.

#### Is this the new status quo in China?

Some take the pessimistic view and say that the current leadership's anti-corruption drive is only a way to rid of political opponents. However, I like to believe that there is true determination to grow a cleaner political structure for the future. The government has made it clear that bad behaviour will no longer be tolerated. This is a clear warning signal to Chinese party members on all different levels, as well as local and foreign companies alike.

#### What is the biggest challenge for foreign companies wanting to implement their compliance strategies in China?

Culture is an important factor when it comes to compliance because it is the context in which all people make decisions in their



Luxurious banquets have always been popular in China

**“Compliance has to be taken in a cultural, social, and economic context. Many companies underestimate this aspect and simply say “this is the Chinese way of doing business.”**

### How Fiducia Can Help



At Fiducia, we have believed in clean business practices since the day we were founded in 1982. We can help you ensure that your business is healthy by:

- ▶ conducting Due Diligence checks on third parties to identify any warning signals.
- ▶ ensuring if your licenses, documents, and registrations are in order.
- ▶ establishing proper financial compliance and reporting procedures.
- ▶ formulating a comprehensive Employee Handbook.
- ▶ aligning your accounting and controlling practises across borders.
- ▶ ensuring individual and corporate tax compliance.
- ▶ recruiting candidates with strong compliance records and understanding

For more information email us today at [contact@fiducia-china.com](mailto:contact@fiducia-china.com)

personal and professional life. Eastern and Western customs are very different, especially in showing appreciation and relationship building. In Asian culture, entertainment and gift giving is part of everyday business and even sometimes the basis of strategic interactions. In the Western world, by contrast, these concepts are treated as separate. Understanding this is one of the biggest challenges for companies who want to implement their global compliance policy in Asia.

Luxury has often been at the centre of business interactions in China, manifested in extravagant gifts or banquets. The country has developed rapidly in the last few decades, but the mentality has remained the same, with more emphasis being placed on material items than activities such as playing golf, which is more popular in longer developed Asian nations such as Japan or Taiwan. As the living standard evolves, business relationships demand even more costly gifts. The real problems arise when people do not observe the fine line between showing appreciation, asking for a favour, and giving a bribe.

#### **How would you evaluate the awareness and attitude of Chinese employees towards compliance issues?**

In my experience, local colleagues in management positions are well aware and fully understand the importance of compliance. But when it comes to middle management and lower (e.g. sales staff, operators, and floor workers), it is more challenging as they tend to not see the bigger picture. Often times, they overstate the importance of personal relationships and understate other factors such as quality and service. Since they interact directly with clients, they consider this decision their prerogative or even as beneficial for the company. For managers, it is a big challenge to keep this kind of behaviour in check.

#### **How do you discourage this behaviour as people move up?**

Good behaviour can be fostered through training, internal whistleblower hotlines, and a positive company culture that reinforces the company's values at every level. To some low level or entry level employees the concept of compliance is just theoretical. For many fresh graduates in entry level positions, the temptation to find a shortcut to get rich is very enticing, especially because the social pressure for buying luxury goods in the modern Chinese society is immense. Furthermore, when successful performance is rewarded with promotions, compliant

behaviour is not a prerequisite. As we get older and more senior, we gather life and work experiences that teach us that there are certain areas we just should not touch. Overall, there seems to be more awareness for this topic due to the number of public cases and scandals, but it still remains a cultural challenge for China.

#### **What are your top tips for international companies on how to enforce a compliance strategy in China?**

In my opinion, compliance should not be left only to the HR and legal departments, but should be on the agenda of all senior executives of a company. People development is a task that all managers must spend time on. While compliance trainings are important, they do not shape employees' behaviour. Every single manager must lead by example and highlight the company's key values: true, long-lasting success doesn't come from kickbacks and entertainment but from good quality products, service, and reputation.

Compliance has to be taken in a cultural, social, and economic context. Many companies underestimate this aspect and simply say “this is the Chinese way of doing business.” But the Chinese way is changing! It will take time to really enforce this but we have already seen positive changes in attitude. As the awareness for compliance issues improves along with the internationalisation of the Chinese business environment, doing clean business in China is possible, but not guaranteed. We have to work at it and with time we will see the results.



Dr. Richard Zhang joined Heraeus Group in 2012 and was appointed as President of the newly-established Regional Headquarters of Heraeus Greater China two years later. Besides his strong leadership

in the Chemical Industry, Dr. Zhang also has profound expertise in compliance and spares no effort in advocating and strengthening compliance in business environments. Dr. Zhang worked in Germany for more than a decade and thereafter continued to work for German companies globally. His multi-cultural background and extensive management experience gives him a unique understanding of compliance across countries and cultures. His latest contribution was one chapter titled “Corporate management as a compliance tool in China” to the recently published book “Compliance Management in China”. ☘

## “Hunt Tigers, Swat Flies”: Compliance Policy Changes

After China underwent its first reform in the 1980s, a window of opportunity opened up for bribery and financial fraud. Three decades later, by 2015, the government has completed over 180,000 investigations and punishments of high- and low- level officials for corruption and abuse of power. In 2014 alone, over 55,000 officials were investigated – a significant 7% increase from the previous year. One thing is clear: the Chinese government is serious in its anti-corruption efforts, a prime example of this being the recent case of former Senior Leader Zhou Yongkang, who was sentenced to life in prison. This sent shockwaves through the country, as now even high ranking party members were no longer immune to scrutiny.

### Status Quo

China still has a long way to go when it comes to eradicating corruption, considering that even after dramatically stepping up efforts, its Corruption Perception Score is still embarrassingly low according to Transparency International. Nonetheless, these reforms have triggered a new awareness for transparency and compliance within the government and business sector. After Premier Li Keqiang announced the government's plan to streamline administration, delegate power and further facilitate market access for foreign companies earlier this year at the Davos World Economic Forum, the State Council took action and issued reform plans for the year 2015. Now, local and international companies alike are subject to more stringent reporting regulations, creating an increasingly fair and transparent playing field and, consequently, new opportunities for foreign firms in China.

### New Systems

As part of this initiative the government launched the Enterprise Credit and Information Disclosure System (ECIDS) in October 2014, for all companies incorporated in Mainland China, replacing the previous annual inspections. This online platform allows the public to access the creditworthiness of these companies and provides transparent and open information submitted by the companies themselves regarding their business scope. Inspections are enforced through a lottery system and if companies are discovered to be noncompliant, they will be added to a blacklist and as a consequence will be restricted or banned from participating

in government procurement programs, land usage rights and tendering processes.

In addition, the Chinese customs administration launched the Interim Measures for Enterprise Credit Management (IMECM) in December 2014 to increase transparency in the customs process, in line with the ECIDS. These new measures replaced the existing Customs Compliance Rating Scheme, reducing customs clearance time and delays in the supply chain for compliant companies.

The State Council is planning to introduce a unified social credit code system to enhance effective management and information sharing. This will replace the current, rather tedious system of companies incorporated in China applying and paying for various codes, including an industrial and commercial registration number, an institutional credit code and a taxpayer identification number when dealing with registration procedures. The government is urging Industrial and commercial departments to introduce this new code system by October 1st, 2015.

**For international companies operating in China, this is a crucial time to ensure compliance with these new policies.**

### Local Preferential Policies

Until now, it has been common practice for local governments to enforce their own preferential policies for specific companies and their investors, especially in the realm of taxation, non-taxed revenue, and fiscal expenditure incentives.

Since this year, the State Council is enforcing investigations of all relevant ministries and local governments on their existing policies. These will be abolished and aligned with state regulations within a transition period of 3 years, in an effort to create a consistent, nation-wide policy system. The government's aim is to prevent such policies that impair market mechanisms, undermine government controls, or may even violate international trade obligations.

For international companies operating in China, this is a crucial time to ensure compliance with these new policies. All companies will have to adjust to and integrate new reporting regulations. The consequences of not doing so could not only have legal consequences for you, but also affect your global business and reputation. Fiducia can help you run a check on your operations, licenses, partners, and reporting to make sure everything is in line with current regulations. Email us at [contact@fiducia-china.com](mailto:contact@fiducia-china.com) to discuss how we can help you. ☎

## Guanxi 关系



Guanxi (or 'relationship') - driven gift giving is an important success factor in Chinese business culture. But even these practices are becoming more and more regulated. While its enforcement is questionable, the Chinese government announced the regulation of gifts from a value of RMB 1,000 or higher. Another rule requires government officials to hand over any gifts they receive from foreign guests that exceed RMB 200.

The challenge for foreign companies will be to find the right balance between guanxi gift-giving and being compliant with the recently established Chinese regulations. Doing business in China will increasingly become a balancing act between cultural adaptation and being compliant with the Chinese anti-corruption policies.



# 5 Tips on How to Be Compliant in China



## Whistleblowers



According to the Chinese authorities, 4 out of 5 major fraud or corruption cases were initiated by a whistleblower allegation. While this is, of course, a positive development, it could also encourage unjust accusations or situations in which a company did not have the opportunity to rectify any issues.

A common alternative to reduce this risk is to establish a neutral third party complaint centre for all employees and parties related to the company. Not only does this increase the satisfaction of employees and partners, but it also provides an opportunity for them to solve their issues internally, indirectly involving senior management before making public allegations.

Fiducia can advise you on how to set up and run a third party complaint centre.

While the Chinese government has been very active in issuing new regulations over the last 12 months, there is still much uncertainty as to how these will be implemented in practice. Here are some compliance tips you can implement to set yourself up for a smooth transition and guard yourself from potential problems.

### 1. Do thorough background checks

Are you sure all third parties you deal with are operating with good compliance standards? It pays to do exhaustive due diligence on any suppliers, customers, or partners, to ensure that they will not be investigated. This is not only important for existing and new contacts, but also when you are acquiring a new asset, such as a company or production site. While your business may be clean and transparent, any third parties you are dealing with could be engaging in illegal behaviour, even if they seem fine on the surface. Hire an external party that can help you run comprehensive background checks on your partners and suppliers.

### 2. Ensure cross-border tax compliance

As business between China and other countries becomes increasingly interlinked, we have seen many people faced with taxation issues and in need for a transparent tax compliance solution for both jurisdictions. A number of new Double Taxation Agreements make these situations increasingly complicated. In addition, the State Administration of Taxation recently published new measures of General Anti-Tax Avoidance, making the procedures related to tax investigations more concrete. Fiducia can act on behalf of you, handling your tax matters and compliance, providing cross-border tax consulting and advisory on expatriate employment arrangements.

### 3. Put proper procedures in place

Every company in China should have an Employee Handbook that clearly outlines the responsibilities of each role within the company. Good corporate governance must

be enforced by all senior managers and not only by the HR and legal department of a company. Fiducia can help you prepare a solid Employee Handbook, in line with China's Labour Law and compliance regulations.

Another essential measure is training your employees to enhance the awareness of compliance issues, anti-corruption guidelines, and procedures for potential investigations. Some international companies may even hire compliance officers to enforce a unified standard across all subsidiaries. Our Executive Search Team can assist you in finding the right employees with comprehensive knowledge of compliance procedures.

### 4. Prevent fraud and corruption

For international companies, it is particularly important to properly identify how compliance can be enforced under different regulatory regimes and cultural backgrounds. In light of past corruption scandals involving MNCs in China, we advise companies to:

- ▶ adapt their growth expectations to the development of the Chinese market.
- ▶ not engage in discretionary spending.
- ▶ audit third party payments especially to industry organisations, affiliate networks, and event organisers.
- ▶ ensure their sales teams are acting compliant in the increasingly price sensitive market.
- ▶ set comprehensive compliance standards and expectations, and react appropriately if problems occur.
- ▶ communicate their compliance standards clearly with partners and distributors.

### 5. Be aware of local differences

For now, compliance investigations still vary from province to province and there is no general rule on what rights and responsibilities companies have. Before there is a unified investigation system in place, we encourage you to work with a partner who fully understands how to navigate these regional differences. ☹

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