



Joe Havely

# Knowing the Risks

*Knowledge and planning key to protecting your assets*

By Joe Havely

**S**taff, information and property are the most valuable assets of any company, but for foreign businesses drawn to China, identifying and minimizing risk to those assets in a fast changing business environment can be a complex issue.

At a panel discussion held in Shanghai on April 21, a wide range of concerns from fraud and counterfeiting to corporate security and staff evacuation were discussed. The discussion was moderated by US Foreign and Commercial Service and Waterstreet Asia, a risk consultancy.

## Business risks in China

“We live in a world where everybody is very euphoric about China, about the China dream and the China opportunity,” said Peter Humphrey,

founder and managing director of risk consultancy ChinaWhys. “But we have to remember that there are risks to balance the rewards.”

He said that companies need to be aware of and plan contingencies for the very real risks of the Chinese business environment. Outsourcing, localization, technology transfer and transfer of know-how are all components in the movement of supply chain operations to China, but they carry significant risk.

Investors that fail to identify, reduce, and manage those risks ultimately put themselves in line for major costs in the future, Humphrey told the gathering.

“Risk touches every single department and function of a company doing business in China,” he said, but few firms have a single executive responsible for overseeing risk. Auditors, security ▶

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### In a nutshell: Risky business

- Outsourcing, localization, technology and knowledge transfers all carry significant risks
- A lack of coordination in risk management can result in wasted efforts and huge losses
- Security can be breached easily when adequate measures and systems are not adopted
- Lack of rigor in the selection process of suppliers
- Failing to make risk management planning an active and ongoing process

◀ departments and legal teams are rarely brought together, making for a lack of coordinated risk management. “For multinational companies operating in this environment it really is essential to have someone sitting at the top of that pyramid,” Humphrey said.

### Apparent and hidden risks

Fellow panelist Daniel Benefield Sourcing & Quality Director of China Golden Source Ltd, said understanding both the apparent and the hidden risks of doing business in China was essential.

The latter includes exposure to counterfeit goods, graft and corruption, design and material substitution, transportation issues and contract misrepresentation – all of which can lead to conflict further down the road. To lower these risks, companies need to go through a rigorous identification and selection process of potential suppliers, he advised.

“Suppliers in China are abundant and will say they can do almost anything for you, but do your due diligence – do a supplier qualification test to see whether they can meet your numbers.”

Fifty percent of relations between Chinese suppliers and foreign firms end up with some kind of dispute, largely because of failures of due diligence in the start-up process, according to Benefield. Issues disputed include late deliveries, product substitution, delivery of the wrong item, or even delivery of items that simply don’t work. Companies selecting suppliers in China should negotiate and thoroughly document all terms, conditions and quality expectations.

Benefield added that factory audits were a key part of the process. Investors need to confirm certifications with their suppliers rather than take them on face value, he warned, as standards documentation such as ISO and CE often simply bought or

borrowed by factory owners.

Another factor to consider was the use of third party consultation services, which can speed up the process and increase understanding. “What you assume you can do may not be able to be done in China,” Benefield said.

### Contingency planning

A key message that emerged from the discussion was that companies conducting business in China should consider risk management planning to be an active and ongoing process. The emergence of last year’s SARS outbreak, for example, demonstrated that the risk environment is constantly evolving; and corporate risk management must evolve too.

“As we all learned during SARS, you can’t make a contingency plan during a crisis,” said panel moderator Tony Motola of WaterStreet Asia.

The infectious disease threat was a particular concern highlighted by Robert Valente, Vice President of US-based health and security firm MedAire. The nature of the SARS outbreak, its dramatic spread, and its impact on medical services in China and its immediate neighbors caused a major rethink of risk management among foreign companies, he said.

“Emerging infectious diseases have the potential of taxing the infrastructures of developing and even developed countries beyond breaking point,”

“Auditors, security departments and legal teams are rarely brought together, making for a lack of coordinated risk management”

Valente told the gathering.

Valente’s company was involved in organizing medical evacuations of foreign personnel during SARS and he noted that as the crisis developed, such procedures became increasingly complex and expensive. When commercial airlines banned suspected SARS cases from their aircraft, for example, the only repatriation option available was air ambulances. Each flight by air ambulance to the US costs around half a million dollars, he said.

In terms of broader health and physical risks, events like the recent chemical gas leak in Chongqing have further raised questions of what action companies and individuals can take ahead of time to minimize risk to staff and business. Of particular concern for companies operating in China is how to interact with local and national authorities in the wake of such events.

Often, businesses think of security only in terms of physical perimeter, intellectual property, and the risks from fire, theft and other losses. But some of these risks are not insurable and involve

the making of effective and active contingency plans. The case of SARS, Valente said, illustrates the need to constantly revise approaches to risk.

## Corporate security

Another panelist, Gregg Doddrell, focused his presentation on corporate security.

Security awareness among Chinese firms is extremely low, he told the meeting, with most having weak or virtually no security. Lax procedures mean walking or breaking into company premises is easy, he said. The lack of data security in terms of document disposal is another potential leak of sensitive information.

But the top concern, Doddrell said, was employees. "Employees are dangerous animals," he said, pointing to the almost carte blanche access many companies give their employees to corporate premises and data. Employees need to be controlled and restricted in what they can do, he said, noting that many companies are simply unaware that there are systems available that allow them to do so.

Employee integrity and the vast problem of fraud was also a point emphasized by ChinaWhys' Peter Humphrey in his presentation.

"Due diligence is not just about looking at balance sheets, it's about looking at people," he said. Having a systematic brand protection program where you protect intellectual assets against abuse, theft and counterfeiting is directly connected to who you employ within your organization, he said.

Issues of fraud, Humphrey told the gathering, took up almost 90 percent of his business time with almost all the recent major cases involving internal collusion between a brand-owner's employees and people outside of the company.

He gave the example of a consumer goods manufacturer where almost every department had at least one employee colluding with a counterfeit syndicate outside the company, run by a former HR director of the very same company.

Once exposed, Humphrey said, investigation of such cases can be extremely costly and rarely result in any prosecutions or jailing. Instead, the major cost is borne by the company itself, which usually suffers months of lost time, money, staff (in the case of mass sackings), lowered morale and a battered reputation.

Overall the broad message from the panel was doing a little work now can save major costs in the future. Companies have a choice between spending a little money now on prevention systems, Humphrey said, or they can spend "a hell of a lot more money" responding to the problem.

Let the businessman beware.

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*Panelists in the discussion were:*

*Peter Humphrey, Founder and Managing Director of ChinaWhys*

*Robert F. Valente, MedAire, Senior Vice-President responsible for global medical and security operations*

*Daniel Benefield, Sourcing & Quality Director of China Golden Source Ltd*

*Gregg Doddrell, Director of Risk Management Services at GRM Shanghai*



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