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By Ben Rowse

Murky Waters: Navigating Business & Politics in Asia

Politics and business intertwine in a unique way in Asia, where state-run economies, crony capitalism and social networks prevail. These three forces are present across the region, though they manifest differently from country to country; understanding their influence is essential for anyone doing business in Asia.

Relationships and reciprocity

In China, society is deeply influenced by guanxi, a Confucian principle that loosely (and inadequately) translates to "connections" and "relationships". Trust and reciprocity are key elements of guanxi, and are facilitated by social networks. The long history of Chinese influence in East and Southeast Asia – and the large ethnically Chinese diaspora in those countries – has firmly embedded the principle of guanxi in other societies throughout the region. These norms apply as much to business interactions as to any other aspect of society, resulting in economies where personal relationships have considerable influence on decision-making.

It can be difficult for outsiders to succeed in the relationship-based economies of Asia, where trust depends upon personal connections in lieu of transparent and reliable processes for functions such as procurement, licensing and dispute resolution. Ambiguity in these processes perpetuates the system, as there is plenty of room for personal discretion and trading favours. It also creates uncertainty and ample opportunity for corruption.

For example, China's nascent securities exchanges are influenced by low-paid civil servants who act as gatekeepers for listings and regulate trading. There are reportedly more than 600 companies waiting to list on the Shanghai and Shenzhen exchanges, whose funding capabilities depend on a small number of well-placed officials. It is perhaps unsurprising that in November 2015 the vice chairman of the China Securities Regulatory Commission was arrested on suspicion of "serious disciplinary violations" – Chinese government language for corruption – as part of a wider purge in the wake of the summer 2015 market crash that wiped $5 trillion from publicly traded securities.

For outsiders the prevalence of guanxi in Asian business can be frustrating. In many cases, it appears to run counter to Western corporate values of merit and transparency. In some instances it may even be incompatible with Western laws and regulations, as JPMorgan recently discovered when its "Sons and Daughters" hiring programme sparked a corruption investigation by the US Department of Justice.[1] Guanxi is a necessary element of business strategy for those operating in the region. However, clear parameters should be set to ensure that the reciprocity it involves does not contravene bribery laws.

State influence

State-centric economies are prevalent across the region, from the communist models of China and Vietnam to the authoritarian ones of Myanmar and Cambodia. Even in more liberalised South Korea, the economy is dominated by a handful of conglomerates (chaebols) that align their strategies with those of the state.

State-owned enterprises ("SOEs") dominate many Asian economies – none more so than China's. There are an estimated 155,000 Chinese SOEs with an aggregate market value of $17.4 trillion. Though their share of the economy has declined over the past decade due to market reforms, the majority of China's largest and most influential companies are still SOEs. The degree of autonomy varies considerably between SOEs, depending largely on the industries in which they operate; the roughly 75,000 Chinese SOEs in "strategic" sectors such as telecommunications and defence are typically subject to overt state intervention. Ascertaining the degree of state influence at an SOE can be difficult, as they are often characterised by opaque governance and decision-making processes.

SOEs tend to enjoy benefits such as cheap credit from state-owned banks, tax breaks and preferential treatment for government procurement. The odds are thereby stacked against privately owned firms – both domestic and foreign – with barriers to entry typically greater for foreign competitors, which are often targets of state protectionism. This not only applies to strategically important sectors, but to any industry in which local governments and their officials have an interest, from real estate to hospitality to manufacturing.

State protectionism may take obvious forms such as barring foreign firms from entering certain industries or withholding permits. Increasingly however, it manifests in more subtle ways. The Chinese government often targets foreign companies for price gouging and violating product quality rules while overlooking wrongdoing by domestic competitors. Wal-Mart was fined nearly $10 million between 2011 and 2014 for pricing and quality issues that the retailer claims could be traced to local manufacturers, which were not held accountable. The state-controlled media also plays a provocative role fomenting discontent with foreign companies, as it did in 2008 when a popular brand of Chinese baby formula was found to contain high levels of melamine, a harmful chemical additive.

For foreign businesses, the state's reach further complicates compliance with anti-corruption laws. In state-centric economies such as China's there are many touch points with government – all the more so as employees of SOEs may be considered government officials under foreign bribery laws. China's own anti-corruption drive poses another risk, as foreign businesses are often targeted first as a signal to domestic counterparts to change their business practices. This was arguably the case when British pharmaceutical company GlaxoSmithKline was fined nearly $500 million for paying kickbacks to doctors to prescribe its drugs.

Cronyism and corruption

Corruption is a problem in many Chinese SOEs and government agencies, but the enormity of the Chinese state ensures that there is some oversight and accountability. As the Communist Party's ongoing corruption purge has repeatedly shown, high-ranking but corrupt officials can only act with impunity for so long before they fall prey to those outside their sphere of influence. This contrasts with several countries in Southeast Asia where a small and unaccountable ruling elite use their unchecked political power to rig the economy to their advantage.

Malaysia's Sarawak region is one such example. It has been under the control of its former chief minister Abdul Taib bin Mahmud and his family for more than 30 years. Over the course of his career as a government official, Taib has accumulated what some estimate to be a $15 billion fortune. Taib is widely believed to have taken substantial kickbacks for commercial transactions, particularly in the forestry sector. Companies in which the Taib family has an interest are major players in the palm oil and forestry sectors, having benefited from special government treatment. Due to this institutionalised corruption, some 80% of the harvestable timber in Sarawak has been logged, much of it illegally.

In Myanmar, two military-owned conglomerates – the Union of Myanmar Economic Holdings ("UMEH") and the Myanmar Economic Corporation ("MEC") – control the country's lucrative gem trade. All major players in the country's multibillion-dollar jade sector have close links to prominent military figures with influence over the allocation of mining concessions and the terms of royalty agreements.

Corrupt governments like those in Sarawak and Myanmar depend upon extensive patronage networks for support, and to quell dissent. Their regulations seem designed to favour certain groups and are ambiguous enough to give government officials maximum latitude in decision-making. Rules are applied and enforced selectively in order to sideline or punish those who fall out of favour.

When business relationships do go sour, resolving disputes in this sort of market can prove difficult, especially for foreign companies. Local partners can use their influence to have goods impounded, visas and licences revoked, and to put up other hurdles. In some cases, a corruptible judiciary may further complicate efforts to salvage a bad investment. These risks can be managed by negotiating contracts that include clauses for international dispute resolution.

For most companies, navigating Asian markets is best done with the help of a local partner who has the necessary connections and an understanding of both local and Western business cultures. A local partner can be a great asset or a significant liability, and finding the right one can be challenging. The selection process should include a thorough due diligence investigation to ensure that a potential partner is both capable and reputable.

1. JPMorgan started the "Sons and Daughters" programme in 2004 to protect its business in China through guanxi with members of the country's ruling elite. Recent reports suggest that the bank hired family members and friends of executives at 75% of the Chinese companies it took public between 2004 and 2013; those included several state-owned enterprises ("SOEs"). If the bank is found to have offered jobs to relatives of government officials in order to win business from SOEs, it could be in violation of the US Foreign Corrupt Practices Act.

About the author

Ben Rowse is a Managing Director and heads the firm's Asia-Pacific practice, which is based in Hong Kong. Ben has lived and worked in Asia since 2000, both in his capacity as a business intelligence specialist and as a senior investigator with international consultancies. He has managed due diligence, litigation support, competitive intelligence, fraud, corruption and asset tracing investigations throughout the region on behalf of financial institutions, law firms and multinationals.

Ben manages the firm's regional staff and travels on behalf of our multinational clients throughout Asia on extremely sensitive matters, including anti-corruption, internal fraud and compliance issues. He specializes in helping clients identify and understand the distinct business, political and cultural risks that they may face when doing business in Asia, particularly with regard to the US Foreign Corrupt Practices Act and the UK Bribery Act.

About our firm

Nardello & Co. is a global investigations firm with experienced professionals handling a broad range of issues including the FCPA/UK Bribery Act and other corruption-related investigations, civil and white collar criminal litigation and arbitration support, asset tracing, strategic intelligence and political risk assessment, computer forensics and reputational due diligence. Our clients include the world's leading law firms and financial institutions, Fortune 500 and FTSE 100 companies, high-net-worth individuals and family offices, governments, NGOs, sports organizations and academic institutions. With offices in New York, London, Washington DC, Atlanta, Hong Kong, Tokyo, Milan and Dubai, Nardello & Co.'s professional staff includes former US federal prosecutors, US and international lawyers, former general counsels of multinational corporations, former law enforcement personnel and intelligence operatives, licensed investigators, research analysts, former journalists, financial crime specialists, forensic accountants and computer forensic experts.

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