



By Nicholas Blank

## Batten Down the Hatches: The “Perfect Storm” for White Collar Crime is About to Hit China

After breaking up a fraud ring inside his US company’s operations in China, “Peter” (as I shall refer to him here) hardly had the chance to draw breath before discovering a separate group of coworkers engaged in the same scheme—faking meal, taxi, and hotel receipts for business travel reimbursement over many months, with losses to the company running into the hundreds of thousands of US dollars. Peter, a US expat who leads his company’s security team in China, described his investigations duties as “a game of Whack-a-Mole.” And “the moles,” he said, “are multiplying.”

Ask any security manager at a Western company with a footprint in mainland China, and they are likely to tell you similar stories of proliferating internal fraud schemes and theft, especially of intellectual property (IP). For those of us in the investigations industry, this comes as no surprise. Corporate theft and fraud, after all, tend to flourish when the economy sags, and China is currently in the midst of a slowdown, the likes of which we have not seen in some 30 years.

Other factors, however, have exacerbated this uptick in corporate crime. A slow exodus of businesses and supply chains out of China, combined with a rise in Chinese nationalism, have created a “perfect storm” of compliance risks confronting multinational corporations operating in mainland China. The attitude of Chinese employees disposed toward misappropriation is, “We’re stealing from America, so that makes it okay.”

Take in any mainland Chinese newspaper or local television news in China these days, and it is easy to see why anti-American sentiment there is deepening. More than a year into the US-China trade war, China’s news media has unleashed a propaganda campaign far exceeding Beijing’s usual America bashing. To be sure, some US news outlets (as well as certain politicians) could be fairly accused of also demonizing China, but in mainland China—where virtually all local news media are state-run—the duration, intensity, and ubiquity of this campaign betrays its roots in the central government. One underlying—but unspoken—message of the propaganda is that it is “okay to get one up on the Americans by stealing their IP or committing some other fraud.” With no end in sight to the trade war and as the overall US-China relationship continues to deteriorate, such thinking is only going to increase.

Further compounding matters is the migration of manufacturing from China to places like Southeast Asia, India, and Taiwan. Although it is early days, this dislocation—not just of whole supply chains but also a growing number of multinationals that were once sweet on China—will likely further incentivize some Chinese companies to engage in questionable behavior while they still can. Expect incidents of outsourcing work to unauthorized third parties, IP infringement, and the switching out of prescribed materials with substandard substitutes to increase.

Similarly, local employees of Western companies who see themselves as vulnerable to layoffs as those companies downsize their operations in mainland China are more likely to engage in internal fraud or IP theft than employees who expect to stick around.

But this is not to say that only US companies are at risk. Chinese citizens and businesses themselves seem to be falling victim in greater numbers to white collar crime in China. In July 2019, for example, Chinese regulators suspended dozens of bond and initial public offerings by companies on the Shanghai and Shenzhen bourses, after discovering that the auditor that had audited the companies, Ruihua Certified Public Accountants—China’s second biggest audit firm—had signed off on fake books belonging to other publicly-traded Chinese corporations. When those corporations defaulted on an array of debts, the knock-on effects for China’s shadow banking system were significant, with losses reaching billions of US dollars for local investors. According to local media reports, embezzlement and fictitious sales had triggered the defaults.

For corporate investigators, security managers, and auditors in the Asia-Pacific region, such developments are a bellwether suggesting that a rare confluence of systemic factors—from an alarming deterioration in Sino-American relations and China’s historic economic downturn, to tectonic shifts in the global supply chain—are turbocharging the already prevalent problem of corporate theft and fraud in China. Multinationals with exposure to the Middle Kingdom must prepare accordingly.

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