A question of trust

For companies doing business across borders, the politics of globalisation can be a serious obstacle

Last April A retooled assembly line complete with 120 new robots at Ford's sprawling factory on the outskirts of São Paulo started churning out sporty redesigned Fiesta hatchbacks. By July Ford's Brazilian output was 30% up on a year earlier, thanks in part to the Fiesta's popularity and in part to an unexpected protectionist move by Brazil.

Companies such as Ford had been importing cars into Brazil from Mexico at a lower tariff under an agreement between Mexico and Mercosur, a Latin American trade block. But in March 2012 Brazil, fretting over a surge of imports, negotiated a quota on purchases from Mexico. Ford's Brazilian production is up partly because planned imports from Mexico are down.

"The trade-agreement change with Mexico happened very quickly and the timing caught us by surprise," says Steven Armstrong, president of Ford Brazil. Later in the year the government introduced the Inovar-Auto programme under which imported cars attract higher taxes unless the manufacturer meets local-content requirements for innovation and engineering as well as fuel-efficiency targets. Ford, which has a design centre in Brazil, expects to hit those targets. Nonetheless, it must now spend considerable time and effort tracking the local content throughout its operations to satisfy government audits.

Multinational enterprises have always been subject to the political idiosyncrasies of their host countries, and have learned to live with them. The restrictions that have appeared in the past five years have not made them any less multinational, but have forced them to respond more rapidly. For Mr Armstrong, that is the price of doing business in a dynamic market such as Brazil's. "Exchange rates move rapidly and governments tend to negotiate regularly and quickly around trade agreements. That's part of my job, and my team's job: to figure out ways to be nimble and flexible, to adjust to that."

Ford can cope. Back in 2006 it had begun to consolidate its range of models (many of which were specific to particular markets) into a few global platforms, which meant assembling and selling the same cars in Europe, the Americas and Asia. That allows it to shift production more easily from one market to another if quotas, tariffs or other rules change.

Small is problematic

But whereas large companies have the resources to respond to shifting requirements, smaller companies find it much harder to adjust. MiTek, for instance, a manufacturer of audio equipment based mainly in Arizona, with a staff of 500, does not enjoy tariff-free treatment for its output, but it often finds itself competing with products that do (under the Information Technology Agreement). Currently it sells a small portable Bluetooth speaker for $49 in America, but in China the price tag would be $100 because of tariffs and other costs, and customers would not pay that much for an accessory to a $400 tablet, says John Ivey, MiTek's vice-president of sales and marketing. Only premium brands can command such mark-ups.

The company could make the speaker in China, but that would double development, certification and marketing costs, which for a small production run would be prohibitive. "If we could just sell our traditional American product there, none of that would be necessary," says Mr Ivey. But unless and until China agrees to include audio products in a new Information Technology Agreement, that solution is probably out of reach.

Few markets present foreign companies with as many challenges as China does. When the country lowered barriers to imports and investment around the time of its accession to the WTO in 2001, virtually every big multinational that was not already in China started to pile in, but since then many have had second thoughts. In a recent survey of its members, the US-China Business Council found that only 39% were optimistic about business in China over the

next five years, down from 58% in 2011. Some of this disenchantment is due to the slowdown in the economy, but most of it stems from political barriers to growth.

Starting around 2008, the pace of reform in China stalled noticeably and Western companies often found their plans frustrated by rules that seemed designed to give Chinese competitors a head start. In critical sectors Western companies were limited to working with joint-venture partners with which they often found themselves competing later on. Forced technology transfer, intellectual-property theft and cybercrime have all reduced the allure of the Chinese market.

Financial services have been a particular disappointment. Foreign insurance companies had hoped for a sizable chunk of China's business, but last year their share of the life-insurance market was under 5%, lower than in 2007, according to PWC, a consultancy.

China classifies foreign investment as encouraged, restricted or prohibited, depending on the sector. In the past five years the list of prohibited and restricted sectors has changed but not shrunk much. Many of the fastest-growing technology sectors, such as internet businesses and cloud-computing services, are on the restricted list, requiring joint ventures. This poses problems not only for foreign companies but for their customers too. More than 70% of companies surveyed by the American Chamber of Commerce in China said they would not store their data on a server owned by a Chinese company.

The fate of globalisation rests on whether America, China and the rest of the world see open borders as being in their national interest

In July China and America agreed to restart long-dormant negotiations on a bilateral investment treaty. Importantly, China agreed to do so without conditions, meaning it would consider according national treatment to foreign investors at the "pre-establishment" phase, before they had entered China. Rather than specifying which sectors foreign investors can enter, China would create a less restrictive "negative list" of sectors from which they are barred. Last month Li Keqiang, the Chinese premier, said a negative list may also be used in the soon-to-open Shanghai Free Trade Zone.

Yet against those encouraging signs from on high, a darker reality has unfolded at ground level. Chinese regulators and media have launched a number of high-profile investigations of Western companies: GlaxoSmithKline for allegedly bribing doctors to use its medicines; Mead Johnson, Danone and Nestlé for allegedly fixing the price of baby formula; Yum! Brands (the parent of KFC, a purveyor of fried chicken) for the use of antibiotics in its meat. Even for companies that are never charged, mere investigations or allegations can devastate sales.

According to Gregory Gilligan, the American Chamber's chairman, "companies should not approach these things as a commercial issue." They often reflect political priorities rather than impartial enforcement of consumer-protection or competition laws. It is not clear whether the Chinese government is singling out Western companies as a covert form of support for domestic firms. Many Chinese companies have also been targeted, but they are smaller and attract less attention.

It works both ways

Chinese companies, for their part, complain of problems they encounter in Western markets, many of them to do with national-security concerns. Huawei was blocked from buying America's 3Com in 2008; from acquiring assets of 3Leaf Systems, a defunct internet company, in 2011; and from bidding for a share in Australia's national broadband network earlier this year. Also this year, America's Congress prohibited the federal government from buying information-technology gear "produced, manufactured or assembled" by entities "owned, directed or subsidised by the People's Republic of China".

When Shanghui International, a Chinese food company, bid for America's Smithfield Foods, senators urged the administration's foreign-acquisitions watchdog, the Committee on Foreign

Investment in the United States (CFIUS), to treat the food supply as “critical infrastructure” in considering the security implications of the takeover. That, in turn, raised nationalist hackles in China.

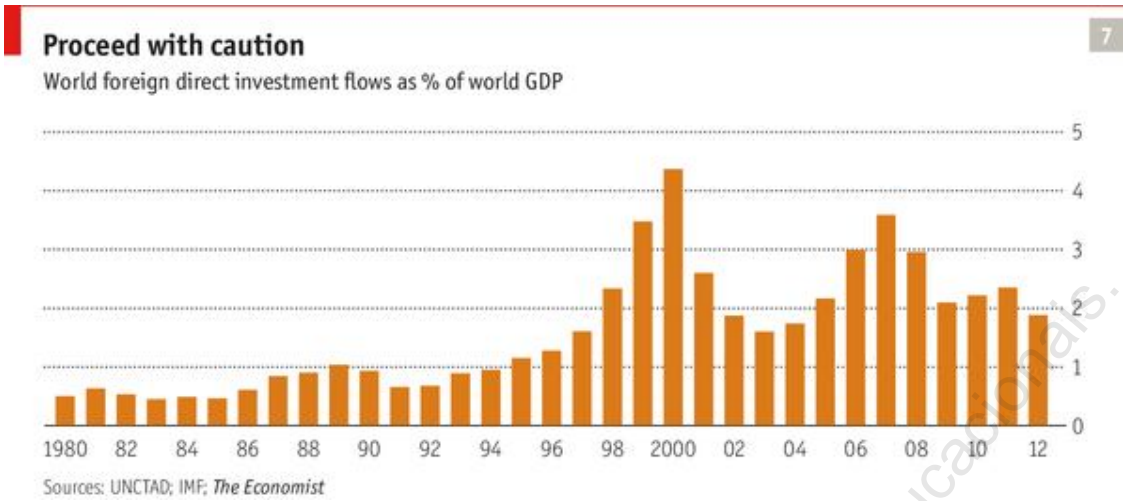
Ultimately CFIUS did approve the Smithfield takeover. Yu Qiao, an economist at Tsinghua University in Beijing, notes that America has also permitted several takeovers in the energy sector. Chinese companies, he says, need to learn that doing business in the United States is not the same as in Africa and Latin America, where large deals are often done government-to-government. “Maybe telecommunications isn’t sensitive in Africa, but it is in mature countries,” he says. John Frisbie, head of the US-China Business Council, reckons that as Chinese companies invest more abroad, foreign companies’ rights in China might be strengthened.

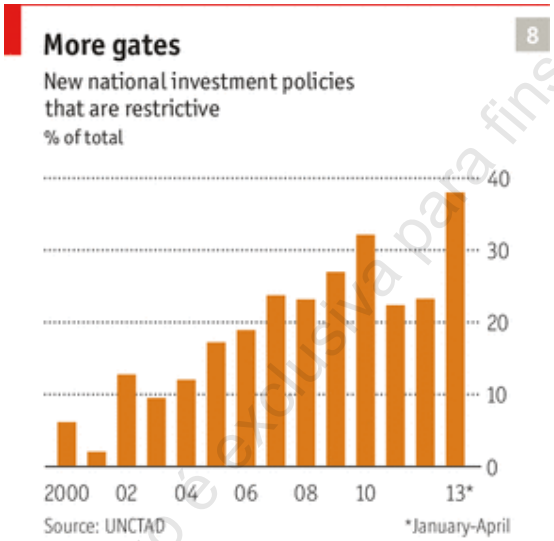
Security concerns are not confined to Chinese companies: other countries, too, often suspect American technology companies of acting as electronic conduits for America’s spy agencies. That is particularly true for companies offering cloud computing services which host customers’ data so that they are easily accessible from anywhere. Some foreign customers worry that the Patriot act, passed in 2001 and renewed in 2011, could compel data providers based in America to hand over information on foreign customers to American security services. Those concerns have grown since revelations by a former federal contractor, Edward Snowden, that America’s spy agency was eavesdropping on electronic conversations in other countries on a massive scale.

France has invested in two domestic cloud computing companies, Cloudwatt and Numergy, with the express purpose of enabling its companies and its government to keep their data in French hands on French soil. Fleur Pellerin, France’s minister for small business and innovation, said the Snowden revelations raised the importance of having data centres on French territory to ensure the security of national data.

Such sensitivities mean that aspiring foreign cloud-service providers need to tread carefully. Nnamdi Orakwue, head of cloud computing at Dell, says that although having a single data centre in America might be the most efficient way for his company to provide services around the world, it might run counter to local “mores, cultures inside industries, customer preference or industry standards”. So when Dell markets its public cloud-computing equipment and services abroad, it works with local partners who know their way around such contentious issues. In France its partner is Quadria, an information-technology consultancy. French customers “want Dell equipment, they want Dell’s stamp of approval,” says Mr Orakwue. But Quadria deals with the local authorities and anything else that raises French sensitivities. “We don’t get in the middle of that. They view them as a French company.”

Navigating such foreign sensitivities will be part of multinational executives’ job description and a source of income to local lawyers, consultants, fixers and lobbyists for years to come. Ultimately, though, companies are at the mercy of other countries’ policy priorities. The fate of globalisation rests on whether America, China and the rest of the world see open borders as being in their national interest.





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