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Corruption/fraud ranked as one of the most serious business challenges in China: Survey

Healthcare, energy sectors most vulnerable to corruption and fraud

Intellectual property infringement and labour disputes identified as serious hindrances

Shanghai, 27 February 2012 – Corruption/fraud is ranked amongst the top five most serious business challenges for American companies operating in China, according to the “China Business Report 2011-2012” jointly released this month by Control Risks, a global business risk consultancy, and the American Chamber of Commerce in Shanghai (AmCham Shanghai). This year’s report polled 315 American companies, of which 80 per cent have been operating in China for more than five years and 50 per cent for more than a decade.

Sixty-one per cent of respondents cited corruption and fraud to be a hindrance to their business operations, with 13 per cent saying that these are serious obstacles to their operations and profitability. The most common types of corruption reported were kickbacks to customers (38 per cent), followed by employee fraud (24 per cent) and government tenders (21 per cent). Moreover, 12 per cent of companies indicated that corruption and fraud had worsened in 2011 as compared to 2010. Corruption was seen as most serious in the central region and deteriorating in the North-eastern part of China.

Across the industries, the healthcare and energy sectors reported the highest incidence of corruption and fraud, with healthcare showing marked worsening in corruption and fraud (29% reporting deterioration, by far the worst of any industry). By contrast, the auto and consumer good sectors view corruption to be less of an issue. Respondents said that the increased prevalence of corruption and fraud in the healthcare and energy sectors was due to the rapid growth of the industries, outstripping the authorities’ ability to regulate them effectively.

“This year’s findings provide a reason for both optimism and concern,” said Kent Kedl, Managing Director of China and North Asia for Control Risks. “While many firms continue to place strategic importance to their China operations, the overall incidence of corruption and fraud has risen and these pose significant financial and reputational risks to organisations who are seeking greater exposure in what is increasingly viewed as a mature market rather than an emerging economy.”

Developing the necessary culture and controls to curtail fraud and corruption will be one of the key challenges going forward for businesses. According to the survey, only 30 per cent of the companies said that it is more important to comply with international regulations, such as the Foreign Corrupt Practices Act and UK Bribery Act,

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as well as benchmark their practices against these standards, in comparison to compliance with local laws or a company's code of conduct.

Adds Mr. Kedl, "If you look at the preponderance of incidences in the last year, companies seem unprepared to deal effectively with fraud and corruption even though they have prioritised compliance on their business agenda. There is a clear need to train senior management, agents, vendors and foreign employees to be compliant with international laws and at the same time, undertake rigorous due diligence before hiring these parties to avoid reputational and financial damage."

Notwithstanding heightened efforts by the Chinese authorities to curb intellectual property rights (IPR) violations, companies saw little improvement in IPR protection in 2011. More than half of the respondents (54 per cent) consider IPR infringement to be a hindrance to their business, ranking sixth amongst their top business challenges, and 10 per cent said that infringements have worsened as compared to the previous year. Of concern to companies are the uneven application and enforcement of IPR regulations across Chinese cities and this appears to have stalled progress in IPR protection in the last year.

The survey also identified labour and business disputes as a source of concern, with 10 per cent of companies indicating that these disputes pose serious hindrances to the growth of their business. Business disputes were somewhat more likely to have worsened in less developed inland areas of China, but they were of greater concern to larger operations on the East coast. Particularly when the legal and regulatory framework in China has not matured in tandem with the growth of the market, companies looking to minimise the occurrence of business disputes must perform thorough background checks of individuals or companies prior to any investment.

Labour disputes, on the other hand, were of greatest concern in the Yangtze River Delta and the Pearl River Delta. Although of lesser concern to other areas, labour disputes in Central, Northeast, and Northwest China were reported to have worsened at similar rates. Comparing labour unrest across different industries, it appears that the consumer goods, automobile and electronic sectors were most affected. This was caused by a number of factors such as restructuring and layoffs from slowing export growth, the appreciation of the *yuan* and accompanying squeeze on margins, and greater awareness of employee rights.

Mr Kedl concludes: "The foremost priority for foreign companies looking to use China as their key export base is to get their labour issues right. Factoring in labour risks during the stakeholder risk assessment process and planning contingencies around protests and other disputes would ensure minimal disruptions to their businesses. The ones who get these issues right are those that will reap the greatest rewards out of this market."

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The AmCham Shanghai China Business Report 2011-2012 includes a detailed analysis of the key business challenges facing American organisations in China. To obtain a copy please visit www.amcham-shanghai.org/

About the 2011-2012 China Business Report

The 2011-2012 China Business Report highlights the results of the business climate in China, asking companies to answer topics ranging from corporate structure to company performance and plans for future investment. It also covers business challenges that companies face as the market matures, prices rise and competition increases. The survey was conducted online from mid-November through mid- December 2011 by AmCham Shanghai and Control Risks. A total of 315 companies participated in the anonymous survey, yielding a response rate of 20%.

About Control Risks

Control Risks is a global risk consultancy specialising in political, security and integrity risk. The company enables its clients to understand and manage the risks of operating in complex or hostile environments. Through a unique combination of services, wide geographical reach and by adopting a close partnership approach with clients, Control Risks helps organisations effectively solve their problems and realise new opportunities across the world. www.controlrisks.com

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