Chinese business & finance

Western companies take slow steps towards China 'de-risking'

Most strategies are focusing on ways to insulate China operations rather than reduce them

Yuan Yang in London and **Patricia Nilsson** in Frankfurt 11 HOURS AGO

Western companies are slowly insulating their China operations from the mounting tensions over trade and geopolitics between Beijing and the west, as governments call for increased "de-risking".

The notion, which has replaced the radical "decoupling" as a diplomatic buzzword this year, is a sign that the west is seeking a less antagonistic approach to managing relations with China. But businesses have yet to formulate clear strategies to give it substance, analysts say.

While a small number of companies such as US toymaker Hasbro have announced plans to quit manufacturing in China completely, the vast majority are still weighing their options, which range from partial divestments to delayed spending decisions and ways to make their China operations disruption-proof by having them serve only the Chinese market.

"Europe is still thinking about what de-risking is and how to implement it in practice," said Agathe Demarais, senior policy fellow at the European Council on Foreign Relations. "Over the past year there's been much more private sector talk of localisation strategies as a form of de-risking, but it takes several years for investment to come to fruition."

Beijing's pandemic lockdowns and Moscow's assault on Ukraine have intensified the sense of urgency as western leaders fret about China's dominance of key supply chains, the potential for a clash over Taiwan, and trade hostility between Washington and Beijing. On Monday, EU trade commissioner Valdis Dombrovskis is meeting Chinese officials to discuss the EU's growing trade deficit with China and the EU anti-subsidies investigation into EV imports.

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There are emerging signs of longer-term shifts in production. A report this year by the European Chamber of Commerce in China found that 11 per cent of European businesses surveyed had already reallocated investments out of China, while 22 per cent had decided to or were considering such a shift. For the first time since 2016, less than half of respondents planned to expand their operations in China this year.

The American Chamber of Commerce in China found this year that 12 per cent of US groups surveyed were considering relocating their sourcing outside of China, with another 12 per cent already doing so.

"Most companies have no alternative to China", said Trey McArver at consultancy Trivium China, but "they have to find strategies for operating in an environment of much higher risk".

Apple and Intel have allocated future investments to other countries including India or south-east Asia while maintaining their China plants, in a hedging strategy known as "China plus one".

But the most contemplated strategy is "China for China", whereby China operations are reorganised so that they produce goods only for domestic consumption.

Anglo-Swedish drugmaker AstraZeneca is drawing up plans to spin out its China arm and list it in Hong Kong, partly to insulate it against regulatory moves against foreign

companies. Government procurement guidelines mean state bodies, which include hospitals, must increasingly buy from Chinese brands.

Apple has allocated future investments to other countries including India or south-east Asia while maintaining China plants © Prakash Singh/Bloomberg

“China for China” also involves localising supply chains. German pharmaceutical company Merck said in May it would expand its Chinese supply chains to reduce reliance on raw materials from outside China, particularly the US, which are vulnerable to sanctions.

German machinery association VDMA has found that more than a third of its members are looking for alternative suppliers so they can service both the US and Chinese markets with “neutral” products without Chinese or US components.

Volkswagen, which relies on China for about half its profits, has announced €4bn worth of investment in the country in the past year. The move would give “more autonomy and decision-making powers in China than ever before”, said Beijing-based board member Ralf Brandstätter. The Chinese business was “gradually becoming a second headquarters” for the global group, he added recently.

While the US, Netherlands and Japan have imposed sanctions on exports of high-tech chipmaking equipment to Chinese groups, some Chinese clients want products without foreign-made components in order to future-proof themselves against further measures, according to executives.

French-Italian chipmaker STMicroelectronics in 2021 separated its Chinese sales and marketing functions from the rest of its Asia-Pacific division, along with its payroll, staff management and reporting structures, according to two people familiar with the company.

The decision was partly aimed at making it easier for the company to carve out its China arm should it need to, they said. The reorganisation is designed "to better balance our customer focus and support", STMicroelectronics said.

A focus on local hires had already started during the pandemic, as Beijing's zero-Covid policy prevented multinationals from sending expatriates to their Chinese businesses. For some foreign executives who had been in China for the long haul, making a life there has also become more difficult.

"The anti-foreigner sentiment is the worst in the 30 years I've been in China," said

one European tech executive, who is making plans to leave. "I see constantly this sentiment in the news, in social media comments, when speaking with people and customers. I can't shut my ears to this."

Consultancies such as McKinsey and Boston Consulting Group are among businesses separating their Chinese IT systems. This is a result of increasingly stringent anti-espionage and data protection laws that mean companies require regulatory approval to transfer large amounts of data out of China.

"The "risk" is coming from many directions, said Samm Sacks, an expert on global cyber policy at Yale Law School's Paul Tsai China Center. She cited "uncertainties in Beijing's new data regime but also as a response to US-China tensions as well as Taiwan crisis contingency planning".

The STMicroelectronics NV factory in Muar: the French-Italian chipmaker in 2021 separated its Chinese sales and marketing functions from the rest of its Asia-Pacific division © Ian Teh/Bloomberg

In order to comply with Chinese laws, as well as headquarters’ concerns over data theft, companies have turned towards creating China-specific IT systems — often meaning teams cannot use the same platform to work together across borders.

“China is increasingly treated as a special market, including for hosting of data, exporting of data, and exposure for executives visiting — including the devices they take with them,” said Duncan Clark, head of consultancy BDA China.

“If China is a silo,” added the European tech executive, “it’s much more easy to control what info enters and what leaves: you just need a few doors on the silo to control.”

Additional reporting by Andrew Edgecliffe-Johnson in New York

China and corporate de-risking strategies

Western companies face a range of options when seeking to reduce their dependence on China. Apart from **China for China** and **China plus One**, buzzwords including “nearshoring” and “friendshoring” have become increasingly popular among business executives and policymakers.

Friendshoring is the shifting of production from China to countries that are perceived to be friendlier to the west, or at least geopolitically neutral. While manufacturers in countries such as India and Vietnam are also geographically distant from western markets, they seem less at risk of western sanctions than rivals in

China.

Nearshoring involves bringing production closer to consumers, potentially reducing exposure to supply chain disruptions at sea as well as geopolitical ruptures. Businesses selling to EU consumers could boost production in eastern European manufacturing centres, while US companies could bolster supply chains in Latin America.

Onshoring, often the most secure but also the most costly strategy, involves sourcing goods in the same country where they will be sold or used. This year, for instance, Washington unleashed $53bn in funding for manufacturers to boost US development and production of semiconductors, a critical component in electronic goods.

Oliver Telling in London

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