Key to successful globalization of Chinese enterprises - Managing your global operations in a diverse business environment
Globalization has been driving the growth of China’s outbound investments in recent years. During the past decade, China’s outward FDI has increased eightfold. In 2016, China’s outward FDI rose 25.7% year-on-year to a record high of US$183.2 billion.

However, the voices of protectionism, nativism and populism are getting louder in the West, especially in the favorable destinations for Chinese outbound investment such as the US and Europe. Meanwhile, as Chinese companies expand their footprints along the Belt and Road, complex geopolitical situation, high political risk, and cultural and religious differences also imply non-negligible challenges. Learning how to better manage and overcome these challenges will be a key factor of success.

At EY, our professionals can assist you in navigating the challenges arise from diverse business environment so that you can manage your overseas business with greater flexibility and dynamism.


Foreword

Albert Ng
Chairman, China
Managing Partner, Greater China
Summary

Opportunities always come with risks. As Chinese enterprises' overseas investments grow, we are seeing the emergence of a number of potential risks. When expanding globally, Chinese enterprises are surrounded by ubiquitous challenges such as cultural and linguistic disparity, legal and compliance problems, financial and accounting system differences, and discrepancies in risk assessment. Altogether, these challenges may increase the risks that can fail an investment. Diversity and inclusiveness (D&I) may be leveraged as a foundational tool by enterprises to effectively navigate these challenges, and move ahead on their globalization journey.

D&I are about seeking common ground while respecting differences among individuals. Diversity is about all the differences and inclusiveness is about leveraging these differences to achieve growth and better business results.

Nowadays, the D&I principle is needed in all stages of an overseas investment, from planning, execution to integration. It also embraces the four key aspects in overseas investment: risk and return, legal and compliance, financial and control, and people and culture. Enterprises inevitably have to undertake uncertain risks in overseas markets when seeking returns, but overseas regulatory and compliance environments and the target company’s financial and accounting procedures can differ significantly from the ones in the investor's home country, making it more complicated to the investors.

In addition, how to coordinate employees with diverse cultural backgrounds and value propositions to achieve cooperation and synergies is an arduous but urgent issue for overseas investments and operations management. For instance, generally Chinese employees prefer to undertake more work and get more payment, while western employees prefer work-life balance. Therefore, when the East meets the West and wish for a smooth integration, it is necessary to exercise global sensitivity and a flexible approach to work through and mitigate cross-cultural, working and communication style differences.

An inclusive development or business strategy helps enterprises to better balance risk and return, reduce unexpected cost, and improve productivity and innovation in the complex global environment. Through the principle, the investor can obtain knowledge of the global legal and tax compliance requirements, coordinate different financial systems and accounting standards, efficiently reduce attrition and retain key talent in overseas regions with diverse cultural backgrounds, and eventually improve brand value and achieve success overseas. For Chinese enterprises, D&I enables them to be more competitive with their western counterparts and reach their globalization objectives.

EY, equipped with professionals with different cultures, backgrounds experiences and skillsets, is a global organization with cross-border teams and practices across over 150 countries and territories. By focusing on risk and return, legal and compliance, financial and control, and people and culture, we provide "one-stop" services to Chinese enterprises throughout their different stages of overseas investment, including risk services, IT advisory, performance improvement, assurance, tax and law, financial accounting advisory, and people advisory, etc. Through diversified and professional services, we are dedicated to helping enterprises achieve greater diversity and inclusiveness, address challenges in overseas investment unhurriedly and achieve sustainable growth against the global landscape.

Loletta Chow
Global Leader
China Overseas Investment Network
EY
“The real power of diversity is in the incredible synergies that result when different people and cultures come together united behind a common goal of winning and creating shared value. Extraordinary things truly happen.”

Muhtar Kent
Chairman of the Board, Coca-Cola

“To be the most innovative, you must leverage the best talent. And that talent comes from everywhere.”

Yang Yuanqing
CEO, Lenovo
In recent years, news about Chinese enterprises experiencing challenging situations in overseas investments is familiar. It seems a significant number didn't fully achieve their intentional outcome and incurred considerable financial cost to learn a lesson from these money-consuming deals. In a significant number of cases, Chinese investors didn't pay enough attention to culture integration, which eventually caused a negative impact on the investments. According to a survey on CFOs of Fortune 500 companies, “failure to effectively integrate” is the greatest concern in an M&A transaction; as for the board directors and CFOs of those companies, they think to “achieve culture fit” is the greatest concern during the integration. However, factors like cultural disparity should not only be considered at the integration stage. Many successful entrepreneurs have suggested enterprises embed the D&I approach into all investment stages to realize synergy, and eventually achieve successful overseas investments and global business management.

Integration is critical to deal success

For CFOs of Fortune 500 companies, what single factor is the greatest cause for concern in an M&A transaction? 1

<table>
<thead>
<tr>
<th>Factor</th>
<th>43%</th>
<th>16%</th>
<th>14%</th>
<th>12%</th>
<th>4%</th>
<th>8%</th>
<th>2%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failure to effectively integrate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inaccurate target valuation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Changing regulatory or legislative environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Economic uncertainty</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Insufficient due diligence process</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
<td>5%</td>
<td>15%</td>
<td>2%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improper target identification</td>
<td>2%</td>
<td>4%</td>
<td>8%</td>
<td>12%</td>
<td>14%</td>
<td>16%</td>
<td>43%</td>
</tr>
</tbody>
</table>

Note: Responses might not equal to 100% due to rounding

Culture is critical to the integration

For board of directors and CFOs of Fortune 500 companies, what single risk is the greatest cause for concern during the integration? 1

<table>
<thead>
<tr>
<th>Risk</th>
<th>51%</th>
<th>47%</th>
<th>27%</th>
<th>25%</th>
<th>20%</th>
<th>15%</th>
<th>11%</th>
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<tbody>
<tr>
<td>Achieve Culture Fit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer Retention</td>
<td>32%</td>
<td></td>
<td>20%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Synergy Capture</td>
<td>25%</td>
<td>15%</td>
<td>5%</td>
<td>11%</td>
<td>4%</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Workforce transition</td>
<td>4%</td>
<td>3%</td>
<td>3%</td>
<td>5%</td>
<td>8%</td>
<td>12%</td>
<td>14%</td>
<td>16%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
<td>2%</td>
<td>4%</td>
<td>8%</td>
<td>12%</td>
<td>14%</td>
<td>16%</td>
<td>43%</td>
</tr>
</tbody>
</table>

It has been proved through practice that when enterprises invest in D&I in multiple areas, it is more likely for them to achieve better team collaboration and greater retention, improve their market share and win in new markets. Across industries, research shows that organizations rated highly on D&I report the following results:

- +57% Better Team collaboration
- +19% Greater Retention
- +45% More likely Improve market share
- +70% More likely Success in new markets

Source:
1. Corporate Board Member Magazine Survey, March and April 2013
D&I Dashboard
D&I assist enterprises to achieve growth - the higher level of D&I, the more adapted the enterprises are to the changing global landscape, and they are more likely to gain success in new markets.

**What is Diversity and Inclusiveness (D&I) ?**

**Diversity and Inclusiveness means growth**

Diversity is about all differences. It refers to having different cultures, genders, ethnicities, backgrounds, sexual orientation, religions, etc. respect each other's differences.

Inclusiveness is about leveraging these differences to achieve better business results. It refers to creating an environment where all people feel, and are, valued.

Chinese companies should put more focus on building a diverse and inclusive performance and talent management practice to manage overseas operations with flexibility, embrace diverse workforce and develop inclusive leadership teams. This will enable Chinese companies to compete more effectively with Western companies for the talents they need during their transformation by climbing up along the value chain. An inclusive leadership team with broad experiences and background becomes crucial for Chinese enterprises to address challenges and provide guidance in outbound transactions and achieve sustainable growth in a global landscape.

**How D&I impact your business?**

To lead business inclusively

- Retain key talent and improve attrition
- Minimize unanticipated costs & business disruption
- Increase productivity and level of innovation so to shorten payback period
- Gain in external brand value with increased stakeholder’s confidence

D&I should be embedded into all the stages from planning to integration during overseas investment, and be reflected in the sectors such as risk and return, legal and compliance, financial and control, and people and culture that enterprises pay special attention to in the investment.

Key to successful globalization of Chinese enterprises - Managing your global operations in a diverse business environment / 7
How EY can help?
D&I need to be assessed and embedded into all stages during overseas investments, from planning stage, execution stage and to integration stage.

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</table>

**Key to successful globalization of Chinese enterprises - Managing your global operations in a diverse business environment / 9**
Risk and return
How to better strike a balance between control and autonomy over the overseas operation?
How far is standardization of operations and procedures possible for multi-location companies?
How to integrate all financial and operational data out of different information systems developed by different companies and countries?
How can we possible turn the diversity into better results?

>> Overall framework for outbound investment risk management

Risk averse events

Outbound investment lifecycle

Pre-deal
- Project screening
- Project establishment
- Due diligence
- Feasibility analysis
- Scheme design

In-execution
- Scheme approval
- Contract signing
- Initial closing
- Payment
- Accounting treatment

Post-deal
- Company setup
- Governance structure
- Institutional construction
- Staff management
- Operation management

Integration and synergy

Risk management basic framework

Objective Structure People Policy Instrument

Investment risk management strategies

Outbound investment risks

- Geo-political risk
- Macro-economic risk
- International regulatory risk
- Capital risk
- Financing risk
- Exchange rate risk
- Interest rate risk
- Valuation risk
- Investment decision risk
- Culture conflict risk
- GSHE risk
- Social responsibility risk
- Human resources risk
- Investment team risk
- Contract risk
- Tax risk
- Partner risk
- Financial risk
- Technical risk
- Integration and management risk

Risk Services:
- Outsourcing of internal audit
- Overseas investment risk management
- Corporate governance for multi-location companies
- Post-deal asset performance assessment
- Information system audit
- IT program management and advisory
- Transformation and system integration
- Digital risk management
- Information security

Performance Improvement:
- Supply chain & operations for globalized business
- Finance management of the overseas entities

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Have you identified the legal compliance requirements in the global landscape and did you have the detailed knowledge of the requirements?

Did you timely understand the updates to the legal compliance requirements and the changes in the compliance reporting procedures for your overseas business?

Did you realize the difficulties in communicating with and responding to the challenges from the regulators in the outbound jurisdictions?

Have you established a legal compliance team locally to effectively assist the group in dealing with the compliance issues?

Did you experience any loss from failing to identify potential legal issues or disputes in the jurisdictions outside China?

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## Legal considerations

### Foreign investment review
- Reign investment access
- National security review

### Export control
- Technique export restrictions
- Product export restrictions

### Anti-monopoly review and compliance
- Declaration of the concentration of business operators
- Monopoly agreement
- Abuse of dominant market position

### Political risks
- Government default
- Foreign exchange restrictions
- Expropriation and nationalization
- War and internal strife

### Export control
- Technique export restrictions
- Product export restrictions

### Labor and employment
- Remuneration policy
- Overtime limitation
- Labor union relationship
- Layoff and wrongful termination
- Strike
- Immigration and working permit

### Other compliance issues
- Anti-money laundering
- Anti-corruption and anti-bribery
- Cybersecurity and data protection
- Environment protection

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### How EY can help?

#### Market access stage:
- Investigate legal/political environment and detect legal risks of the host country
- Conduct legal due diligence
- Conduct feasibility study and assess transaction risk
- Assist in developing investment and market access plans
- Design transaction structure
- Draft and review legal documents
- Assist in negotiations
- Obtain approvals from governmental authorities
- Coordinate with local agencies

#### Operation stage:
- Assist in strategic planning of labor and employment management
- Deal with labor and employment issues and the relationship with local government
- Communicate with labor unions
- Prevent and handle labor and employment disputes
- Provide legal opinions regarding major issues
- Deal with government investigation and legal proceedings

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Did you timely understand the updates to the tax compliance requirements and the changes in the compliance reporting procedures for your overseas business?

Have you established a tax compliance team locally to effectively assist the group in dealing with the compliance issues?

Global tax management framework: Design and transform global tax operation model to support enterprise business development

- Establish a global framework for Tax policies to support global tax governance and risk management
- Define a set of consistent global data standards and common chart of accounts
- Implement single sources of data
- Build an organisation of the right resources with the right skills in the right locations
- Promote a global Tax community
- Deliver effective and efficient Tax processes in the right location and integrated into the business
- Establish a global performance measurement framework
- Deliver continuous improvement of Tax service levels
- Structure the organisation to deliver value to the business
- Define appropriate local, regional, global tax structures including shared services and outsourcing
- Define a Tax system architecture and tools to enable value adding Tax activities

How EY can help?

Tax:
- Global compliance and reporting
- Integrate global tax planning and business operation
- Ex-im trade compliance review
- Multi-location tariff management
- Solve global tax disputes
- Tax performance improvement and tax information system construction

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Financial and control
Have you considered the different accounting principles used by the overseas acquired entities as compared to those used by the parent?

Are there any reporting packages designed for the overseas acquired entities for their reporting to the China headquarters for consolidation purposes?

Have you considered processes integration: conduct ‘as is’ processes diagnostics and design future state processes of your overseas business?

Did you understand the management and disclosure policies on sustainable development by regulators of different countries, and how do they impact your corporate governance potentially?

**Financial Accounting Advisory Services**

**Pre deal phase:**
Provide analysis on complex transaction structures, related key accounting and financial reporting issues, identify GAAP differences and assess impact on the parent's consolidated financial statements, support the preparation of disclosure documents to satisfy related regulatory requirements.

**Implementing phase:**
Advise on the accounting treatments at acquisition date, subsequent reporting periods, assist in the preparation of technical memorandums for hypothetical transactions associated with the acquisition, support the preparation of combined or pro-forma financial information.

**Post deal phase:**
Align financial statements closing processes and accounting systems of overseas acquired entities to those of the parent, provide training to headquarter finance team on consolidation, GAAP differences identification and conversion and common reporting issues.

**Case study – FAAS project for an outbound client:**

**Project background:** A post-deal integration project for a giant Chinese state-owned enterprise ("SOE")'s subsidiary acquiring a multinational group based in Europe which has operations in ten countries and four continents.

**Challenges:** Accounting processes and GAAP differences as well as ERP systems differences which increase the operational and communication challenges on consolidation and reporting after acquisition.

**Client issues:** The Chinese SOE had concerns on how to structure and align the reporting internally with the European country's accounting standards and the implementation of the accounting mapping and ERP systems integration.

**How EY helped:** Assisted client in the mapping of chart of accounts from the acquired European subsidiary to the Chinese parent company as well as assisted with developing a global accounting policy manual under IFRS. EY also advised on the development and integration of the European subsidiary's future global ERP implementation for all of its entities, which will be adopted by the giant Chinese SOE as a benchmark for its future global system integration undertaking.

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People and culture
How to better harmonize entities within the corporate with different cultural backgrounds?

How to further enhance the information and communication between all overseas companies and headquarters?

Did you measure your overseas management productivity but at the same time, listen to their concerns?

Did you think of developing your tomorrow’s leaders today?

Have you considered cultural integration:

- conduct ‘as is’ culture diagnostics and design future state culture blueprints of your overseas business?
- develop and implement Diversity and Inclusiveness strategies including gender equity, ethnic diversity, flexible work practices in your organization?
- post-merger business integration and sustainable development while retaining core local staff and management?

Comprehensive solutions on M&A and integration advisory

Case study - Culture assessment and communication in an integration project

**Project background:** Integration project for a Chinese SOE acquiring a business from a US firm

**Challenges:** Culture and language barriers as well as the time difference increased the operational and communication challenges after taking-over

**Client issues:** The Chinese SOE worried whether the acquired company would be responding negatively, and had concerns on how to manage and communicate with this company

**How EY helped:** Assisted the client in performing culture assessment and employee health check. Worked with US human resources team to develop a detailed communication plan and FAQs to ensure employees understand Chinese company ownership and culture, and address their concerns. EY also conducted a training session for the key stakeholders at SOE in terms of the culture differences and things to be aware when working with their new US colleagues

**How EY can help?**

**People Advisory Services:**

- Culture optimization & communication
- Behavior change for the group
- Capability mapping & assessment
- Defining roles & accountabilities for the acquired entity and the group
- Create D&I workplace & organizational development
- Implement D&I in all integration process design and change management

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About EY
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