Citigroup woes reflect risks of China operations

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Citigroup Inc.'s recent suspension of two senior China bankers might prompt foreign firms to rethink their traditional reliance on well-connected power brokers for a fast-track to market share.

Citigroup confirmed late last month that it had suspended Margaret Ren, daughter-in-law of former Chinese premier Zhao Ziyang and the vice chairman of its China investment banking operations, and Earl Yen, director of China investment banking.

The two were suspended for "presentation of false information to the company and its regulators" unrelated to client matters, Citigroup said, without elaborating.

Ren was critical to Citigroup's success in several big ticket China deals including last year's hugely successful initial public offering of China Life Insurance Co. (LFC).

Her unseemly fall from grace highlights the risks attached to locally-hired figures employed for their guanxi, or connections, rather than business acumen and acquaintance with international standards of ethical practices.

Citigroup has declined to provide additional details about the suspensions, or to say whether criminal charges may be filed by any party.

But the Citigroup incident serves as a lesson for multinational firms operating in China, Hongkong and Shanghai Banking Corp. Ltd. Chairman David Eldon said. His bank is a unit of HSBC Holdings PLC (HBC).

"(Foreign companies) leave their common sense behind and they do things (in China) they wouldn't do in their home country," Eldon said.

"While the country is still developing certain codes of practice, codes of ethics and all these regulations... people still have to be very careful (about) whom they invest in and why they're investing," he said.

Foreign firms have long-prized well-connected local staff such as Ren to guide them through the unpredictable, often capricious maze of China's bureaucratic system.

China Market Madness

But lack of understanding or willful ignorance of the methods key local staff employ while trying to seal deals in China can expose companies to risks that far outweigh the benefits, managing director of the **ChinaWhys** risk management consultancy **Peter Humphrey** told Dow Jones Newswires.

"Very often when foreign businessmen come to China they're confronted by people who offer short cuts, easy remedies, panaceas, a guy who says he's got a connection to the highest people in the land," **Humphrey** said.

"They clutch on to that helping hand and forget everything else... it's like taking a poisonous drug to alleviate an immediate need and after a few months you realize that this drug has totally destroyed your health," he said.

Pressure from overseas corporate head offices for their China teams to deliver a piece of an economy that expanded at a blistering 9.1% year-on-year in 2003 amid flat or declining growth in home markets boost the prestige and value of such local rainmakers.

That obsession can at its worst foster corporate behavior that violates Organization of Economic Cooperation and Development, anti-corruption guidelines or the U.S. Foreign Corrupt Practices Act, or FCPA.

Perceived violations of the FCPA prompted U.S. telecommunications equipment company Lucent Technologies Inc. (LU) in April to fire its top four China executives.

"There are some managers... that actually take the risk of outright violations of the law to avoid losing lucrative business opportunities," James Zimmerman, Beijing-based chief executive of international law firm Squire, Sanders & Dempsey said.

Crackdown Concerns

China's weak judiciary and opaque regulatory environment, coupled with a cultural tradition of gift giving as a facet of normal business negotiations, can push foreign firms down a slippery slope toward corrupt practices as a means of landing lucrative deals.

International non-government anti-corruption watchdog Transparency International, or T.I., rated China's business environment as the world's 66th most corrupt out of 133 countries surveyed in 2003.

That ranking classifies China as cleaner than regional neighbors such as Thailand, the Philippines and Vietnam, but more corrupt than Taiwan, South Korea and Malaysia.

The temptation for foreign firms to play by local rules incompatible with anti-corruption regulations of their home countries is often irresistible, T.I.'s Asia-Pacific Regional Director Peter Rooke said.

"They take leave of their senses... but in the long term it won't help them as China improves its legal system and governance standards," he said.

Foreign firms have taken the recent Citigroup suspensions as a warning that the traditional tolerance for bending or breaking regulatory rules in order to do business in China may be coming to an end.

"Recent cases we've seen reported are probably the tip of an iceberg," **Humphrey** said.

"(There's) concern because this might become a trend, and if it becomes a trend it might affect their business."