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Five Themes Impacting the Chinese TMT industry in 2021

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Today, leaders of global TMT companies face complex business and geopolitical challenges, as well as an evolving regulatory environment that is impacting everything from corporate strategy, technology innovation, to customer and supply chain management.

Looking ahead in 2021, we identify five themes impacting the Chinese TMT industry: the rise of U.S. China techno-nationalism, increased regulatory pressure on Big Tech around anti-monopoly and data privacy issues, " The New Normal," focus on digital transformation and technology infrastructure buildout, and ESG as an urgent business imperative.

Five Themes Impacting the Chinese TMT industry

THEME ONE:
U.S.-China techno-nationalism and the decoupling of innovation

THEME TWO:
Tightening scrutiny of big tech around anti-monopoly & data practices

THEME THREE:
"The New Normal"

THEME FOUR:
Digital transformation and technology infrastructure buildout

THEME FIVE:
ESG as an urgent business imperative

THEME ONE

U.S.-China techno-nationalism and the decoupling of innovation

The rise of U.S.-China techno-nationalism presents a growing set of complex risks to TMT companies seeking to operate across the world's two largest markets, and is set to further escalate in the years to come.

For TMT companies, the risks are especially acute – in addition to the entity list and others, the U.S. Department of Commerce put new rules into effect in March, 2021, empowering the Secretary of Commerce to prohibit virtually any technology industry transaction that involves "foreign adversaries" or poses an undue risk to U.S. national security. TMT companies are especially vulnerable given the complexity of their supply chains, as well as the wide range of applications for their products – any computer hardware, software or components may easily fall afoul of restrictions.

Technonationalist restrictions also create separate spheres of innovation, increasing the cost of bringing new products to market. At the macro level, this includes restrictions on access to funding and R&D resources, restrictions on mobility, challenges to protecting intellectual property, forced technology transfers and more, exerting a chilling effect on international collaboration. At the micro level there are growing restrictions on cross-border data flow. Diverging regulations are 'balkanizing' data, forcing companies to firewall their operations in different locales.

Both the U.S. and China are increasingly scrutinizing foreign investment, with particular focus on the TMT sector. Some U.S. executive orders of 2020 and 2021 focus on Chinese apps (e.g. Alipay, WeChat and TikTok) and the U.S. Trade Representative's 301 reports are skeptical of Chinese companies taking VC investment to participate in the U.S. tech sector.

China has also revamped its national security review of foreign investment, with a new CFIUS-style mechanism to assess cross-border technology transactions. The reform significantly expands the number of sectors subject to review and lowers the thresholds for triggering one, requiring it for any investment that could be deemed to expose critical technology to foreign hands. The definitions of "foreign controlled" and "critical" remain ambiguous, allowing authorities wide discretion in enforcement.

Addressing these risks effectively, will be critical in determining the success of TMT companies in the years to come. Maintaining a keen awareness of the rapidly shifting landscape and enhancing strategic communications and engagement with key stakeholders should be a pillar of any firm's response.

THEME TWO

Tightening scrutiny of big tech around anti-monopoly & data practices

After a relatively lax two decades which saw the explosive growth of the Chinese technology industry, the Chinese regulators are tightening scrutiny. A record US$2.8 billion (RMB18.2 billion yuan) fine imposed on Alibaba, which represents four percent of Alibaba's 2019 domestic sales, Chinese regulators also ordered 34 local tech firms including Pinduoduo, JD.com, Kuaishou, Bilibili and Didi to conduct a 'comprehensive self-inspection' within a month.

The recent crackdown on Chinese Big Tech like Alibaba, Tencent, and Baidu is part of a broader push to rein in, using an antitrust regime only instituted in 2008, large digital platform companies which have over the years fundamentally changed Chinese consumers' behavior, and the way people pay and borrow money. In fact, the critical market infrastructure built and owned by large technology companies is perceived to carry the risk of upending the Chinese banking and finance system.

In November 2020, China's competition authority, the State Administration for Market Regulation ("SAMR") issued Antitrust Guidelines for the Platform Economic Industry and opened them to public consultation. In February 2021, just three months after starting the public consultation, the State Council finalized a set of antimonopoly rules targeted at China's homegrown technology giants. This also signals that SAMR strengthened its antitrust enforcement in the Internet platform sector, the entire ecosystem of businesses and economy centered around the internet has been potentially and significantly affected. The rules, although softened from the first draft, took a hard stance on practices deemed monopolistic, such as abuse of market dominance and concentration of undertakings.

At the same time, the Chinese government has also made strides to control the practices around consumer data collection and data privacy by private sector companies. In October last year, the NPC released a first draft of the Personal Information Protection Law (PIPL) for public comment. The PIPL coordinates and unifies what is currently a patchwork of local and regional privacy laws and is seen as China's answer to the EU's General Data Protection Regulation. While still in deliberation, the PIPL may be passed soon after one or two readings. It sets out seven principles of data protection and would give consumers ownership over their own data. The impact to business would be significant – any company, domestic or foreign, collecting the personal data of Chinese citizens would be subject to this new law.

Both Chinese companies with foreign operations and multinational firms with a presence in China must ensure that their operations stand up to fresh scrutiny. Corporates should step up transparency on sensitive issues around governance, principles, and practices. Companies would be much helped by a strong narrative that emphasizes transparency on policies surrounding antimonopoly practices or how data is collected and used. They must also ensure their operations are compliant and aligned across the patchwork of still-developing privacy and antimonopoly regulations to avoid being caught up when least expected.

THEME THREE

“The New Normal”

The Covid-19 pandemic has radically changed our lifestyle. Besides radically altering traditional business sectors, the pandemic is accelerating the “stay-at-home” economy, giving rise to new consumption concepts and business models. Across markets, we observed a rapid adoption of new lifestyles including working from home, eCommerce, online social entertainment, and e-learning at all ages. The need for automated and non-contact smart manufacturing have also led to accelerated digitization in production. In the post-pandemic era, most of these trends will continue to be important forces driving the economic recovery to “The New Normal”.

The pandemic has profoundly changed our view on the “Future of Work”, and the “Future of Education and Knowledge”. The discussion of remote work among C-suites was previously negligible, and now some form of it seems to be irreversible. Studies have all but confirmed that the future of work in a post-pandemic world will likely entail a hybrid model with a much bigger proportion of mobile workforce than before.

The blurring of home and office will have huge consequences to workforce management and business operations. It is critically important to review what impact this “New Normal” has on businesses, and how they in turn can help society. Cybersecurity risk is on the rise as system weaknesses are being exposed through the proliferation of work-from-home arrangements. The “Future of Work” trend will also force enterprise executives to raise their game, ensure transparency and frequent communications with employees, customers, business partners, investors and other major stakeholders, while accelerating investments in digital transformation and cyber security. All of this is particularly relevant to TMT companies that may need to adopt a more distributed remote workforce, and at the same time ensure consistent high quality and assurance when providing mission critical technology solutions around the clock to their own enterprise customers globally.

Even as global economies gradually recover in 2021, corporate executives find that their external stakeholders including institutional investors, international media, regulators, customers, and the general public continue to pay attention to issues such as employee health and safety, work-life balance, engagement to the community, and other social and environmental factors. To establish trust with and take care of the interest of major stakeholders, it is critical for corporate leaders to articulate their purpose, values and principles for doing business; support these with both policy measures and tangible actions at the board and operating levels; and communicate consistently both externally and throughout their own organization.

THEME FOUR

Digital transformation and technology infrastructure buildout

Set out in the latest 14th Five Year Plan (FYP) as part of the national development goals, China is putting digital at the heart of its industrial transformation and will increase investment in new infrastructure as part of its Digital China Initiative to create a "digital society, digital government and healthy digital ecosystem."

To encourage innovation and technological self-reliance, the 14th FYP stated a target 7% R&D spending CAGR across the economy for the next five years. AI and quantum information, among other strategic sectors, were earmarked for fresh support. Industry will also receive more tax breaks to offset R&D costs.

The focus on innovation and next generation industries is propelling China's technology leaders into a new era. Whether it is e-commerce, 5G, AI, health-tech, autonomous vehicle or gaming, many of the global pioneers are from China and the wider Asia-Pacific region. These companies must raise capital and their profile, navigate disruption and competition, deal with thorny geopolitical and regulatory issues, establish ESG and ethics strategies, compete in the global marketplace for talent and address labor issues, all while entering new markets. For companies going through strategic change, there is a clear need for management to articulate how they are adapting to the digital transformation at this critical juncture, and capture explosive growth opportunities in a way that balances major stakeholder interests, and is well understood and supported by multiple stakeholders including employees, customers, investors, regulators, media and the public.

In addition to the execution of actions, an impactful corporate narrative will serve as the foundation to help TMT companies explain their corporate story in a clear, distinct, and consistent way. Against a backdrop of global disruptions created by shifting geopolitics, it is critically important to ensure priority audiences see the company as a leader within the sector, at the forefront of technology innovation with differentiating offers, at the same time a trustworthy partner, and a positive contributor to the community and markets where they operate.

THEME FIVE

ESG as an urgent business imperative

Part One: Major stakeholders calling for integrated ESG strategy and actions

Brunswick's annual perception survey of Chinese corporates doing business overseas published in June 2020 surveyed 9,300 members of the general public in 23 countries in both the developed markets, Belt & Road countries and other emerging economies. Survey respondents rated the performance of Chinese companies highly on innovation, providing quality goods and services, having strong execution abilities and in generating strong financial performance. However, the perception of performance in key environmental, social, and governance areas lagged behind other indicators, revealing widespread concern about how these companies engage with local employees, the communities, the environment, their corporate governance. Across emerging and developed markets, the perception survey reveals the urgent need for significant improvement in corporate ESG factors.

Many Chinese corporates think of ESG as focused almost solely on environmental risk disclosure, protection, and management. In fact, ESG as a definition covers non-financial risks including environmental, social, and governance. This makes ESG fundamentally different from its precursor, Corporate Social Responsibility (CSR). CSR aims at making sure a company commits to not making a negative impact on its major stakeholders including employees, community, the environment, and customers. Due to lack of specific criteria in measuring a company's actions, the focus of CSR often becomes philanthropy and how to give back to the society after a company makes money. On the other hand, ESG focuses on embedding targets and into a company's business strategy. It is about how a business makes money. ESG strategy, disclosure and communications shows with quantifiable measures how a company treats its employees, engages with communities and society, manages climate and environmental externalities, cultivates a diverse and inclusive culture, ensures ethical standards, and manages its supply chains.

In the summer of 2020, Brunswick Group conducted a proprietary ESG investor survey. **The results revealed that all major investors evaluate company financials through an ESG lens**. On governance issues, investors overwhelmingly agreed that **board composition, independence and competence** is critical to building trust in a company. They are looking for **diversity** of the leadership's backgrounds and skill sets, **renumeration structure**, and an **accountability framework that embeds ESG targets into the KPIs of the leadership team**. On environmental risk disclosure, investors emphasized the importance of articulating an **integrated approach to environmental stewardship**, incorporating carbon emissions, water, and other energy resources management, etc. This should be **underpinned by a detailed climate policy with consistent disclosures, targets, metrics, and periodic milestones**. For social, **health and safety of workers** are particularly important, especially amid COVID-19. **Human capital management** includes the diversity of the employee base and how companies attract, retain, and develop their workforce to succeed in a rapidly changing operating environment. When companies think about local communities, engagement and empowerment of local communities were identified as key to a company's licence to operate beyond contribution or donations.

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Ultimately, how companies approach corporate governance, environmental stewardship and social responsibility is key to maintaining their licence to operate and strengthening competitive advantage in this new era.

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What I'm typically looking for and what others are looking for is less a specific metric and more a of pattern of behavior. Regardless who you speak to at the organization – whether it's someone junior that you've run into at a conference, or it's a board member or C-suite, you get almost the exact same pitch on what the company is trying to achieve, and what their ambition is, and what they're trying to do."

- Head of Stewardship for APAC, USD100billion to 1 trillion company AUM

From a regulatory perspective, the EU continues to tighten its sustainability policies. Combined with its data protection law, the latest AI legislative proposal issued in April 2021, and upcoming legislative proposals on supply chain due diligence, these coordinated policy and regulatory actions will have far reaching implications not only to TMT companies, but all corporates in general both within and outside of the European Union.

The time to act is now. Public or large private TMT companies with a global presence will need to understand key stakeholder dynamics regarding industry specific ESG factors such as waste and hazardous materials management on the environmental front; social and governance focuses on data privacy and security, labour practices, employee health, supply chain management, materials sourcing and efficiency, product labelling, ethics, and competitive behaviour. Major stakeholders expect TMT company leaders to articulate how material sustainability activities drive their corporate strategy; activate materiality driven ESG strategy and embed integrated ESG messaging into stakeholder communications.

THEME FIVE

ESG as an urgent business imperative

Part Two: Key EU sustainability and technology regulatory policies

New EU disclosure rules for investors and companies

The Sustainable Finance Disclosure Regulation (SFDR) came into effect in March 2021. This requires asset managers and owners with an EU-license to integrate sustainability risks in their investment decision-making processes and to issue a "principal adverse impact statement". This statement is intended to show how investment decisions made by a financial market participant have or may have adverse impacts on sustainability factors relating to:

1. climate and the environment (GHG emissions, energy efficiency, water usage, exposure to water stress areas),
2. social and employee matters (gender balance in board, gender pay gap, CEO pay gap), and
3. governance issues (human rights/bribery incidents of their portfolio and investee companies).

EU lawmakers hope that by mandating institutional investors and asset managers to be transparent about the adverse impact of their investments will ensure that they rethink their investment strategy and lean more towards sustainable investments. While financial market participants must start applying these compliance rules from March 2021, the more detailed technical legislation outlining the format and exact scope required will only be finalized by January 2022.

Meanwhile, the regulator issued instructions in February 2021 for investors to follow the draft rules, and the European Commission made another legislative proposal in April 2021 concerning the legal obligation for large non-financial corporates active in the EU markets to publicly disclose the same information that investors must publish under the SFDR.

Lastly, the European Commission's **upcoming proposals on supply chain due diligence** are expected to include a new legal requirement for companies active in the EU single market to establish and implement adequate processes to prevent, mitigate and account for human rights (including labor rights and working conditions), health and environmental impacts, including relating to climate change, both in the company's own operations and in the company's supply chain. A legislative proposal is expected from the Commission in June 2021.

Proposal for Regulation on European Approach to AI

On 21 April 2021, the European Commission adopted a proposal for a Regulation on an European approach to Artificial Intelligence (AI). These proposals are the first of their kind to regulate AI, underlining the EU's ambitions to become a global standard-setter in trustworthy, ethical, and human-centric AI. This follows the success of the EU's data protection regulatory model, which has been widely adopted by businesses and governments outside the EU.

ESG as an urgent business imperative

Part Two: Key EU sustainability and technology regulatory policies

The draft Regulation classifies AI systems into four risk-based categories: unacceptable risk; high-risk; limited risk; and minimal risk. It prohibits the use or placing on the market of AI systems with unacceptable risk, i.e. those used for exploiting the vulnerabilities of a specific group of people, such as children or disabled people, and for social scoring. The use of high-risk AI systems and their placement on the EU's market will only be allowed if they have undergone data quality, conformity assessment, human oversight, and security procedures. AI systems are considered high-risk if they create an adverse impact on people's safety or fundamental rights. Examples of areas involving high-risk AI uses are critical infrastructure (e.g. credit institutions, transport, energy, and health), toys, Internet of Things (IoT), education, recruitment, or law enforcement. Biometric identification systems in public places would be prohibited in principle and may only be allowed for limited law enforcement purposes.

Companies that do not comply with the new rules could be fined up to €30 million or 6% of their worldwide turnover, whichever is higher. National market surveillance authorities will supervise the new rules, but some AI providers will be allowed to comply through self-assessment. The current expectation for the conclusion of legal deliberations is the first or second quarter of 2023. According to the current draft text, the Regulation will become applicable within two years after legislative approval.

The European Commission also adopted a New Coordinated Plan on AI, which builds on the 2018 version of the Plan laying the foundation for policy coordination on AI. The update links the proposed actions to the European Green Deal, environment, and health policies of the EU.

THE AUTHORS

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Cynthia is the Asia lead for the firm's global technology, media, and telecoms (TMT) group, investor engagement and ESG practices, helping corporate leaders navigate stakeholder communications amid significant geopolitical change. Her razor-sharp strategic communications skills have been honed over two decades in the global TMT industry as an investment advisor, senior publishing equity research analyst on Wall Street and strategic management consultant. She has experience advising clients throughout Asia and has also served as a lead sell side research analyst on multiple IPOs for Chinese technology and internet companies in the US and Hong Kong. Cynthia has significant insight and understanding of most Asian equity institutional investors. Cynthia joined Brunswick from Credence Investment Holding, a firm she founded to advise high-potential technology entrepreneurs.

Hua Li
Partner, Beijing

Li Hua joined Brunswick in 2021 with a focus on M&A, anti-monopoly and competition, outbound investment, export control and sanctions, and public affairs.

Prior to joining Brunswick, she was a partner at two international law firms. She started her career in government at the Ministry of Foreign Trade and Economic Cooperation (now the Ministry of Commerce) in Beijing before becoming Deputy Director of Foreign Trade at the former State Commission for Economy and Trade (SETC).

Li Hua has experience in handling complex international issues and investment disputes, including WTO-related affairs and international trade remedies and has advised well-known multinational companies in their investments in China across consumer, telecoms, oil & gas, industrial and car manufacturing sectors. She has also assisted Chinese state-owned enterprises and private companies in their outbound investments.

She acted as legal advisor in the first WTO dispute with the United States in the WTO Panel and has advised more than 3,000 European companies in the anti-dumping and anti-subsidy procedures initiated by MOFCOM against wine originating from the European Union (EU).

Li Hua is an arbitrator of the China International Economic and Trade Arbitration Commission (CIETAC) and a board member of the International Board on Economic Regulations (IBER) initiated by the Foundation for Civil Law.

Fiona Wright
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Fiona has more than 15 years' experience in government and public affairs with a particular focus on financial services, trade, and economic affairs.

Prior to joining Brunswick in 2016, she spent four years at another Brussels consultancy covering EU financial services for a range of buy-side and payment services clients. Between 2004 and 2012, Fiona worked in a range of roles at the UK Treasury, latterly as a seconded national expert at the European Commission's Economic and Financial Affairs DG. Fiona has a Ph.D. in Political Science from the University of Florida where she won a Research Fellowship at the Brookings Institution in Washington, DC (1998-99). Fiona started her career as an Assistant Professor of Political Science at the University of Wisconsin (Milwaukee) in 2000 including a year-long secondment in Washington, DC as a legislative assistant in the office of a U.S. Senator (2001-02).

Robert Moran
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Robert leads Brunswick Insight, our global public opinion, market research and analytics function with research teams in New York, London, Washington, Dubai, Beijing, Hong Kong, San Francisco, Munich and Dallas.

Brunswick Insight provides intelligence for market-moving decisions by combining experienced, data-driven counsel with an emphasis on rapid research and analysis. Brunswick Insight converts research into strategic advice for communications programmes and campaigns.

Robert was previously President of StrategyOne's US operations, Edelman's strategic research consultancy. Prior to that, Robert was Vice President at Fabrizio, McLaughlin & Associates. He began his career at political polling giant Public Opinion Strategies.

Robert is a Partner in the Washington office. He is a published thought leader and frequent speaker on trends in public opinion and market research and frequently writes on future forward subjects. He has lectured at the National War College in Washington and is a frequent contributor on Huffington Post.

Nick Howard
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Nick leads Brunswick's employee engagement offer in Europe. He advises clients on the people implications of transactions, transformational changes, and other significant business challenges and opportunities.

He helps organizations create an employee experience that attracts and retains great people, creating the conditions for them deliver the best work of their lives. He also advises on new ways of communicating with employees, connecting them with each other and customers; and how to create world-class communications functions.

Nick joined Brunswick from Edelman where he led the European employee engagement business and organization design offer. Before Edelman he was retail communication director for Lloyds Banking Group where he led communication for the successful integration of Lloyds TSB and HBOS. Before that he led the EMEA workforce engagement and change business of Mercer HR Consulting where he specialized in helping clients drive people performance during significant change. Nick's background is in financial services and management consulting.

Pru Bennett
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Pru Bennett joined Brunswick Group in April 2019 following a career at BlackRock where she was a Managing Director and Head of Investment Stewardship for the APAC region. At BlackRock Pru led a team that responsible for engagement and proxy voting activities in relation to the companies in which BlackRock invests on behalf of clients.

Pru is an active participant in the public debate on corporate governance, stewardship and responsible investment and as such regularly speaks and writes on the importance of these issues for company performance and investment decisions. In 2018 Pru received the Asia Industry Leadership Award from 100 Women in Finance. In 2013, Pru was named as one of Australia's top 10 Women of Influence in Corporate Governance.

Pru is a director of Global Compact Network Australia and a member of a number of industry and regulatory bodies including Public Shareholder Group of Hong Kong's Securities and Futures Commission, the Monetary Authority of Singapore's Corporate Governance Advisory Committee, a council member of the Asian Corporate Governance Association, director of the International Integrated Reporting Council and a member of the Deakin University Integrated Reporting Centre Advisory Board.

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About Brunswick

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