

# Planning for Geopolitical Disruption

How can MNCs best plan for China “Gray Swan” risks?

Member Webcast – October 13, 2022



# 1. Framing the Issue



# Setting

- Geopolitical tensions between China and the West continue to intensify.
- Amidst these tensions, the list of plausible “gray swans” – i.e., **geopolitical developments that could lead to serious, even business-stopping outcomes** – is long and getting longer.
- Rising risks in the military domain see waning attention to/support for Sino-western commercial and economic interests.
- While gray swan events are generally assumed to be rare, the unfolding Ukraine situation shows that gray swans do indeed happen.
- Planning for geopolitical disruption – for gray swan risks – has become a critical competency.



# Sino-western geopolitical tensions have intensified significantly across many fronts

## Among other things...

- The UN Human Rights report of August 31 has re-elevated Xinjiang concerns and progressed deliberations about expanded human rights sanctions in the US and EU.
- The US Chips Act has re-elevated Chinese allegations about US 'Cold War mentality' and containment motives.
- US-led diplomatic and security developments in the region appear to be gaining momentum – IPEF, QUAD, AUKUS, NATO Indo-Pacific...
- China's position on the Ukraine situation has increased the pessimism of US and EU policy makers.
- Speaker Pelosi's Taiwan visit provoked unprecedented military response. Proved PLA force readiness; firepower strike capabilities, joint force integration, coordination...
- Xi—Putin meeting on September 15 in Xi—Putin meeting in Uzbekistan reaffirmed Sino-Russo friendship (it seems).
- Biden's September 18 statement (on US TV show "60 Minutes") arguably affirmed the US policy on the defense of Taiwan.
- The expanded US semiconductor export control regime (October 8) could dramatically change the global electronics value chain.



BEIJING, Aug. 2 (Xinhua) -- Xinhua News Agency is authorized on Tuesday to release the following notice: from 1200 (Beijing Time) August 4 to 1200 (Beijing Time) August 7, 2022, the Chinese People's Liberation Army will conduct important military exercises and training activities including live-fire drills in the following maritime areas and their air space



# One thing is crystal clear, MNCs have an increasingly difficult middle ground to navigate on China



**Q** Looking forward, what is your view about the interaction of US and/or EU compliance requirements and Chinese compliance requirements?

**A** **24%** -- There will be more and more conflicting and irreconcilable demands.

**68%** -- There will be more and more conflicting demands that will be difficult to resolve.

Source: Polling Exercise: China Center DDE – May 12, 2022



Poll 1

At the present time, how much are geopolitical developments or concerns influencing the China business?

- a. Extremely so, across the board
- b. Significantly, in a few areas
- c. No much so far
- d. Not at all



## 2. Assessing Gray Swan Risks



# Types of gray swans



## COMPANY SPECIFIC GRAY SWANS

### China-side:

- The emergence of another dangerous virus in China
- SCS military accident with Taiwan, Japan, Australia, India, Vietnam, Philippines...
- Forced sale of controlling stake of an American company in China under auspices of national security concerns

## GEOPOLITICAL GRAY SWANS

### US-side:

- Official USG statement of support for Taiwan re-designation or independence
- Reintroduction of FIRRMA outbound investment and commercial screening
- Sweeping ban on US visa issuance to Chinese nationals

### EU-side:

- Introduction of strict, restrictive inbound investment screening legislation
- NATO extends presence in Indo-Pacific
- EU invoked hard economic sanctions on China for human rights abuses in Hong Kong

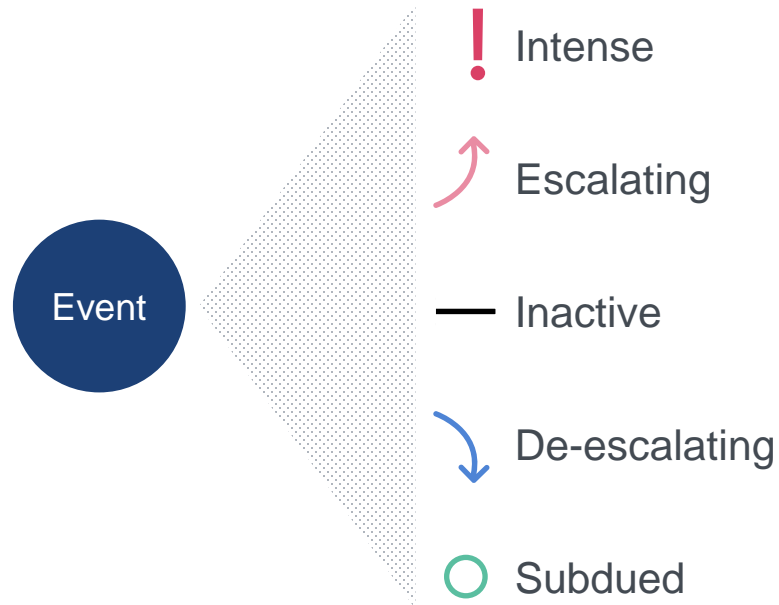




# Means of assessing and framing probability and impact

## Trend direction

Indicates the prominence of a given gray swan event as a function of recent developments, media attention or political discourse.



## Impact scores

Indicate the general ways that MNC business could be impacted and responses to each event.

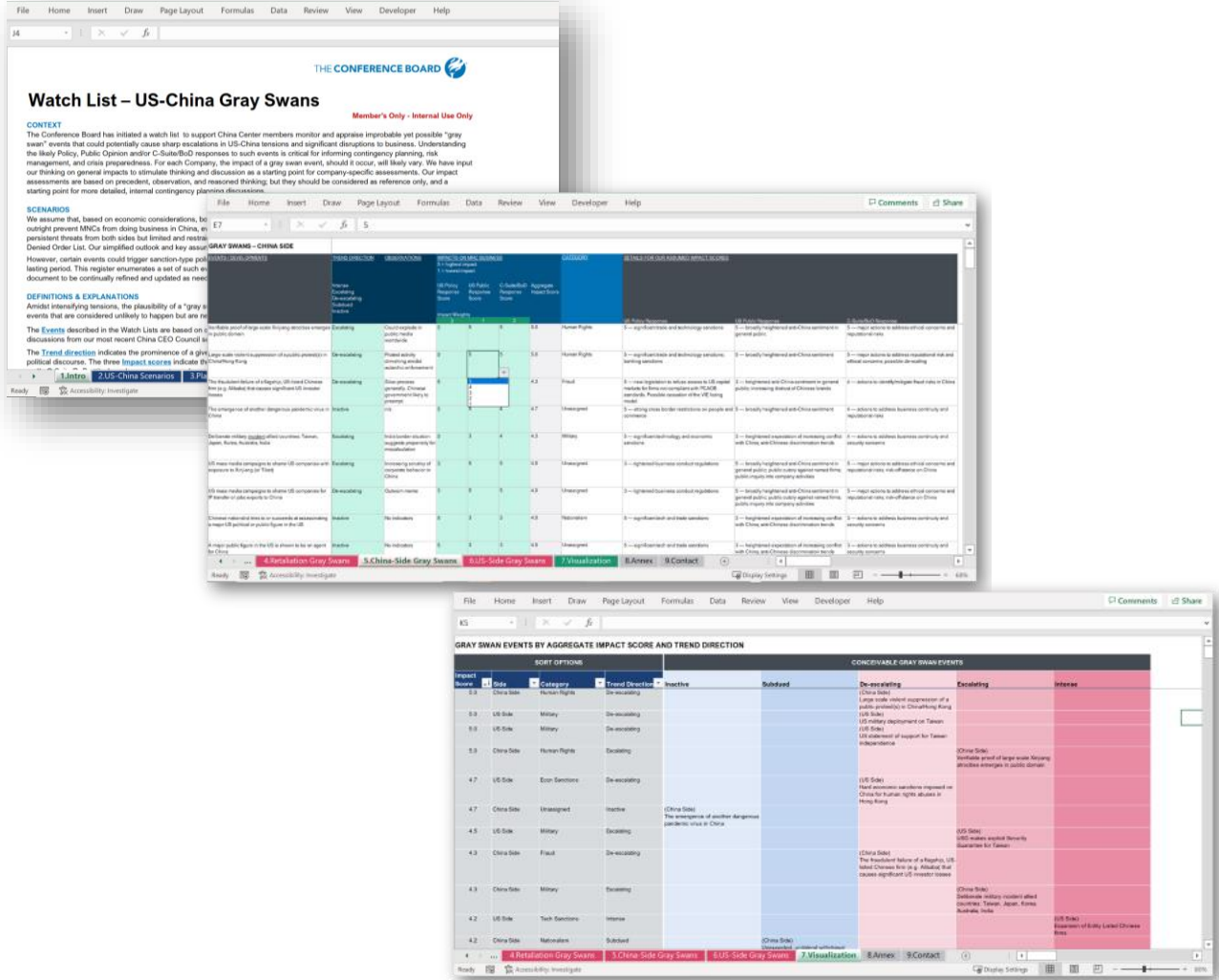
Three types of impact:

1. Policy action
2. Public opinion
3. C-Suite/BoD attitudes and responses

**!** *Impact scores will necessarily vary significantly according to the specific circumstances of any one event – e.g., how an event transpired, its scale and duration, and/or the publicity it received.*

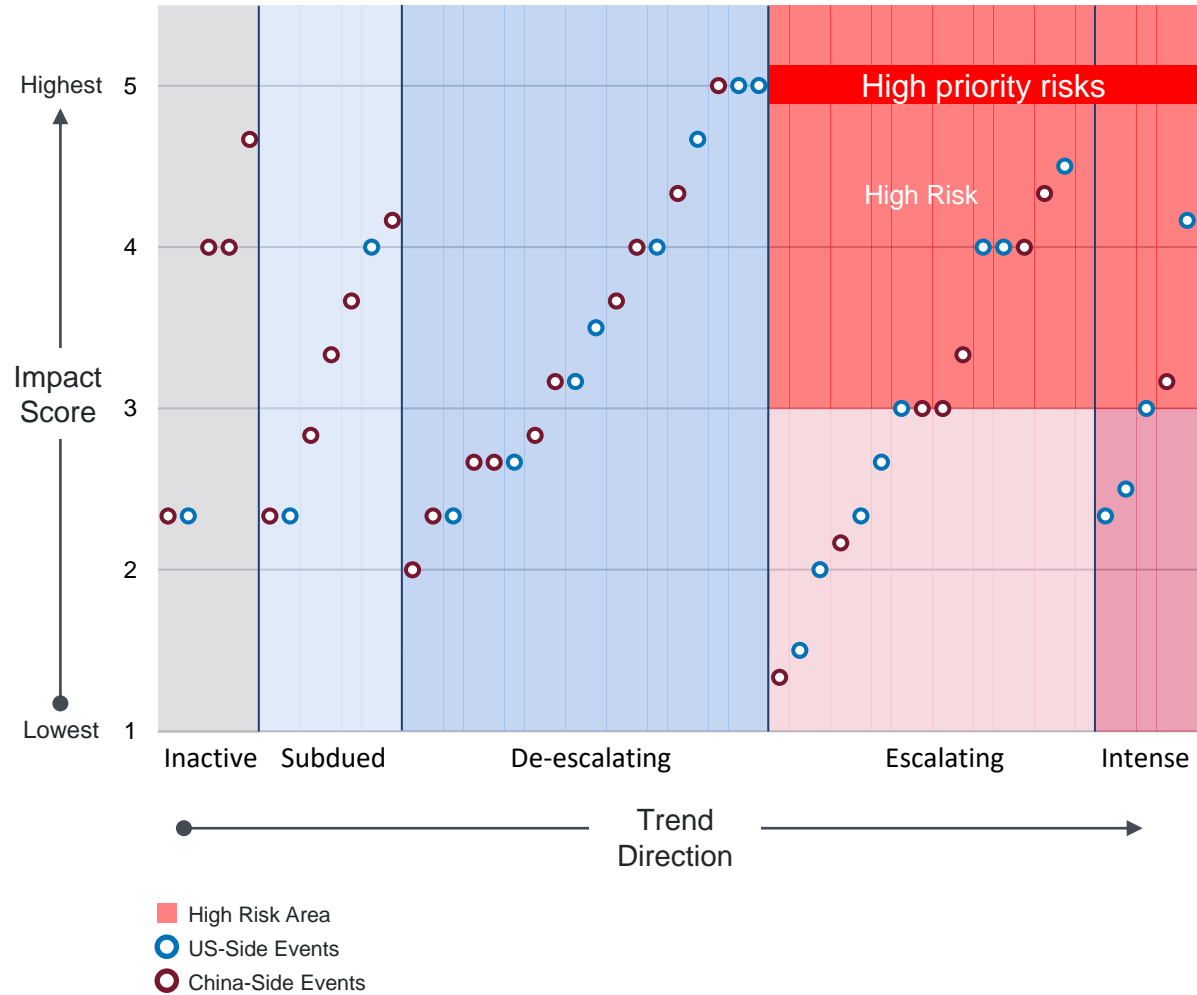
# The Gray Swans watchlist: scope, structure, features, use

- Introduction to the concept of gray swans and detailed company planning guidance
- Pre-populated Sino-Western gray swan lists, including over 100 gray swan events, trend directions, and impact ratings, with detailed explanations
- Users can use drop down menus to adjust trend directions and impact ratings to change the aggregate score of individual events
- Any changes made will automatically be reflected in the visualization tab, to produce a customized representation of company-specific assessment of events



# Visualizing conceivable gray swan events and drill down into high priority risks

(illustrative)



## High priority risks

- 'Intense' or 'Escalating' with one or more "5" impact rating

### On close examination:

- Most risks aren't Intense or Escalating
- Most risks aren't likely to be high impact – at least in first instance
- Those that are considered high priority risks require close monitoring



# High priority risks – US-side

<u>Event</u>	<u>Trend</u>	<u>Policy</u>	<u>Public</u>	<u>C-Suite</u>	<u>Category</u>
Hard sanctions on China for alleged human rights abuses in Xinjiang	Intense	5	3	3	Econ Sanctions
US military deployment on Taiwan	Escalating	5	5	5	Taiwan Issue
Official USG statement of support for Taiwan re-designation or independence	Escalating	5	5	5	Taiwan Issue
US-led reinforcement/ upgrade of military assets on China's periphery in North Asia (e.g. South Korea, Japan)	Escalating	5	3	2	Military
USG makes explicit Security Guarantee for Taiwan / Passing of Taiwan Policy Act (designation Taiwan as non-NATO military ally)	Escalating	5	5	5	Taiwan Issue
Closing of SWIFT access or FED settlement windows in Hong Kong – or with just BOC HK	Escalating	5	4	1	Financial Sanctions
Denied Order Listing invoked for Huawei or other prominent Chinese tech firms	Escalating	5	3	3	National Security Sanctions
Termination of university partnerships in US and aligned countries	Escalating	3	5	2	National Security Sanctions
Expansion of Entity Listed Chinese firms	Intense	5	4	3	National Security Sanctions
Formal NATO expansion into Asia	Escalating	5	3	4	Military
US support for Japanese military expansion	Escalating	5	3	4	Military
Ban on TikTok in the US	Escalating	5	2	2	National Security Sanctions



# High priority risks – China-side

<u>Event</u>	<u>Trend</u>	<u>Policy</u>	<u>Public</u>	<u>C-Suite</u>	<u>Category</u>
Verifiable proof of large-scale Xinjiang atrocities emerges in public domain	Escalating	5	5	5	Human Rights
The fraudulent failure of a flagship, US-listed Chinese firm (e.g. Alibaba) that causes significant US investor losses	Escalating	5	3	4	Financial Sanctions
<b>Deliberate, limited Chinese military action against Taiwan</b> , Japan, Korea, Australia, India...	Escalating	5	3	4	Military
US mass media campaigns to shame US companies with exposure to Xinjiang (or Tibet)	Escalating	5	5	5	Human Rights
Chinese regulators force sale of controlling stake of an American company in China under auspices of national security concerns	Escalating	3	1	5	Commercial Interference
In retaliation for US tech sanctions, a major US enterprise IT platform is banned in China (e.g. Microsoft, IBM, AWS)	Escalating	3	1	5	Commercial Interference
<b>SCS military accident with Taiwan</b> , Japan, Australia, India, Vietnam, Philippines...	Intense	5	2	4	Military
Chinese state media foment major anti-American rallies in China including vandalization of US brands and/or violence against Americans in China	Escalating	3	4	5	PTP Relations
Overt obstruction of US or allied Freedom of Navigation Operations (FONOPS) in the South China Sea (SCS)	Escalating	5	2	2	Military
Arrest/detention of American(s) in China in retaliation for US arrests/detentions of Chinese scholars in US	Escalating	3	3	5	PTP Relations
<b>Demonstrative temporary economic blockade of Taiwan maritime cargo routes</b>	Escalating	5	5	5	Taiwan Issue
Stringent enforcement of DSL and PIPL, incl cross border EIT process and corporate data audits	Escalating	3	2	5	Trade Policy/Regulation



# Response - Gray Swan planning

## Preliminary Response Planning



## Comprehensive Planning

- Who: Everyone
- What: Regularize brainstorming discussions with relevant executives and managers, involving both HQ and China-based executives, on the evolving geopolitical situation and related business risk concerns

- Who: Companies with significant sunk investment in China, and/or making major long-term investments – especially in sensitive sectors
- What: Robust, continuous process in place for continually monitoring and managing geopolitical risks

## Retaliation-Specific Planning

- Who: High-profile Western brands, especially those who contend or interact with flagship Chinese firms
- What: Game plan high level response measures for tit-for-tat retaliations from Chinese regulators that could be invoked against your Company in response to US or EU injunctions against related Chinese firms, persons, or entities



Poll 2

Are you programmatically monitoring gray swan risks?

- a. Yes – in a significant way
- b. Yes – at a basic level
- c. Not yet, but considering
- d. No



### 3. The Taiwan Issue





# The Taiwan Issue

## Thesis:

- Russia's invasion of Ukraine does not signal that a Chinese invasion of Taiwan is imminent.  
The two cases are not comparable.
- For Mainland China, the invasion scenario for Taiwan is exceedingly high risk, whether near-term or later.
- At the present time, a confluence of three factors makes an invasion scenario even more remote (opposite).
- Maintenance of the status quo is the path of least resistance and risk for all involved.
- Nevertheless, semiconductor supply chain concentration on Taiwan is a serious resiliency risk for global business.
- Serious business planning on semiconductor supply chain de-risking, resilience and security should begin today.

## Key Timing Considerations:

**China's military readiness.** It is estimated that that China is at least five or more years away from having the requisite combined force military capability to consider invasion a viable military option. Russian military travails in Ukraine should temper Chinese confidence.

**US and global resolve to support Taiwan.** Military readiness notwithstanding, China is less likely to act militarily against Taiwan if western powers are poised to support Taiwan's cause. At present, western support for Taiwan is now at a highpoint

**The economic costs of sanctions.** The sanctions regime imposed on Russia would be utterly devastating to China's economy and introduce acute social and political stability risks.



## In the wake of the Pelosi tempest, key policy, military and security guideposts to monitor in the near-term are several

1. Progress and content of the [Taiwan Policy Act](#) in the US congress:
  - ✓ Potentially provides expanded arms procurement and weaponry support, the renaming Taiwan representative office in DC, non-NATO ally designation...
2. Political dynamics of upcoming Taiwan presidential elections (May 20, 2024).
3. Substantive escalatory moves:
  - ✓ PLA exercise/sortie locations: Straits “center line”, Taiwan’s continuous zone (24-miles), the 12-mile nautical territory limit...
  - ✓ Law enforcement actions – e.g. Taiwan shipping intercepts; inspection for military goods, etc.
  - ✓ Direct PLA air-force overflights of Taiwan – i.e. actions that provoke Taiwan to shoot first
4. Signs of PLA mobilization:
  - ✓ Public communications to prepare the populace
  - ✓ Ship building activity; build up of “lift capacity”



### Poll 3

To what extent are cross straits tensions impacting management thinking and action?

- a. Extremely so, across the board
- b. Significantly, in a few areas
- c. No much so far
- d. Not at all



## Questions? Contact Us

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# Appendix 1: Zoom Slides



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GRAY SWANS – CHINA SIDE

EVENTS / DEVELOPMENTS	TREND DIRECTION Intense Escalating De-escalating Subdued Inactive	OBSERVATIONS	IMPACTS ON MNC BUSINESS 5 = highest impact 1 = lowest impact				CATEGORY	DETAILS FOR OUR ASSUMED IMPACT SCORES		
			US Policy Response Score	US Public Response Score	C-Suite/BoD Response Score	Aggregate Impact Score		US Policy Response	US Public Response	C-Suite/BoD Response
			3	1	2					
Verifiable proof of large scale Xinjiang atrocities emerges in public domain	Escalating	Could explode in public media worldwide	5	5	5	5.0	Human Rights	5 — significant trade and technology sanctions	5 — broadly heightened anti-China sentiment in general public	5 — major actions to address ethical concerns and reputational risks
Large scale violent suppression of a public protest(s) in China/Hong Kong	De-escalating	Protest activity diminishing amidst autarchic enforcement	5	5	5	5.0	Human Rights	5 — significant trade and technology sanctions; banking sanctions	5 — broadly heightened anti-China sentiment	5 — major actions to address reputational risk and ethical concerns; possible de-scaling
The fraudulent failure of a flagship, US-listed Chinese firm (e.g. Alibaba) that causes significant US investor losses	De-escalating	Slow process generally. Chinese government likely to preempt	5	5	4	4.3	Fraud	5 — new legislation to refuse access to US capital markets for firms not compliant with PCAOB standards. Possible cessation of the VIE listing model	3 — heightened anti-China sentiment in general public; increasing distrust of Chinese brands	4 — actions to identify/mitigate fraud risks in China
The emergence of another dangerous pandemic virus in China	Inactive	n/a	5	5	4	4.7	Unassigned	5 — strong cross border restrictions on people and commerce	5 — broadly heightened anti-China sentiment	4 — actions to address business continuity and reputational risks
Deliberate military incident allied countries: Taiwan, Japan, Korea, Australia, India	Escalating	India border situation suggests propensity for miscalculation	5	3	4	4.3	Military	5 — significant technology and economic sanctions	3 — heightened expectation of increasing conflict with China; anti-Chinese discrimination trends	4 — actions to address business continuity and security concerns
US mass media campaigns to shame US companies with exposure to Xinjiang (or Tibet)	Escalating	Increasing scrutiny of corporate behavior in China	3	5	5	4.0	Unassigned	3 — tightened business conduct regulations	5 — broadly heightened anti-China sentiment in general public; public outcry against named firms; public inquiry into company activities	5 — major actions to address ethical concerns and reputational risks; risk-off stance on China
US mass media campaigns to shame US companies for IP transfer or jobs exports to China	De-escalating	Outworn meme	3	5	5	4.0	Unassigned	3 — tightened business conduct regulations	5 — broadly heightened anti-China sentiment in general public; public outcry against named firms; public inquiry into company activities	5 — major actions to address ethical concerns and reputational risks; risk-off stance on China
Chinese nationalist tries to or succeeds at assassinating a major US political or public figure in the US	Inactive	No indicators	5	3	3	4.0	Nationalism	5 — significant tech and trade sanctions	3 — heightened expectation of increasing conflict with China; anti-Chinese discrimination trends	3 — actions to address business continuity and security concerns
A major public figure in the US is shown to be an agent for China	Inactive	No indicators	5	3	3	4.0	Unassigned	5 — significant tech and trade sanctions	3 — heightened expectation of increasing conflict with China; anti-Chinese discrimination trends	3 — actions to address business continuity and security concerns



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GRAY SWAN EVENTS BY AGGREGATE IMPACT SCORE AND TREND DIRECTION

SORT OPTIONS				CONCEIVABLE GRAY SWAN EVENTS				
Impact Score	Side	Category	Trend Direction	Inactive	Subdued	De-escalating	Escalating	Intense
5.0	China Side	Human Rights	De-escalating			(China Side) Large scale violent suppression of a public protest(s) in China/Hong Kong		
5.0	US Side	Military	De-escalating			(US Side) US military deployment on Taiwan		
5.0	US Side	Military	De-escalating			(US Side) US statement of support for Taiwan independence		
5.0	China Side	Human Rights	Escalating				(China Side) Verifiable proof of large scale Xinjiang atrocities emerges in public domain	
4.7	US Side	Econ Sanctions	De-escalating			(US Side) Hard economic sanctions imposed on China for human rights abuses in Hong Kong		
4.7	China Side	Unassigned	Inactive	(China Side) The emergence of another dangerous pandemic virus in China				
4.5	US Side	Military	Escalating				(US Side) USG makes explicit Security Guarantee for Taiwan	
4.3	China Side	Fraud	De-escalating			(China Side) The fraudulent failure of a flagship, US-listed Chinese firm (e.g. Alibaba) that causes significant US investor losses		
4.3	China Side	Military	Escalating				(China Side) Deliberate military incident allied countries: Taiwan, Japan, Korea, Australia, India	
4.2	US Side	Tech Sanctions	Intense					(US Side) Expansion of Entity Listed Chinese firms
4.2	China Side	Nationalism	Subdued		(China Side) Unexpected unilateral withdrawal			

