Your Company Exited Russia: Will China Be Next?

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A business's departure from an international market requires extensive board contemplation.

When Russia invaded Ukraine on Feb. 24, 2022, the reaction of the American business community was swift. According to the Yale School of Management's Chief Executive Leadership Institute, over 1,000 companies have since curtailed operations in Russia to a point beyond the minimum legally required by international sanctions. But does a departure from the Russian marketplace establish a slippery slope for companies operating in countries with questionable track records on human rights that might also be threatening invasions? Should companies that exited Russia leave China too?

In early February 2022, mere weeks before the onset of the Ukraine invasion, Russia and China announced the signing of an agreement that would, among other things, challenge the United States as a global authority and stand up against NATO as a touchstone of international security. In keeping with the agreement, China has neither condemned nor condoned Russia's invasion of Ukraine, electing instead to adopt a position of neutrality. But, of course, China presents problems beyond its position on Russian aggression.

Serious questions remain about human rights violations in China, with the United Nations calling for assessments on the treatment of Uyghur Muslims and citizens of the Tibet Autonomous Region, as well as excessive force used against protesters in Hong Kong. There is also increasing concern regarding a Chinese invasion of Taiwan, with Chinese President Xi Jinping ordering military exercises — including the firing of missiles over the island — in mid-August in reaction to a visit by U.S. Speaker of the House Nancy Pelosi. So, if China were to invade Taiwan, would the boards of American companies consider an exit from the Chinese market? To help answer that question, we should assess whether American companies made the right decision when they decided to leave Russia.

Departure from Russia

To Norman Augustine, retired chairman and CEO of Lockheed Martin and United States undersecretary of the Army from 1975 to 1977, there is no question that boards of U.S. companies made the right choice in advising management to end business operations in Russia.

“Companies should not abet invasions of free and independent countries,” says Augustine. “The U.S. government’s position regarding sanctions, in this particular case, simplifies a firm’s decision. Some matters are more important than business.”

Lieutenant General David Deptula, a former director of the National Military Intelligence Association who served as chief of intelligence, surveillance and reconnaissance for the U.S. Air Force, agrees that the correct decision was made,

while acknowledging that the decision was easier for larger companies than for small ones.

Deptula, a director for both AEVEX Aerospace and Genesis Systems LLC, says, “Russia represents a comparatively smaller market than some of the larger developed-country markets that larger companies operate in, so such companies can minimize the impacts of exiting the Russian market. But smaller companies, which cannot absorb the potential financial loss, appear to be staying in the Russian market.”

Major General Barbara Faulkenberry, independent director for Target Hospitality, Callon Petroleum Company and USA Truck Inc., served over 30 years in the U.S. Air Force. She believes that before choosing to exit Russia, U.S. boards and companies had to consider a variety of factors, most of which virtually required their aggressive action to step away from Russian relationships. Those factors included sanctions, U.S. national policy, their customer and supplier bases, and the sentiment of their employees and other stakeholders. Another factor she believes may have come into play is the possible duration of the conflict.

“With Vladimir Putin being the prime driver of this attack and his probability of staying in power until at least 2024, and with the recent constitutional amendments he helped push through, he has the potential to stay in power until 2036,” says Faulkenberry. “There’s no doubt this current situation will endure for a significant length of time, and sanctions have the potential to be ratcheted up further.”

Deptula, who points to the withdrawal of American oil and gas and financial companies as major impediments to the continuation of Russia’s military operations, notes that finances are just one factor in American companies’ decision to exit the Russia market.

“The companies who have left are really choosing between supporting the rules-based, international order that has maintained the peace in Europe for decades and a revisionist oligarchy that seeks to redraw borders in Europe. For a company’s brand image and values, the decision to withdraw from Russia will likely have positive effects.”

China Considerations

ConocoPhillips, Black & Decker and Procter & Gamble

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U.S. companies that operate in China, whether their production facilities are based in China or they rely on Chinese companies in their supply chains, "should absolutely start thinking of diversifying out of China," says Deptula. But not for the reasons you might think. Deptula points to the ownership requirements for Chinese joint venture projects (China must own 51% of the venture) and China's complicated history of intellectual

property theft leading to serious potential complications for U.S. businesses. Leaving the country as a moral stance? To Deptula, that is a move that is likely to backfire.

"For U.S. companies that leave the Chinese market, the next day it is very likely that you might find a Chinese logo slapped over the U.S. company sign at the production facilities or storefronts. I think that leaving the China market as a moral stance would likely just help China push some of their strategies for developing their own domestic companies. By staying in the market, you are competing with those Chinese companies and buying some level of soft power and influence in the country itself."

Faulkenberry warns that an exit from China is much different than an exit from Russia because of simple economics. China boasts the second-largest (and rapidly advancing) GDP in the world in U.S. dollars, while Russia comes in at a respectable, but considerably lower, 11th. Still, she believes the ramifications of an exit must be considered as part of one of the board's most fundamental roles: risk assessment.

"Boards should 'red-team' the implications of deepening their supply and manufacturing ties with China, with possible scenarios ranging from aggression against Taiwan and resulting sanctions to more U.S. restrictions on supply chain and raw materials to increased taxes. Diversification as a way of mitigating risks is always a critical consideration."

Scott Michael Moore, director of China programs and strategic initiatives at the University of Pennsylvania, expresses concerns about China's recent human rights abuses but does not see a direct linkage between Russia's invasion of Ukraine and a possible departure from the Chinese market.

"I don't think any decisions about exiting the China market or substantially affecting China operations should be made as a direct response to the Ukraine crisis or to China's position on the Ukraine crisis. They are two very different situations and present different considerations for boards and executives," says Moore.

The point is driven home by Michael Montelongo, a director for Civeo Corporation and Conduent Inc., and a former assistant secretary of the U.S. Air Force, when he states that 58 other nations, including Mexico, Egypt and Singapore, abstained from a vote to expel Russia from the United Nations Human Rights Council, and 35 countries representing 50% of the world's population either abstained or voted

“No” to a March U.N. resolution condemning the Ukraine invasion. Aside from the fact that China is not alone in choosing not to condemn Russia’s aggression, Montelongo is concerned about the precedent that is set when boards guide their companies toward a departure from nations.

“Precedent-setting decisions should be a factor in the decision-making process. Companies that left Russia will likely be criticized for being selective and inconsistent if they don’t act similarly with China,” says Montelongo. “But the extraordinary decision to depart from a country should not be done reflexively, impulsively, summarily or in a vacuum.”

Montelongo believes that the situation offers boards an opportunity to proactively double down on risk management principles, update their risk and crisis management plans, and reevaluate their reliance on certain regions and their dependencies on specific partners, suppliers or governments before a crisis takes hold.

“Taking action now to war-game, organize, prepare and equip the enterprise for probable scenarios is a prudent step,” says Montelongo. “Companies with significant operations in China may consider steps now to gradually lessen their dependencies in that market.”

Ramifications of a Chinese Exit

Boards that choose to plan scenarios around an exit from the China market must consider ramifications on the business. Deptula believes that for small and medium-sized businesses, the need to find new production facilities as well as the loss of opportunities in the Chinese marketplace would be devastating. He is also concerned that a departure from China and the accompanying removal of competition would serve as a boon to an already burgeoning Chinese economy.

“Foreign goods are still seen as a luxury in China, but that trend is moving as the focus for ‘produce domestic, consume domestic’ continues under President Xi’s dual-circulation strategy,” says Deptula of China’s model of prioritizing domestic consumption while remaining open to international trade and investment. “Without foreign companies in the market, these companies will have full control.”

A company’s degree of exposure, including revenues, profits, facilities, employees and reputation, plays a major role in determining possible ramifications, says Montelongo. “For companies with nominal ties to the China market,

disengagement should carry minimal risk. But transnational companies with considerable dependencies should expect economic and brand impact, sanctions, perhaps nationalization as well as possible cyber retaliation."

The Board's Responsibility to Consider Increased Aggression

In weighing a company's possible departure from China, a board would have a large amount of considerations, whether financial, reputational or cyber-related. As evidenced by recent diplomatic visits to Taiwan, China is a country that takes slights — either real or perceived — quite seriously. So, would a large-scale departure of American businesses result in an increase in aggression between the United States and China? Should boards be factoring this possibility into their discussions on a potential exit? Augustine believes the answer is simple.

"While concern is valid, such considerations should be the province of the federal government, with industry input and compliance."

If there were to be a mass exodus of U.S. companies from the China market, Deptula sees the possibility of repercussions, but none that would rise to the level of military action. He states that blowback would be more of the propaganda variety, with China trumpeting that American companies were not able to succeed in China or lobbing accusations that the United States is waging an economic war against an international competitor.

Says Deptula, "This may not have immediate consequences, but it certainly helps China continue to build up an internal narrative of China being treated unfairly by the West, especially the United States."

Montelongo believes China's reaction to a possible pullout of American companies would rely heavily on the footprint and scale of the departing companies and their impact on the Chinese economy, as well as the impact of parallel actions taken by policymakers, such as the recent move by several advanced democracies to eject Chinese firms from their financial markets. Nevertheless, he points to possible escalation of conflict with China as a major impetus for boards to enhance their risk management processes and stock their boards with geopolitical expertise.

"Boards must prospectively and retrospectively consider what it means to do business with entities that might provide revenues, but are also threats to national security and human rights," says Montelongo. "To avoid being blindsided, U.S. boards need to be current with what policymakers are doing or contemplating, incorporate geopolitical risks in their long-term strategies and

continuously monitor how the global security situation is evolving.”

Should Shareholder Primacy Override Humanitarian Concerns?

The principle of shareholder primacy holds that corporate governance should focus on maximizing the value to shareholders before considering the interests of other corporate stakeholders, such as consumers, employees, the community and even society at-large. Is there an argument to be made that exiting China (or Russia, for that matter) is a decision that should not be weighed by a public company board of directors, simply because it is not a strategy that would result in a financial benefit to the shareholder? Augustine believes it’s a decision that must not be taken lightly by board or CEO.

“It should be the board’s responsibility to define whatever position is taken — within prevailing law — on major political, humanitarian and economic issues. It should be the CEO’s responsibility to convey that position,” says Augustine. “Situations may arise wherein a board finds it necessary to terminate activities in a country for humanitarian reasons, but doing so should be under compelling circumstances.”

Montelongo fears that for many companies, the decision to leave Russia may have been the result of reacting to events in the moment, rather than having a plan in place. He believes the situation in China now demands that boards proactively plan for possible scenarios and evaluate the tradeoffs, including the adoption of a decision framework for dealing with countries that may violate international norms.

“What’s important is the candid deliberation and consideration of options against a range of decision criteria,” says Montelongo. “The right people around the table, coupled with an environment that encourages open dialogue, candor and good faith, increases the probability of a decision that is best suited for that company's specific situation."

According to Deptula, there is simply no way for boards to ignore the actions of hostile countries on the grounds of it not suiting the shareholder. Consumers are becoming more particular about the causes they support when choosing to purchase a brand. Companies have become increasingly intertwined in geopolitical conflict, and their boards must be acutely aware of how their business decisions impact the policies and people in the countries they operate. In his view, it is impossible for directors to stay on the sideline when it comes to

decisions relating to actions on the international landscape.

“I do not see a case for saying it is outside the board’s role to consider international conflict. If the board is operating in the best interest of the shareholders, this decision should fall to the board.”