Confronting Complexity:

Lessons Learned from Engagement with Chinese Enterprises

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CDA
PRACTICAL LEARNING *for* INTERNATIONAL ACTION

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Introduction

A little over a decade ago, the Chinese Government began to actively encourage Chinese companies to invest abroad as part of its "going out" strategy. Since then, with the introduction of the One Belt One Road (OBOR) Initiative in 2013, the overseas investment of Chinese State Owned Enterprises (SOE) and private companies has increased exponentially. While both companies and local stakeholders in the recipient countries have high expectations for these projects, many companies become quickly frustrated at their inability to identify and manage various risks, particularly at the societal level. Chinese corporate projects have, in many cases, provoked community dissatisfaction and unrest, and in some cases contributed to broader tensions and instability within the host state. This has resulted in substantial losses incurred by Chinese companies, particularly when involving highly complex environments such as Libya, Myanmar, or the DRC. This experience is leading to a growing awareness in China about the need to learn from responsible business practice approaches in order to better manage risks to and impacts of their overseas investments.

One such Chinese company, The Union Development Company (UDG), operates a concession in Southwestern Cambodia for development of the Cambodia Tourism Coastal Zone Development Project. In the early 2010s, UDG recognized growing tensions between its project and local communities. It identified a need for a new approach to stakeholders and sought to learn from global experience in responsible business practice to enhance the conflict sensitivity of its approach and to strengthen its social license to operate. In 2015, UDG invited the New Century Academy for Transnational Corporations (NATC), CDA Collaborative Learning Projects (CDA), and the American Friends Service Committee (AFSC) to provide UDG with a consultation and pre-assessment of UDG's operations in Cambodia towards those ends.

A NATC, CDA, and AFSC field team visited Cambodia and the UDG project in October 2015 for the purposes of analyzing how the company and communities interact, examining the impacts of company activities on the lives of local people, identifying the broad outlines of a strategy by which the company can approach constructive engagement. This report, which is based on that visit, includes insights about the operations and the context in which UDG operates and preliminary findings regarding Chinese business practices that either help build positive relations with local communities or engender community dissatisfaction and opposition. The findings presented here can provide insights and options for working with Chinese companies to advance social engagement, enhance contributions to development and strengthen conflict risk management practices.

The methodology employed in the pre-assessment is suitable for mapping the major challenges facing a business operation and for ways to approach these challenges constructively. The visit was not intended as a comprehensive or definitive assessment of the company's practices or of its efforts to obtain a social license to operate. A pre-assessment is considered appropriate in this case as the Company begins to adopt strategies and develop structures to respond to a wide range of challenges that may emerge in the coming years.

Section I. Framing the Context

Chinese Enterprise, Chinese Experience

In China, local and central governments have a relatively high level of capacity. Clear and well-established legal and regulatory frameworks mandate that government assume responsibility for managing the majority of social and environmental issues arising from large corporate projects. Companies have little reason to perform social risk analysis, to engage directly with communities, to put forward sustainable social investment initiatives, or to participate directly in the resettlement of populations living at project sites. Many companies have only very limited Corporate Social Responsibility and Public Relations departments, and lack technical staff with experience in community development practice. For example, one major, national-level oil and gas company with operations in nearly every province across China reported having only 3 CSR staff based in its Department of Enterprise Culture. Consequently, within many Chinese companies, there is limited awareness of social safeguards, as, generally speaking, these are viewed as the responsibility of local government authorities.

Most large Chinese companies that attempt to build this *métier* within their organizations do so with limited experience and, generally, they develop business practices that are adapted from the Chinese business environment. Few of them ask themselves whether these same practices are well-suited to projects outside of China. When they invest abroad, they focus on high-level and diplomatic engagement with host state government officials, expecting the host governments to manage relations with local governments, traditional authorities, and communities, as well as addressing environmental issues. They rarely conduct conflict risk assessments or seek to understand how conflict dynamics in the local operating environment might impact operations or drive instability in the operating environment. Further complicating matters is China's well-established foreign policy principles, which mandate that China not 'interfere' in the internal politics of other states. In practice, and particularly in the case of State Owned Enterprises, the application of these principles amounts to stakeholder management strategies that involve incumbent governments exclusively. Company managers repeatedly cite concerns about "angering the host government" or "being perceived as interfering in domestic affairs" when discussing decisions not to directly engage communities or NGOs.

Unfortunately, this approach has not proven particularly effective in fragile and conflict-affected states, where host governments may not always act in the interests of communities and often lack the capacity to resolve social and environmental problems. Further, many Chinese companies find that their business experience in China, however successful, offers them few internal resources, little organizational learning, and scant professional capacity that is helpful in unfamiliar jurisdictions, still less so in fragile and conflict affected states.

Increasingly, Chinese companies are becoming aware of the risks and costs associated with such approaches, and are presently exploring and experimenting with different options to enhance the security of their investments, and to prevent costly conflicts that emerge when social and environmental issues are not handled appropriately. The experience of the Union Development

Group (UDG) in Cambodia can be seen as illustrative of these phenomena. UDG is a private sector real estate investment company with a track record of successful projects in China. Its Koh Kong Project in Cambodia is its first attempt to operate outside of China and is projected to be its largest project to date.

The Cambodian Context

Cambodia poses a number of challenges to large-scale foreign investors. While the ruling Cambodia People's Party (CPP) continues to maintain a strong power base and a high level of influence within all parts of the government, the growing strength of the main opposition party since the 2013 elections represents a significant challenge to which foreign investors must remain sensitive. Over the past several years, as the pace of economic development in the country has picked up, public perception has developed that the vast majority of large investments in Cambodia are negotiated through senior power brokers with close ties to the incumbent party leadership. There are growing popular concerns that the dominance of such power brokers undermines competition, results in misappropriation of national assets, and limits economic prospects of those without connections to politically influential people.

Opposition party leaders have an interest in exposing corruption in such projects, and in undermining or publically discrediting the proponents of large-scale projects as a means of checking the political influence and resources of the ruling party, while also generating public support. The opposition's approach has become increasingly popular, especially in urban centers like Phnom Penh, where frustration regarding the nation's wealth gap is growing.

Corruption, whether real or perceived, also drives significant tensions between the ruling party and the NGO sector. The majority of advocacy, rights, and environmental organizations in Cambodia's large and dynamic NGO sector pay close attention to development and foreign investment projects in Cambodia, as they identify such projects as significant drivers of human rights violations and as opportunities for corrupt individuals. Multiple NGOs have released reports on nearly every large-scale investment project in the country, raising a wide range of concerns, asserting misapplications of the law, or attempting to expose some form of corruption. Project proponents and the government very rarely share information or talk to these NGOs, and as a result, many of the latter have great difficulty obtaining accurate information or verifying facts. Others are actively supporting efforts within the CPP or within government to promote reform.

Land and Land Tenure

The Khmer Rouge destroyed most of the country's land ownership records and displaced the vast majority of the population, and, thus, uncertainty about land rights continues to be highly problematic in Cambodia. Contemporary land titling efforts have proceeded extremely slowly. In general, foreign companies that invest in Cambodia commonly experience difficulty obtaining clear rights to land.[1]

[1] Note that according to Cambodian Land law, foreign natural persons cannot own land. A Cambodian business with a 49% of its shares owned by a foreign entity may purchase land, and this is the vehicle that is generally used by foreign businesses

Lack of clarity in this area has allowed dubious forms of land speculation to proliferate. Powerful individuals with insider knowledge of large-scale projects also often buy up land in the vicinity of proposed projects before plans are made public. The land law is not always respected in these transactions, and "soft" title documentation is sometimes falsified by local officials in favor of speculators. In the UDG case, it is alleged that significant tracts of land were obtained by outsiders in this manner, and that these outsiders continue to press their claims, often cooperating with local villagers.

The Union Development Group in Koh Kong

The Union Development Group signed its first MOU, for a 49,000-hectare concession in Koh Kong Province, in 2008 and holds a 99-year lease. Since then, it has built over 150 kilometers of roads, a reservoir, large hotel, golf course, luxury villas, and supporting infrastructure. The construction phase of the project is projected to continue for another 17 years, encompassing the construction of a cargo port, a commercial airport, additional tourist and retail infrastructure, and a large number of residences for rent and for sale. At the time UDG acquired the concession, the area was relatively remote from Phnom Penh, due to the poor state of the roads. Roughly 3,000 people lived in the area, their livelihoods dependent on farming, fishing, raising animals, and small trades. UDG projects that the concession area will ultimately comprise an urban area with a population of 500,000 people. The scale of the projected investment makes UDG one of the largest overseas investors in Cambodia. The project plan relies on ongoing investment from a range of different businesses and individuals with commercial or personal interests in establishing a presence in the project zone as it develops into a city.

Until early 2014, UDG replicated in Cambodia the business approach that it has employed with great success in China. It signed an agreement with the government stipulating that the government manage land acquisition and all community issues arising from the project. It had no direct role in resettlement negotiations with villages in the concession area. It provided funds to local and communal government authorities to build resettlement villages and the infrastructure associated with them, but neither participated in planning nor performed any formal or systematic monitoring of either of those activities. It had no community relations or CSR staff or department, and little direct communication with local communities before or after their resettlement. At the same time, UDG felt that it had acted in good faith and complied with its regulatory and contractual obligations. In 2015, UDG did establish monthly community meetings, but these were closed, involving only village heads and taking place at UDG's facility in Koh Kong. UDG also recently responded to complaints in resettled communities by constructing a canal to give resettlement villages better access to the sea.

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in the country. In addition, the government offers a number of lease schemes to foreign companies to use the land for a specific period, ranging from 50 to 99 years.

Section II. Problem Areas

Compliance and Social License

Even where companies are able to meet the full scope of their contractual and regulatory responsibilities, communities often still accuse them of failing to meet local expectations of social responsibility. In Koh Kong, communities are not opposed to the UDG project. On the contrary, they see these types of investments as presenting opportunities. But they have already begun to feel that their needs, wishes, and perspectives are not taken into consideration in the project. They lack access to information about the project and access to the company itself, and feel that their representatives are making decisions in their name that ultimately do not benefit them.

When communities feel that they lack agency in corporate projects that affect their lives, they often become more vocal, and at times obstructive. When communities are discontented, it presents opportunities for NGOs to gain community support and to criticize and attack companies publically. Too often, companies respond by becoming further entrenched in the position that they have met their legal obligations, dismissing community perspectives and reducing their level of engagement with external stakeholders. Typically, this further escalates the tensions in the relationship between the company and the community, which then deteriorates, leading to demonstrations, work interruptions, bad press, abuses, charges of complicity, and worse.

Perceptions and Realities

Contextual factors that are currently creating tensions between UDG and its local stakeholders may be further exacerbated by widely divergent perceptions and expectations. The community's perception that the company is not meeting its responsibilities may be driven by a lack of information about the project, but it is as important as factually documented "*truth*", if not more so, and may present increasing risks as the project progresses. Communities speak about what they perceive to be reality and what they assume to be the company's motivating factors. On the other hand, companies speak about or respond in regards to the "facts" that they know. The gap between these two perspectives often drives an escalation of tensions about the community's rights. Under these circumstances, companies find it very difficult to settle with any finality the question of what it takes to meet community expectations regarding their "rights".[2]

Benefits: the 'How' and the 'What'

The way in which the project will impact Koh Kong is, in large part, determined by the way in which the company and the benefits it offers interact with the context. Most community members have some type of request to the company for betterment of the community – improved houses, concrete walk ways, asphalt roads, water, electricity, and so forth. Such requests indicate both dissatisfaction with the current conditions, and, more worryingly, a focus on the transactional aspects of the

[2] See Bardouille, Dost. "Community Perspectives on the Business Responsibility to Respect Human Rights in High-Risk Countries." Case Study, CDA Collaborative Learning Projects, and the Institute for Human Rights and Business, 2011.

relationship between the company and community. When the company-community relationship consists of little more than the provision of material benefits by one party to the other, it encourages the community to make requests continually. Under these circumstances, many companies find that the community's perceived needs are impossible to satisfy. Those benefits, additionally, can become a contested resource within the community and cause division amongst locals, if community members perceive inequity in the distribution of benefits. The extent to which those impacts are understood in advance and managed for will be one of the key determinants of whether locals benefit from sustainable social and economic development, or whether competition for those benefits increase divisions and lead to in-fighting, resource capture, and other, similar ills within local communities.

Engagement: Broad, Inclusive, Ongoing

Community members in Koh Kong want joint meetings between the company, NGOs, and themselves. While the resettled communities feel that the newly instituted monthly meeting between company and community leaders is a step in the right direction, most locals still feel left out of the dialogue. They indicate that they want to negotiate directly with the company, and while the presence in meetings of NGOs and village heads is important, it cannot replace the voice of community-level individuals. Because no community is monolithic, the company will need to be proactive in reaching broadly across the community to understand the full range of perspectives and sentiments. Limiting engagement to matters of project implementation or compensation communicates to communities that the company's engagement agenda is pre-set and defined by company priorities. A lack of proactive engagement by the company may leave stakeholders feeling like they have few options other than disruptive behavior as a way to get the company's attention.

Engagement mechanisms that allow UDG to hear the range of perspectives from community members on an ongoing basis would allow UDG to address minor grievances raised by community members before they become major conflicts. Open-ended engagement (that is, engagement without an agenda that is defined in advance) can also provide the company with a better understanding of different interest and influence patterns that exist within communities, including the extent to which various stakeholders have influence over each other or are being influenced by others. If external groups try to leverage community discontent to support advocacy agendas, a foundation of broad engagement by UDG with the local community could help it to more effectively resolve conflicts related to land tenure, community development, or increased traffic and an influx of workers into the region.

Third Parties and Representatives

The actions of the government in preparing and developing the project, as well as the actions it takes as an intermediary between company and communities, have both direct and indirect consequences for how the project is impacting the community and, thus, for UDG and its own relationship with local stakeholders. Communities do not always distinguish between the company and the 3rd parties acting on its behalf. In the case that 3rd party entities use intimidation tactics to obtain resettlement agreements, for example, UDG may be seen to condone these practices and to benefit from their results. Recognizing this dynamic, and even acknowledging the ways in which UDG's project is influenced or impacted by the actions of others, may be a first step in setting a foundation of dialogue with local communities.

In addition, the actions of community leaders who negotiate with the company on behalf of the entire community can be a determinant of the company's relationship with the entire community, if those community leaders do not act in the broad interests of the community. Taking a narrow approach to stakeholder engagement or engaging with the "wrong" leadership will likely color locals' perspective of UDG and may lead to inter-community conflict, making people feel that they need to compete with each other for access to UDG decision-makers and benefits.

Transparency and Accountability

Residents and some NGOs are deeply critical of the process by which compensation and resettlement has been managed, the construction in new communities, and the slow pace at which social and economic opportunities are being developed. Generally speaking, the community's sense of ownership for their new villages is low and does not yield the company the credit or social license to operate that it hopes for. Frustrations are building among villagers, particularly those displaced and resettled far from their traditional way of life and livelihoods. Many believe that the poor construction quality of the resettlement houses is an indication of misappropriation on the part of some actors involved in the resettlement process. Locals see certain people enriching themselves at the expense of others, and perceive a significant discrepancy between the funds that UDG pays out and the results they see in their communities.

While villagers may want to believe that the company is fulfilling its responsibility of furnishing the funds for proper resettlement, the community blames the company if funds are misspent. To the extent that UDG knowingly invests large sums of money into resettlement and development without positively impacting intended beneficiaries, the community will perceive the company as intentionally supporting benefit captors. While UDG is not to blame for ineffective institutions and weak governance at community and regional levels, locals ultimately will look to the company to address the lack of impact of its investments, and UDG will increasingly become the object of the community's dissatisfaction. Ensuring that land acquisition, resettlement, and economic development is properly managed is, in part, dependent on UDG creating some level of transparency around the investment it makes, such that a better system of accountability can come into being.

Section III. Options and Opportunities

Looking forward

Developing constructive relationships and having positive engagements with its stakeholders, including the government (national and provincial), local communities, other investors, advocacy groups and critics, and others working in the region is critical for UDG to achieve and maintain a successful development project. At the same time, the success of UDG's community-facing activities will be dependent on the extent to which the company is prepared to strategically develop its capacity for engaging local stakeholders on a variety of issues. In contexts such as Cambodia, UDG, and companies in similar positions, are advised to seek 3rd party support to aid in the development of an effective approach to operations such that the presence and activities of the company in that region and in the country contribute to positive relationships and sustainable development, and do not either deepen existing tensions or create new conflict and tensions with communities in the region and with civil society at the national level. Collaborations should aim to mitigate a range of business risks and help UDG to establish and maintain a social license to operate. Key objectives moving forward should include:

- Establishment of corporate-community engagement framework in Koh Kong, and stakeholder engagement at national level, that includes options for navigating the varying interests and expectations between and across local and national stakeholders as well as the establishment of a grievance mechanism;
- Social risk analysis for advancing operations in Koh Kong region;
- Analysis and consideration of measures to mitigate or avoid negative human rights impacts, as well as possible options for positively enhancing the human rights situation of affected communities;
- Monitoring of UDG's social performance including seeking objective feedback on opportunities for improvement/change; and
- Development and assessment of future social investment strategy and initiatives that take into account the impact of various tensions and conflict dynamics on investment opportunities.

Learning from Experience

The Chinese central government continues to encourage foreign direct investment, which in 2014 exceeded the amount of foreign capital invested in China for the first time since the beginning of China's reform and opening in 1979. The approach to business operations that is familiar to Chinese companies is well suited to doing business in China, but it exposes them to considerable risk outside of China, and can be predicted to lead to significant conflict in areas of operational influence and possibly at a broader scale in host-states.

Chinese enterprises have begun to recognize that some of the challenges that they experience in FCAS result from the fundamentals of their approach to business operations. Within the community of Chinese enterprises and their stakeholders (such as financial institutions, business schools, think tanks, and state committees), there has been a noteworthy shift in recent years, and an emerging interest in tools, guidance, and standards that can contribute to mitigating non-business risks. But the gulf between recognizing a need for new approaches and their implementation in institutional practice is considerable. It remains true that, when a country manager in a Chinese firm recognizes that his company's approach to business operations may be causing more problems than it solves, there is little internal organizational or professional expertise for him to draw on, a lack of clarity about how things need to be changed, and uncertainty about what to do next.

Others[3] have observed that the Chinese business community does not need to reinvent the wheel when it comes to social performance; Western companies and their institutional stakeholders such as international financial institutions (IFIs) already benefit from a range of measures to mitigate non-business risks and protect investors, including both institutional mechanisms and tools and guidance based on experience in the field. Many of these tools also focus on increasing benefit to affected communities and other host-state stakeholders, as well.

Chinese companies will need help and support in a range of domains before they will be able to devise operational approaches that achieve and sustain a social license to operate in fragile and conflict-affected states.

I. Internal organizational structures that include professional community-facing functions, and that allow for a high degree of connection between those and operational functions, such as human resources and logistics.

II. Increasing capacity to engage myriad stakeholders. While many Chinese companies operating overseas have experience engaging with high-level government officers, they will need to develop competencies, processes, and human resources to be able to engage a broader range of actors, including service and advocacy NGOs, communities, local government, political parties and other entities that contest governance, journalists, and possibly others as well.

III. Effective engagement with such groups implies an ability to manage relationships with stakeholders with divergent, competing, or contradictory interests. Success in this area depends on an ability to analyze and understand stakeholders' positions and interests in light of the company's values and strategy for positioning itself in relation to external entities. Balancing this need with China's well-established policy of "non-interference" in the affairs of other states may well be possible, but discerning how best to do that continues to be challenging.

IV. Effective company-established non-judicial grievance mechanisms can strengthen company-community relations and reduce legal and conflict risks. Channeling grievances through a formal mechanism also reduces the need for communities to express dissatisfaction in other ways. Establishing and relying on grievance mechanisms will represent a significant change for most Chinese companies.

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[3] Notably Jiang Heng, *An Evolving Framework for Outward Investment; a Chinese Approach to Conflict Sensitive Business* (Philadelphia: American Friends Service Committee, 2014) which is an adaptation of the Chinese-language book *Out of the Minefields and Blind Areas of Overseas Investment* (China Economic Publishing House, 2013) by the same author.

V. The management of community development and social investment requires a set of specific skills that many Chinese multi-national companies do not posses and are not accustomed to managing. Many Western companies hire professional development workers to staff these functions, or in other cases outsource projects to professional development agencies or NGOs.

None of this is to suggest that Chinese companies should simply copy the organizational structures and practices of other multinationals, nor that the social performance of multinational corporations is unimpeachable. Chinese companies that are interested in exploring more constructive approaches to social issues will need to determine for themselves which elements of existing practices are useful to learn from and make their own, or how they might find their own solutions to the sorts of social issues that typically confront large-scale foreign investments in contexts of fragility. As they do so, however, there is no reason they should not benefit from the robust suite of tools and guidance built on the experience of MNCs, and from 3rd party organizations with deep expertise in these areas.

It's worth noting, as well, that Chinese enterprise is different in several ways from Western MNEs. Once such distinction is the absence of established organizational routines and processes in community engagement, stakeholder management, local content, and social investment. In many Western companies, well-established assumptions and routines at times impede a thorough understanding of impacts and risks, and therefore decision-making that would enable constructive and responsible operations. In some ways, this absence may make it easier for Chinese business to take on change.

Conclusions

Drawing upon the aforementioned observations, UDG has been presented with a range of options for the company to consider in order to achieve and maintain positive relationships with stakeholders at all levels, and to implement effective development programs that lead to positive, sustainable impacts for the region. UDG's country-level management realizes that negative publicity, loud denunciations by civil society, and acrimonious relations with affected communities would inhibit future investment in the project and would significantly undermine its long-term success. UDG has articulated the business imperative for changing its previous approach to stakeholder relations and sought out new ways of relating to its stakeholders. Its efforts and experience offer valuable learning opportunities for Chinese businesses more generally, and for stakeholders interested in working with them, about how to operate responsibly in emerging markets.