

Audit Committee Leadership Summit

August 2023

ACLS

VIEWPOINTS

Global governance in an environment of shifting EU-China-US relations

China's relationship with the West remains increasingly complex, and directors continue to cite China as a top concern. Heightened tensions with Taiwan, dependence on China for critical goods, the challenge of formulating effective derisking strategies, and China's patient, often deceptive strategic moves create challenges for companies and boards. One audit chair summed up the situation, saying, *"This is a subject I've devoted much time and attention to. It's a great concern to all multinational companies. Lots of bad things can happen."*

On July 12, 2023, members of the European and North American Audit Committee Leadership Networks (EACLN and ACLN) met with Theresa Fallon, founder and director of the Centre for Russia Europe Asia Studies to discuss the evolving relationship with China and implications for European and American companies. In the spirit of open dialogue that characterizes the network, we encouraged Ms. Fallon to share her own views, however controversial. As with any guest, we emphasize that neither network members, EY, or Tapestry Networks endorses every statement a guest might make.

This *ViewPoints* synthesizes discussions around three themes that emerged during the meeting and premeeting conversations:¹

- **China's intent and tactics are difficult to read, making it riskier to do business.**
- **A Chinese invasion of Taiwan remains a top concern for audit chairs.**
- **Reducing corporate reliance on China is crucial, but effective derisking strategies are elusive.**

For a full list of meeting participants, see Appendix 1 (page 10); for a list of reflection questions for audit committees, see Appendix 2 (page 12); for guest biography, see Appendix 3 (page 13).

China's intent and tactics are difficult to read, making it riskier to do business

Ms. Fallon opened the discussion by noting that China deliberately makes its policies, communications, and intent difficult to decipher. *"To paraphrase strategist Sun Tzu: China's overall intent is often deception,"* Ms. Fallon said. Members discussed with Ms. Fallon China's widespread use of ambiguity and mystery and how this creates a riskier business environment.

The following observations surfaced:

- **China’s communications are often deceptive.** By employing misleading or vague communication tactics, China has been able to play the US, Europe, and Russia against one another. This ambiguity makes it challenging for the West to improve relations with China and creates risks for Western companies doing business with China. Ms. Fallon emphasized, *“China tells various audiences what they want them to hear. They told Russia, ‘We’ll help you avoid sanctions,’ and to make sure everyone knew, Russia released a video which was kind of hard for the Chinese to refute, so they ignored it. They tell Russia and tell Europe they want to be a peace mediator. They see what they want to see.”* She added, *“[Chinese President] Xi has got to do a very diplomatic dance; tell the Europeans we’re neutral but we lean toward Russia—whatever that means. China has never condemned the Ukraine war. More Europeans are skeptical about what China is doing. How does this affect Europe’s view? We are seeing more fragmentation in Europe, an East-West divide of views with those countries in Central and Eastern Europe, along with the Scandinavian countries, taking a much tougher position on China than those in Western Europe.”*
- **China’s investment in Europe has been a long, stealthy process.** Several members were surprised to learn how much China has invested in Europe. The lack of transparency over ownership is a top concern for directors. Referencing Chinese investment in European ports, Ms. Fallon said, *“With the introduction of the Foreign Direct Investment (FDI) screening mechanism, I’ve been told that it is similar to bolting the door shut after the horse has already left the barn; European officials often don’t know who owns what because the Chinese have invested so much through shell companies it makes it more difficult to trace ownership. Chinese investment into Europe peaked in 2016 and overall patterns have changed with investment now focused on France, Germany, the UK, and Hungary. Even with the European Union’s (EU) FDI toolbox designed to help protect strategic infrastructure from Chinese investment, the current German government chose to ignore the guidelines of the EU, North Atlantic Treaty Organization (NATO), and even six ministries within the German government, and allowed Chinese owned Cosco Shipping to purchase a 24.9% stake in the key port of Hamburg thus setting a precedent for other less wealthy countries in Europe who may be tempted by Chinese cash for key infrastructure. Although the Cosco Shipping sale was not covert, some people complain that Europe is far more open to foreign investment than China and call for reciprocity.”* The quantity and nature of the covert investments make it difficult for some European countries to control the rate of investment. Ms. Fallon said, *“In Greece, a Chinese company was going to buy a company that manufactures missile parts, and some people knew about it, and decided to leak the information to a journalist in order to help block the sale.”*
- **China has gained leverage from its European investments.** Ms. Fallon said, *“Huawei got 11 Horizon 2020 projects. There’s no way you get that many unless someone in Europe is giving them the go-ahead. EU taxpayers are funding research from Huawei that might*

curtail their freedom of expression. It's fascinating how this has worked." A member replied, "Influence from China on the Western front is changing, they want higher participation and to force investments there. They'll be very visible in Europe, more than they are now. If we accept that as fact, it won't change; whether you find it good or not, European companies are not given the same footing as China." Ms. Fallon noted that Europe is not in agreement on how to respond, further complicating the picture: "There are 27 European Member States; it's hard to get everyone on the same page—they all make so many different points. Beijing is able to benefit from the EU's lowest common denominator approach to policymaking and has certain countries it can count on to water down or block directives not to China's benefit."

- **China's aim is to weaken the transatlantic relationship.** Before the Russia-Ukraine war, the US and Europe were not aligned in their approaches to Moscow; around half of Germany's imported gas came from Russia, and France wanted to reintroduce Russia into European security architecture. Since the invasion of Ukraine, the US and Europe are following a more convergent approach toward Russia, hindering China's goal to weaken the relationship. Ms. Fallon said, *"The US-China-Europe strategic triangle is always adjusting and changing. Russia's war on Ukraine had a galvanizing effect on transatlantic relations. China's approach is to search for cracks in the alliance and then to drive wedges into them. They don't like to see a strengthened transatlantic relationship; their goal is to neutralize Europe. This is harder to do now because of the war in Ukraine."* The US and Europe are aligning their responses to Russia, but they have yet to agree on an approach to China, with Europe itself divided on how it perceives China and what kind of policy to adopt. Ms. Fallon noted, *"Traditionally, Europe tries to position itself to benefit from the trade tensions between the US and China, to arbitrage it to their benefit. Now that is far more difficult to do because of the fragmentation in Europe with Central and Eastern European and the Scandinavian countries far more concerned about their security and Russia's ties with China."*
- **The US responds with strategic ambiguity regarding Taiwan.** Ms. Fallon took the view that Washington's traditional policy of strategic ambiguity was designed to create uncertainty in both Beijing and Taipei about whether the US would intervene in a war across the Taiwan Strait. This dual deterrence, she said, *"Was intended to prevent Taiwan from declaring independence and to prevent China from invading. It has worked for several decades and has prevented the US getting pulled unwillingly into war. There have been calls by some analysts to abandon this approach and make a US security guarantee for Taiwan explicit."* But, Ms. Fallon explained, *"If the Biden administration changed their policy away from strategic ambiguity Beijing would view this as an escalation."* One way around this, she said, was a strategy she termed 'Gaffe-plomacy.' *President Biden said four times that the US would protect Taiwan— he is not supposed to say this. His advisors walked back President Biden's statements. The first time might be a mistake, but saying the same thing*

four times is a policy. In his way, he's trying to send a message to Beijing. With strategic ambiguity you can dial up the pressure and also dial it down."

The due diligence dilemma and China's revised counter espionage legislation

China's expanded counter espionage law, which took effect on July 1, 2023, bans the transfer of information related to China's national security and interests, but it does not define what information falls under these categories. This lack of clarity means that companies could be punished for pursuing their regular business activities, or even for an employee's post on social media. The revised law allows authorities to use an anti-espionage probe to gain access to company data, electronic equipment, and information on personal property. Since the law first came into effect in 2014, China has arrested and detained dozens of foreign nationals on suspicion of espionage, and there are fears that this could now increase. Ms. Fallon said, *"The crackdown in China on due diligence providers like Bain created a catch-22 for businesses required to meet their legal and fiduciary requirements. On the one hand, under Chinese law, they will not be able to carry out due diligence to demonstrate that there is no forced labor in their supply chains, but on the other hand, by not completing diligence procedures, they are in danger of breaking the laws of the countries where they operate. These new regulations signal a danger of increased unpredictability and risk. After COVID, we are seeing in China a new era where security considerations are taking a larger role and ideology is trumping economics more and more."*

A Chinese invasion of Taiwan remains a top concern for audit chairs

As tensions between China and Taiwan escalate, a Chinese blockade or outright attack is a growing concern for directors. Ms. Fallon reinforced these worries: *"Everyone's exhausted. We've suffered from COVID-19 and sanctions on Russia. If China did something now, would governments have the will to do something? Every strategist's worst nightmare is a two-front war."*

Members discussed with Ms. Fallon their concerns over a Chinese invasion of Taiwan and how it would affect their companies, with the following key themes emerging:

- **The timing of a possible invasion is highly uncertain.** China continues to send military jets across the Taiwan Strait's median line and warships into waters around Taiwan, but as the number of these vessels continues to increase, it is difficult to determine whether this is simply another move in a long-running intimidation campaign or a signal of imminent invasion. Members noted the difficulty for a company when there are varying opinions within the organization and even on the board: *"It's very hard to summarize what*

companies are thinking about strategically with regard to an invasion of Taiwan; in the board, we're discussing multiple views, not one. We frequently and intensely discuss the issue. It's hard to say we have one strategy or view in the companies I'm in."

- **The global supply of microchips is top of mind for boards.** Taiwan is a leading producer of microchips and Taiwan Semiconductor Manufacturing Company (TSMC) is the world's biggest contract chipmaker. An invasion of Taiwan could jeopardize the global supply of microchips. One member commented, *"If there was a Chinese attack on Taiwan, I think it'd be much worse than the Russia-Ukraine war. The consequences might be absolutely huge. What would be the impact on our chips? Such a large amount of chips is produced in Taiwan."* Members noted that despite slow economic growth, China continues to innovate in strategically important areas, and Chinese control of TSMC could cause severe global trade issues. Ms. Fallon described how the Taiwanese are prepared to destroy TSMC in the event of an invasion: *"If there's a blockade, which would be the most likely way for China to attack Taiwan, then Taiwan will use a porcupine strategy, and the world will suffer from a lack of advanced chips."* She added, *"I have been told that the area around TSMC is mined. Even though TSMC is investing in fabrication plants in other countries, the key ecosystem remains in Taiwan where chips produced there are the most advanced. Government officials in Taipei told me their goal was to keep a five-to-six-year advantage in semiconductors produced in Taiwan, a sort of 'silicon shield.' Even with large government subsidies, China has been unable to produce the most advanced semiconductors. US sanctions on the export of advanced chips and equipment to China has hurt."*
- **Boards must continue to monitor tensions and formulate scenario plans.** Members agreed that despite varying views on the nature and timing of an invasion, they must continue to monitor Chinese actions. One member said, *"China is so important to most companies that trying to figure out a contingency plan is almost impossible."* Another member highlighted the possible impact of a Taiwan invasion on companies and entire industries: *"As audit committee chair, I asked for a risk analysis on what would happen to us if China invaded Taiwan. It was eye opening because we don't have the power to change much; the dependencies are so massive."*
- **China is learning from the Russia-Ukraine war.** Members observed that China has taken note of how the US and Europe responded to Russia's invasion of Ukraine and how it could apply these lessons in an attack strategy. As Ms. Fallon put it, *"How Russia has been able to circumvent sanctions has been a real learning activity for Beijing."* Reflecting on sanctions imposed on Russia, members said China has seen just how severe sanctions might be for them in response to an invasion. One member highlighted that the sanctions on Russia have so far been soft and that enforcing stronger restrictions would have greater impact and act as a better deterrence to China: *"If Russia suffered the same sanctions as Iran, history would be completely different. They're lukewarm sanctions."*

- **Deterrence is key but finding the formula is difficult.** Ms. Fallon identified lessons from the Russia-Ukraine war that the West can also apply when considering a possible invasion of Taiwan. *“I would say deterrence, deterrence, deterrence.”* She added, *“We learned from Russia that subtle deterrence didn’t work. We need stronger deterrence to prevent a war rather than fight it later. I see some European leaders or companies say they’d never put sanctions on China if there was some sort of tension in the Taiwan Strait. The US and Europe need to come up with an agreed set of sanctions, which will act as a deterrent to lower the temperature in the region. It will be a test of wills. Watching what happened with sanctions on Russia, I am not certain that the West has the will to implement tough sanctions that will hurt not only China but also their own economies.”*

Reducing corporate reliance on China is crucial, but effective derisking strategies are elusive

Members recognized the need to reduce dependency on China within their supply chains, but they noted that in many of their boards, views are still split. One member said, *“We have two views: some say we can’t afford not to be in China, while others are cautious.”* Acknowledging the complexities of disentangling from China, another member asked, *“We had interests in Russia and paid for that—it cost a lot of money. We have interests in China and maybe many of us have interests in Taiwan. What is a wise strategy for companies that are active in China, given all things?”* Members and Ms. Fallon discussed the derisking:

- **China has systematically created dependencies that will make derisking difficult.** Members noted that China is innovating, not merely by appropriating Western research but with genuine innovations in areas ranging from biotechnology to semi-autonomous battlefield systems—and the world is more and more reliant on Chinese innovation. One member said, *“Their technologies are good. There’s no way we can produce environmental things like solar or wind power without China. That production isn’t just copy and pasted; they’ve been doing copy-pasting for many years, but they’ve leapfrogged now and they’re doing a lot of innovation.”* Ms. Fallon replied, *“When I think of innovation, I think of advanced semiconductors. China processes lithium; even if we come up with lithium mines outside of China, they are still key to processing it and no one else can do that right now. We’ve created a blind spot.”*
- **China has been derisking for a decade.** China announced a “dual-circulation” strategy as part of its 2021–2025 five-year plan: the balance of working on its own market (the great domestic circulation) while continuing to trade with the world (the great international

circulation). However, Ms. Fallon noted, China has been derisking for longer than this: *“Concerned with security issues like food, they’ve been derisking silently and want the world to be more dependent on them; think of Made in China 2025. They announced their five-year plan and now they say, ‘How dare you say you’re derisking from us.’ But their dual-circulation strategy has been in place over a decade, so they are more advanced in decoupling than the rest of us.”*

- **Provoking China could have severe consequences.** An overly aggressive derisking strategy could lead to further problems, given China’s tight hold on critical resources and its willingness to use legal and extralegal measures to coerce Western companies. Ms. Fallon said that part of the problem is China’s unpredictability: *“They expect pre-emptive obedience. The Chinese Communist Party (CCP) was once described as an anaconda in the chandelier, you can see it as it looms menacingly above your head, but you never know when it will strike at you. Everyone’s afraid to do something that might upset the CCP.”* She added, *“China still offers economic opportunities. The top thing is for companies to mitigate risks without upsetting Beijing. There is a fear of retaliation. China is always searching for leverage.”*
- **Derisking is complex, slow, and requires strategy.** While supply chains can be shifted away from China, doing so is a slow and complex process. One member said, *“We’re not getting a recipe for what to do.”* Ms. Fallon replied, *“It can’t be done overnight; it will take years.”* Members emphasized that the process can also be painful because many parties must be aligned. Working collectively, however, can ease discomfort; one audit committee chair noted how an entire industry moved suppliers for many items from China to India.
- **Companies must learn from their dependence on China and be forward-thinking in their strategy.** As companies diversify their supply chains and reshape their global footprints, many are looking toward emerging markets such as India and Africa—and it is essential that companies learn from their dependence on China and build this into their strategy. One

A Chip Cold War: companies are moving out of China.

China is the leading producer of mass market consumer electronic devices, making it the world’s biggest buyer of semiconductors. In October 2022, the Biden administration began to restrict China’s access to microchip production technology; the goal was to slow China’s technological and military advances. Having already faced the consequences of relying heavily on China, more companies have responded by moving manufacturing to other locations. Reflecting on what has been termed the “Tech Cold War”, one member said, *“From my experience, it’s not that we talk much publicly, but there are lots of discussions on the approach of the supply chain production side being moved from China to other places; and it’s not just discussion, it’s already started. And it’s not just a political issue but economic; we suffer from the weakness of China.”*

member warned, *“We replaced Huawei with other actors, but we kill one of the heads, and seven others grow. We’re creating a replica of China in India and of India in Malaysia. We’re not bringing it back to Europe. We’ve changed dependency to a country who has openly declared dictatorship. If you look at the dynamics, it’s not much better.”*

Although there are no good, quick solutions, audit chairs cited practical actions that can be taken now:

- **Limit the data being sent to China.** One member advised keeping databases separate to avoid providing China with more access to data than necessary: *“We were looking at China, we knew what was happening. To cut off the China database, we run two databases so they can’t talk to each other. We don’t get a global view of our databases. We moved many products from China to India. We’ve started taking action on what we can do.”*
- **Move manufacturing of strategically critical products to other countries but keep lessons of overdependence top of mind.** Members said disentangling from China and finding alternative sources for essential goods and components has proven challenging. Finding a middle ground—for example, keeping some technologies out of China’s reach, or moving manufacturing of strategically critical products to other countries—seems like the only realistic option.² One member said, *“Everyone wants to look for new opportunities and markets and, on the production side, have better conditions and environment, and a stable political situation.”* Another member advised keeping in mind lessons of overreliance when diversifying: *“Expansion in Africa—we need to look at country risk in a completely different way and apply learnings from dependency we have on China and Turkey. We’re looking at that and driving capital-allocation processes in a different way.”*
- **Government action can speed up realignment.** One member described how, owing to a US sanction on one item, an entire industry reduced dependency on China. The member called for government intervention to help drive these changes: *“When a big agent like the US government is putting sanctions on a small part of the supply chain, things start to change. This can’t be left to the business world. With the right level of intervention, things could move fast.”* Another member agreed and emphasized that all governments will need to work together: *“Unity is needed. If everyone gets together, that might work— coming up with decent sanctions that everyone can agree on.”*
- **Take the bitter, begin now.** The Chinese idiom “eat bitter, taste sweet” —meaning “perseverance through hardship” or “no pain, no gain” —came up several times. When discussing the US and Europe’s response to Russia’s invasion of Ukraine, Ms. Fallon explained that China *“thinks the West is weak, have no discipline, and they won’t be eating the bitter. They were taken aback when they saw 11 suites of sanctions. It surprised both Xi and Putin that there was some solidarity.”* Discussing the challenges of moving away from China, one member said, *“Chinese take the bitter. Europeans are not ready to take the*

bitter.” Members agreed that companies will need perseverance and resilience to derisk their operations and advised beginning the process immediately.

About this document

The European Audit Committee Leadership Network (EACLN) and Audit Committee Leadership Network (ACLN) are groups of audit committee chairs drawn from leading European and North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The networks are organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Meeting participants

The following members participated in all or part of the meeting:



Jeremy Anderson
Audit Committee Chair,
UBS



Werner Brandt
Audit Committee Chair,
Siemens



Liz Doherty
Audit Committee Chair,
Novartis and Philips



**Ana de Pro
Gonzalo**
Audit Committee Chair,
STMicroelectronics



Renato Fassbind
Audit Committee Chair,
Nestlé



Byron Grote
Audit Committee Chair,
Akzo Nobel and Tesco



Margarete Haase
Audit Committee Chair,
ING



Liz Hewitt
Audit Committee Chair,
Glencore



**Suzanne Nora
Johnson**
Audit Committee Chair,
Pfizer



Dagmar Kollmann
Audit Committee Chair,
Deutsche Telekom



Pilar López
Audit Committee Chair,
Inditex



Benoît Maes
Audit Committee Chair,
Bouygues



Leslie Seidman
Audit Committee
Member, Moody's,
Audit Committee Chair,
Janus Henderson



**Maria van der
Hoeven**
Audit Committee Chair,
TotalEnergies

EY was represented in all or part of the meeting by the following:



**Marie-Laure
Delarue**
Global Vice Chair,
Assurance, EY



John King
Americas Vice Chair -
Assurance, EY



Jonathan Milligan
Chief of Staff to the
Global Vice Chair,
Assurance, EY



Pat Niemann
Partner, Americas
Center for Board
Matters, EY



Julie Linn Teigland
EMEA Area Managing
Partner, EY

Appendix 2: Reflection questions for audit committees

- ? What conversations are your audit committee having on China? What are the top concerns?
- ? Has your company discussed moving manufacturing from China? Has it started the process?
- ? What conversations are your board and audit committee having on the implications of a Chinese invasion of Taiwan? How can boards prepare for this?
- ? How prepared is your organization to handle disruptions in supply chains, especially in areas like microchip supply, in the event of a conflict between China and Taiwan?
- ? How is your company most effectively mitigating China-related risk?

Appendix 3: Guest biography

Theresa Fallon is the founder and director of the Centre for Russia Europe Asia Studies in Brussels. She is concurrently Adjunct Professor at the George C. Marshall European Center for Security Studies, a Nonresident Senior Fellow of the Chicago Council on Global Affairs, a member of the Loisach Group on transatlantic relations, and a member of the National Committee on U.S.-China Relations.

Theresa's current research is on EU-Asia relations, maritime security, and global governance. She has testified to European Parliament committees as well as to the UK House of Lords and briefed Members of the U.S. Congress and other U.S. government institutions.

From 2003 to 2007 Theresa worked in Beijing as a researcher and consultant. From 1998 to 2003 she was the Moscow representative of PlanEcon and taught economics in the first MBA program established in Russia. She was educated at the University of Chicago, Loyola University, and the London School of Economics.

Endnotes

¹ *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

² J. Stewart and Allen J. Morrison, "[The Strategic Challenges of Decoupling from China](#)," *Harvard Business Review*, May 26, 2023.