



Corporate Downsizing, Layoffs and Plant Closures in Times of Crisis

Enterprise risk management solutions and crisis communication strategies to mitigate operational and reputational risk of corporate downsizing in China

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INTRODUCTIONS

Hill & Associates

Headquartered in Hong Kong with offices in 14 countries around the world, Hill & Associates (H&A) is one of the world's leading independent security and risk management consultancy firms. By combining our local knowledge and professional expertise with leading edge technology partnerships, we have enabled companies to operate safely, efficiently and without disruption in the world's most difficult markets. Our solutions address a wide range of business risks including regulatory and compliance issues, while improving transparency and executive decision making in the process.

APCO Worldwide

APCO Worldwide is a global consulting firm and a leading provider of corporate advisory, government affairs and strategic communication services in China. We have been serving clients in China since 1989. Today, our China team includes more than 100 employees from a diverse range of backgrounds, including business, government, journalism, academia and civil society. We maintain well-established offices in Beijing, Shanghai, Guangzhou and Hong Kong.

EXECUTIVE SUMMARY

- Amid forecasts of sluggish economic growth in 2009, many multinational corporations in China are readjusting their operations by downsizing corporate offices and facilities and releasing employees.
- If not managed properly, corporate downsizing can present increased risk to companies' physical assets and corporate reputation.
- Dismissed or disgruntled employees can pose a security threat to company personnel and property through protests, sit-ins, sabotage and intellectual property theft, which can adversely impact continuity of business operations.
- Companies must also manage reputational risk among a wide range of stakeholders, particularly government and media.
- In this report, Hill & Associates and APCO Worldwide jointly identify various enterprise risk management solutions and crisis communication strategies that corporations can take to mitigate the operational and reputational risks of corporate downsizing in China.

- **36.8 million:** Total unemployed
- **20 million:** Migrant workers laid off
- **15,000:** Factories closed just in clothing, textile and toy sectors
- **6.8%:** GDP growth in Q4 2008
- **6 months:** Length of contraction in manufacturing as of Jan. 2009
- **17.5%:** Export decline in Jan. 2009
- **43.1%:** Import decline in Jan. 2009
- **Thousands of protesting workers across China, often violent**

CASE STUDY

A U.S.-based multinational company (MNC) was recently ordered to close one of its major facilities in eastern China and relinquish the land in order to make way for a government-led commercial project. The facility was owned and operated via joint venture (JV) with a domestic firm. The domestic firm, however, had been taking a hands-off approach to the operation for some time and was not aware of the closure order.

The MNC's management faced three primary tasks: (1) plan and execute a phased closure of the facility; (2) review the legal and administrative obligations of the retrenchment plan to ensure compliance with the People's Republic of China (PRC) laws and regulations; and (3) communicate the closure to the JV partner and employees. To do this, managers developed a closure and retrenchment plan based on the company's U.S. model and established a Plant Closure Implementation Taskforce consisting of senior human resources, finance and operations managers. The company then liaised with an outside legal team to ensure its compensation and severance payments complied with PRC labor law. The legal team advised to offer severance packages that well exceeded labor law obligations, to which the company took heed in order to ensure a smooth process. After several weeks of careful preparation, management was ready to launch the plan and announce the closure.

It first informed its domestic JV partner of its intentions, after which the partner disappeared. Before disappearing, the partner firm quickly spread word of the company's intentions among employees. Finally, without support from the local partner, and without their physical presence, the taskforce announced the plant closure to all employees in a "town hall"-meeting on company premises.

The meeting turned into a disaster. Workers immediately became unruly and engaged in physical altercations. Expatriate and Chinese managers were taken hostage by disgruntled workers desperate to extract additional compensation from the company. Following the incident, members of the taskforce resigned due to concerns about their own personal safety. The company asked the local government and Public Security Bureau (PSB) to help restore order, but the authorities refused, calling it an internal dispute that the company should handle on its own. After additional incidents of employee unrest and a prolonged period of operational disruption, the local government and PSB finally agreed to "monitor" the situation. However, the MNC's reputation among the local community and its retained employees had already suffered irreparable damage.

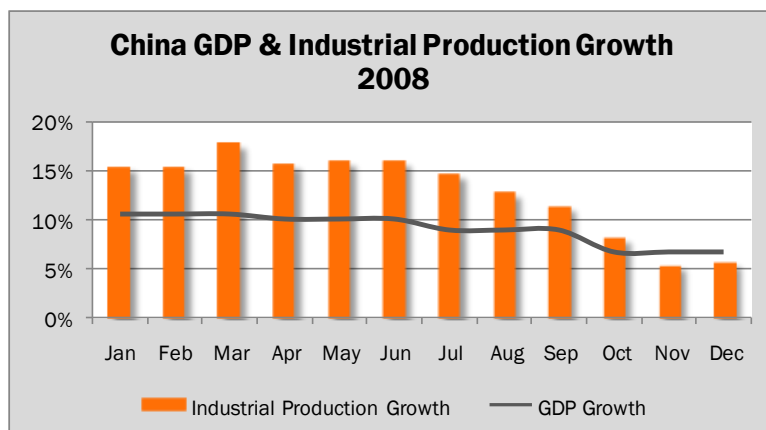
What could the MNC have done to avoid this situation?

PART I: AN UNFOLDING CRISIS

Introduction

Since October 2008, as the global financial tsunami hit the real economy, China has experienced a wave of factory closures and job losses, particularly in the Pearl River Delta (PRD) and the Yangzi River Delta (YRD), China's main manufacturing hubs. While reliable statistics related to the actual scale of the crisis in these regions have been hard to obtain, it is clear that the current economic and social problems are of a magnitude unparalleled in many years.

Even official numbers look bleak: Approximately 20 million migrant workers, or 15.3% of China's total migrant worker population, had lost their jobs by the start of the Chinese New Year in late January 2009.¹ In fact, this figure only includes migrant workers who returned to their home provinces after being laid off and does not take into account the millions of migrant workers who have remained behind to look for other work. Urban unemployment also increased greatly in 2008, to 8.5%.² Based on official statistics, China's total number of unemployed currently exceeds 36.8 million people, though the unofficial rate is far higher. In addition, tens of thousands of factories have closed. Power output, a key growth indicator, declined in November and December of 2008, by a staggering 9.6% and 7.9%, respectively. The opposite chart shows the clear decline in GDP and industrial production growth in the second half of 2008.



Source: Dragonomics

Closures lead to unrest

One visible manifestation of the factory closures has been a recent surge in labor protests and disputes over wages. In the first half of 2008, rising commodities and labor costs combined with RMB appreciation and fewer production orders significantly lowered revenues for many factories in the PRD. In some cases, unethical managers have withheld wages in an attempt to lower costs. Yet as production orders continued to decrease, many flagging domestic enterprises have been forced to close, with workers demanding their back wages and severance payments required under the Labor Contract Law. In many cases, disputes have escalated into protests and even riots on factory property.

Reliable statistics on the number of labor protests are unavailable. The government treats such matters as sensitive and companies are generally reluctant to discuss disputes and protests, meaning that many incidents go unreported. However, recent foreign and domestic news reports suggest growing protests as unemployment spreads. Additionally, the number of court cases arising from labor disputes nearly doubled in the first ten months of 2008 compared with the same period in 2007.

¹ China's Ministry of Agriculture.

² JP Morgan, which also estimated that urban unemployment in 2009 will reach 10%, more than twice as high as the government's target.

Brief Assessment and Short Term Forecast

The timing of the global financial crisis has been particularly unfortunate for China. Although the government was deliberately trying to dampen growth rates in such areas as the property sector, and move the country's economy higher up the industry value chain, the crisis accelerated the planned slowdown to a pace that forced the government to once again prioritize job creation and economic growth. As a result, the government has had to rewind some of its recent economic policies (e.g., ease the previous policy of reducing processing trade and export tax rebates).

The situation is likely to worsen in the first half of 2009 as the impact of the global crisis intensifies. China has unveiled a range of monetary and fiscal incentive policies, but the impact has yet to be felt. Furthermore, prospects for foreign demand for Chinese products in 2009 remain weak: inventory of U.S. and European retailers has been growing and the U.S. household savings rate continues to increase. Finally, China suffers from massive overinvestment, excessive inventories and considerable excess capacity in a number of sectors. This will discourage new capital expenditure, especially in manufacturing hubs such as the PRD and the YRD.

PART II: CHALLENGES AND RISKS FOR MNCs IN CHINA

Shrinking Margins, Cutting Costs

In this challenging environment, many MNCs in China are seeing their margins squeezed or eliminated. Faced with challenges that range from a decline in business opportunities to problems with suppliers, companies must consider how to navigate this new environment, and if they need to cut costs, how to do so: hiring freezes, holding back acquisitions, maintaining cash flow by tightly controlling the value chain or cutting marketing/branding expenditures.

For others, it is no longer a question of profit, but rather of survival. For such companies, downsizing, relocation or even suspending operations may be the only option. However, releasing employees or closing company facilities, even reducing supply contracts and delaying substantial capital projects, can come with considerable operational, reputational or strategic risks.

Operational Risk to Downsizing

Engaging in operational downsizing and employee retrenchment activities in China presents increased risk to company employees and assets. Factory sit-ins, personal injury and death threats, headquarter office disruptions and even kidnapping and hostage crises are increasingly common physical security risks that company managers face when announcing layoffs.

In one famous case in 2007, workers at a South Korean-owned cotton mill in Shanghai detained seven South Korean managers for several days after it was announced that the factory would close. The company's president, who had traveled to Shanghai from South Korea to oversee the factory's closure, was also detained by the workers. We are seeing more cases like this, in which problematic employees threaten or use violence to "test" management's willingness to offer additional compensation.

Threats to company property are emerging rapidly as well. Managers must take into account the possibility of events like work stoppages and management lockouts, sabotage, riots and IP theft from occurring when announcing staff layoffs.

Below are some recent examples of employee unrest:

- **Oct 18, 2008:** 500 workers gathered for three days outside their factory in Dongguan, Guangdong Province, to protest its closure.
- **Oct 27:** More than 1,000 factory workers protested in the streets of Wujiang city, Jiangsu Province, after their factory closed.
- **Nov 25:** Laid-off workers from a liquor factory in Heilongjiang Province protested in the lobby of its parent company's office in Beijing.
- **Nov 25:** 500 laid-off workers at a major MNC toy supplier in Dongguan clashed with police and destroyed office and plant property.
- **Dec 1:** Hundreds of workers in Guangdong blocked a major highway to protest against a decision by management to alter the terms of their contracts.
- **Dec 8:** 1,000 workers from a Taiwanese-owned factory in Shanghai protested for three days over overtime compensation and clashed with police.
- **Dec 19:** 300 workers at a suitcase factory in Dongguan protested and seized the factory for three days after management announced the plant would close.
- **Jan 8, 2009:** Workers of an Italian-owned furniture factory in Shenzhen protested and blocked roads after not being paid for two months.

The downturn is also causing strains in supplier relations. In recent months we have observed an increase in situations in which purchasers and/or suppliers default on payments, back out of contractual commitments—with some claiming “quality issues” in an attempt to renegotiate payment terms—and even disappear entirely. MNC employees deployed to their suppliers' offices to collect overdue payments have been held against their will, and when finally released, warned not to return.

In November, the *South China Morning Post* reported that about 100 employees of a supplier to a local electronics company in Dongguan City assembled outside the electronics company's gate to demand outstanding payments. The suppliers attempted to forcibly enter the company's facility, but were stopped by police, with whom they clashed, resulting in dozens of injuries. Furthermore, we have observed numerous situations in which a MNC's supplier fails to compensate its own vendor, and then either disappears or refers the disgruntled vendor to deal with the MNC directly for settlement.

Reputational and Strategic Risk to Downsizing

Reputational damage to a company can lead to concrete business setbacks, ranging from difficulties extending a license or failing partnerships to a consumer backlash. Downsizing in China comes with considerably more reputational risk than in the domestic markets of most MNCs. In China, the importance of developing and maintaining institutionalized relations with a wide range of stakeholders and demonstrating long-term commitment to the country's social and economic growth means that MNCs should be cautious about layoffs in hard times, only to start a hiring spree after the bad times have passed. Such practices may well be misinterpreted by government, media, grassroots organizations and other relevant stakeholders; numerous MNCs have been accused in the past of “abusing China and its people.”

We outline several issues below that warrant particular caution in the event of downsizing.

Double Standards for MNCs

Even in an economic boom time, MNCs tend to be targets for censure from a media and general public searching for avenues to vent frustration. They are also easy targets for a government wishing to protect local companies and markets. As the current financial crisis originated in the West, MNCs will be subject to even closer scrutiny, making them preferred public scapegoats, especially if the situation continues to deteriorate.

2009: A Year of Sensitive Anniversaries

China's economic challenges occur against a backdrop of several sensitive anniversaries in 2009. While from an "anniversary perspective," 2008 ended on a high note with the 30-year celebration of China's opening up, 2009 marks the following milestones:

- **Tibet:** March commemorates the 50th anniversary of the Dalai Lama's flight into exile after an abortive Tibetan uprising. March also marks the first anniversary of last year's riots, which broke out across China's Tibetan regions.
- **Sichuan Earthquake:** May 12 commemorates last year's massive earthquake in Sichuan. Although the government was initially praised for its response to the quake, controversy arose due to allegations of corruption in the construction of Chinese schools.
- **Tiananmen Student Protests:** June 4 marks the 20th anniversary of Tiananmen.

Each of these issues and anniversaries could potentially spark protests, adding to government concerns about unemployment and consequent social unrest. While the 60th anniversary of the founding of the PRC on October 1 will provide China's leadership with cause for a more celebratory mood, even this kind of festive occasion traditionally prompts the highest level of security concerns.

Increased Government Efforts to Limit Further Layoffs

Given the Chinese government's paramount aim of maintaining social stability, China's leadership has increasingly urged businesses to retain staff in order to make it through these hard times together.

- The Ministry of Human Resources and Social Security announced that minimum wage increases would be suspended and called on state-owned companies to adopt measures such as rotating work positions and flexible salary payments instead of job cuts.
- Leading Chinese State-Owned Enterprises (SOEs) and private companies such as Chalco and Sany are trying to retain staff by asking them to take a collective pay-cut as an alternative to cutting a certain percentage of their employees. Sany's chairman symbolically announced that he would accept a salary of one yuan.
- Local governments (e.g., Kunshan in the YRD) have even approached profitable foreign private businesses to hand over their profits in order to facilitate financial aid to laid-off workers elsewhere in the region.

The central government also announced measures that make it more difficult for companies (including MNCs) to downsize their operations: any layoffs must now be reported to the state-controlled labor union, and a written report must be submitted to local labor authorities one month in advance if a company wants to lay off more than 20 people or more than 10 percent of its labor force. As unemployment rises, we expect that the government will take further measures in this direction.

On the other hand, the government focus on maximizing employment also brings opportunities for MNCs to maintain or build their "license to grow" in China. To give one exam-

ple, senior officials from the Guangdong government advised us that they may potentially reward responsible MNCs—perhaps with tax incentives or favorable investment deals—which retain their employees and search for other ways to reduce costs. The government also has increasingly stressed Corporate Responsibility (CR) to entice companies to assist in tackling China’s social and economic challenges. As an example, China has urged companies not only to retain staff, but also to offer training to migrant workers. Several government officials have indicated to us that they particularly appreciate MNCs that demonstrate a concern for China’s social stability.

And Then Back Home...

In addition to reputational risk in China, labor protests—regardless of the initial cause—could lead to reputational damage in Western markets. The All-China Federation of Trade Unions has cooperated with unions based in the U.S. and Europe in the past to attack MNCs, while the network of human rights and labor organizations operating out of Hong Kong and the West stand ready to campaign against corporations on behalf of workers. Understanding and engaging with these stakeholders in advance could prevent misunderstandings should a labor-related incident occur.

PART III: RECOMMENDATIONS

In China’s current challenging environment, it is vital that MNCs manage their operational and reputational risk effectively, both for short-term success and long-term business growth.

The government’s clear priority for 2009 will be to maintain social stability, and as an extension, to create and preserve jobs. Although Western companies often instinctively turn to an adjustment of employment levels in times of economic uncertainty, we would recommend MNCs explore all viable options to manage their operations without layoffs. Such options could include seeking government concessions (e.g., taxes, land rent) if these forms of support help avoid layoffs.

However, in cases where downsizing—and especially layoffs—is the only option, we recommend an integrated approach with elements of crisis planning; security arrangements; communication with media, government and other relevant stakeholders in each phase of a downsizing operation; and effective long-term CR programs that are aligned with government priorities.

The following table summarizes our recommendations by downsizing phase.

A Consolidated Phased Approach				
	Phase 1 Planning the Downsize	Phase 2 Announcing the Downsize	Phase 3 Executing the Downsize	Phase 4 After the Downsize
Crisis Planning	- Risk assessment - Crisis planning - Develop holding statements, Q&As, etc. - Crisis simulations - HQ coordination	- Crisis preparedness - Crisis monitoring and support	- Crisis preparedness - Crisis monitoring and support	- Crisis preparedness - Evaluate crisis mechanism
Security Arrangements	- Local area risk assessment - Retrenchment action plan - Evacuation plan	- Announcement of company property - Plant protection measures - Security provider	- Plant protection measures - Security provider	- Security evaluation
Communication Issues	- Prioritize stakeholders - Devise phased strategy - Contingency planning	- Stakeholder outreach, track engagement - Unified and tailored messages - Traditional and social media	- Stakeholder outreach - Traditional and social media	- Assess impact - Ongoing engagement - Corporate reputation program
Government Relations	- Prioritize stakeholders - Government matrix - Assess interest - Set up engagement-tracking mechanism - Stakeholder outreach	- Stakeholder outreach, track engagement - Unified and tailored messages - Show long term dedication	- Stakeholder outreach	- Assess impact - Ongoing engagement
Corporate Responsibility	- Identify projects - Align with government priorities - Begin implementation and multi-channel communications as early as possible			

Recommendations: Crisis Planning

1. Proactively assess risks and contingencies for internal and external crisis management.
2. Ensure that you have up-to-date crisis procedures in place, and that all responsible internal parties understand their respective roles and the stakeholder relationships for which they are responsible.
3. Prepare holding statements, Q&As and other communication materials for a variety of scenarios, so these can be issued immediately when needed; ensure messages are unified and stakeholder-focused.
4. Run crisis simulations and ensure that external spokespersons are trained for hostile media interaction.
5. Begin coordination with headquarters as soon as the initial decision is made to ensure the unique regulatory and communication threats are understood in advance; do not waste time on this during a crisis when decisions need to be made quickly.

Recommendations: Security Arrangements

1. A local-area risk assessment is mandatory to understand the community and the employee-company relationship history, and it should be conducted before any downsizing plans are formulated. An effective risk assessment should:
 - a) Review the company's labor relations history;
 - b) Identify key stakeholders/power brokers;
 - c) Identify potentially problematic employees; and
 - d) Assess third-party (e.g., vendor, supplier, and customer) commitments.

2. Carefully devise your retrenchment plans, which should follow a sequence of steps and be kept secret from employees.
3. Develop evacuation plans for management personnel in the event of hostilities.
4. Identify a location off company property to make the announcement; employees are less likely to vandalize a third-party facility.
5. Identify and employ a local private security provider who has strong connections with the local public security bureau.
6. Ensure all plants/equipment/inventory are properly protected and secured. Consider removing valuable or critical company property off affected premises to avoid sabotage.
7. Use caution when and if you decide to include your JV partner in the planning process. JV partners may disappear in order to avoid honoring severance payment obligations.

Recommendations: Communication Issues

1. Identify and prioritize internal and external stakeholders who need outreach, considering multiple channels for delivery.
2. Develop a phased strategy that ensures each stakeholder group is targeted with appropriate messaging at the optimal time. Engagement should be tracked and clear internal responsibility assigned.
3. Prepare contingency plans in case news leaks early.
4. Pay attention to social media (e.g., blogs, Bulletin Board System/BBS, and other online forums) especially if your brand is familiar to consumers. Most corporate attacks now originate online, but a vigilant, proactive and ethical approach to Internet-based communities can help mitigate reputational disaster.
5. If your business has expansion—rather than downsizing—plans, convey those publicly or privately. Chinese stakeholders have long memories for companies that come forth in difficult times.

Recommendations: Government Engagement

1. Identify and prioritize your government stakeholders at central and local levels. Develop a matrix that clearly indicates which departments are responsible for which functional aspects of your business operations.
2. Assess risks from the government's perspective (e.g., social unrest, Labor Contract Law compliance, loss of tax revenue) and ascertain the ways in which particular departments could hinder or facilitate your plans to downsize.
3. Design unified messages that are nevertheless tailored to each department and that take into account the interests of the particular stake-

Know Your Government Stakeholders – A Guangdong Case Study

China's increasingly complex political landscape has made it crucial for MNCs to understand the different interests of their numerous government stakeholders.

As an envoy of President Hu Jintao, Wang Yang became Guangdong Party Secretary in late 2007. He has strongly pushed for his policy to "Empty the Cage for New Birds," i.e. to move away from low-end, labor-intensive manufacturing and up the industry value chain by introducing new investment and indigenous innovation.

However, this push has worried local government officials with vested interests in traditional manufacturing. While the financial crisis helped "empty the cage" and magnified the scale of low-end factory closures, it has also provided ammunition to these officials to call on the heightened risk for social instability.

While Wang Yang argues that the factory closures present an opportunity to expedite economic transformation in the PRD, the central government has responded quickly with attempts to bail out many of these SMEs by easing the processing trade / export tax rebate policies and by urging banks to support SMEs.

holder. Include your company's dedication to China's long-term social and economic development.

4. Establish a mechanism for execution, tracking and reporting of government engagement with individual accountability.
5. Engage with your relevant stakeholders during the planning stages of your downsizing operation; senior local officials (e.g., from Guangdong) have noted a particular dislike of "surprises" and sudden massive layoffs or relocations, and advised us that they would like to be informed of downsizing operations early on, possibly discussing contingency plans together.
6. Maintain open lines of communication during and after the downsizing operation.

Recommendations: Corporate Responsibility

1. Identify CR projects that align your operations and resources with the priorities of China's government and society. In this economic environment, it is critical that CR projects are perceived as cost-effective, strategic and in line with the national mood.
2. If layoffs are expected, prioritize programs that focus on retraining and supporting former employees and the surrounding community. However, also consider ways in which such programs could set expectations in other areas where you operate.
3. As output drops, small businesses throughout the Chinese value chain—from suppliers to distributors to retailers—will suffer. This presents CR-related risks and opportunities, especially in the areas of product safety, working conditions, resource efficiency, and training.
4. It is now more important than ever to leverage multiple communications channels to ensure that stakeholders are aware of your contributions. Adopt a modest and collaborative tone, especially if you are expecting layoffs.

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