OPINION

Where Huawei Went Wrong in America

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A controversy over Chinese investment in the U.S. is again in the news. This time the subject is Huawei, a telecommunications equipment manufacturer whose attempt to buy a small American company was scuttled by Washington on national security grounds. The episode marks Huawei's second failed attempt to buy an American company. Executives surely are starting to wonder how they could improve their chances if they make a third try. Other Chinese companies also should be paying close attention.

It boils down to a question of strategy. Firms simply have to do a much better job of understanding America's political climate, its investment-review system, and how to navigate both successfully. This is not an unusual problem for Western companies—look at the U.S. technology companies' struggles to cope during the 1990s when they ran up against politicians and regulators—but China does face some unique challenges.

China's biggest problem is perception. Every week, U.S. politicians and business leaders decry Chinese infringement of U.S. intellectual property; computer hacking; competition over new technologies; the trade imbalance caused by an undervalued currency; and other negative issues. This drumbeat predisposes policy makers to view Chinese investments, and particularly acquisitions of high technology, with suspicion.

One sign is the steep escalation in 45-day reviews undertaken by the Committee on Foreign Investment in the United States (CFIUS), a government panel that reviews foreign investments for national security risks. According to Deal Magazine, no Chinese transactions were reviewed in 2006, three were in 2007, and six were in 2008. While the economic slowdown starting in 2009 surely contributed to a decline in overall transactions reviewed, it is not hard to speculate that the rise will continue as the economy recovers.

Huawei's failed attempt to buy 3Leaf, a California-based cloud-computing company, is among the most striking examples of what this will mean in practice. CFIUS's review came after the deal had closed, in response to the Pentagon raising a red flag. After CFIUS began its review, Congressmen piled on to oppose the deal. Huawei found itself playing defense in a hostile political environment.

The Huawei matter reveals the problem for any company under CFIUS review—politics is inherently part of the process. And the suspicious lens through which Chinese investment in America is viewed extends well beyond CFIUS into other political, business and legal venues—all of which can be as damaging as CFIUS review to a company's prospects. As Chinese businesses seek to invest billions of dollars in the U.S., the increased investment is triggering more and more alarm bells beyond the federal government—among local officials, businesses and communities.

And how other Chinese companies can avoid similar investment controversies in the future.

Chinese companies must understand that legal box-ticking is only part of their challenge. Improving the political climate arguably is even more important. Western businesses long ago realized this, and expend considerable resources to educate policy makers about business concerns and to inform the public debate on business issues. It's called lobbying and public affairs, and Chinese companies could benefit from doing these themselves.

First, they should proactively develop relationships with U.S. policy makers at the federal and state levels to define themselves before their opponents define them. They must educate policy makers about their companies and the benefits of their potential investments in the United States. According to the Washington-based Sunlight Foundation, Chinese companies spent a mere $425,000 on federal lobbyists in 2010. The U.S. Chamber of Commerce alone spent over $81 million. Huawei's open letter inviting Washington to "investigate" the company's ties to the Chinese military is a start, but it's too little too late to save the 3Leaf deal.

Second, Chinese companies need to be more proactive in their approach to the regulatory process, partly to avoid snafus and partly to assure Americans that they are serious about complying with U.S. laws. Opponents will definitely exploit any available regulatory tools to block investments, so Chinese companies should consider that there can be advantages to being the first on the government's doorstep to discuss a deal. In this respect, Huawei's most serious 3Leaf mistake may have been to not seek a CFIUS review earlier in the process.

Finally, Chinese companies must engage media and the American public more aggressively. One rarely sees Chinese companies or their surrogates in the U.S. media. While problems like language differences might pose logistical challenges, Chinese executives can't afford not to find some way to engage the public on television, in print or on the conference speaking circuit. Companies almost never win a political battle without doing so. As part of this, companies must be prepared to be transparent and give accurate information to the media and U.S. officials. Otherwise, corporate credibility will be undermined before the review process ever begins.

No amount of public education about the companies, their intentions, or their transactions will help in situations in which U.S. national security concerns are legitimately at risk, nor should it. However, the environment for Chinese companies in America is only going to worsen as the 2012 presidential election nears and politicians look for targets to criticize. These companies must rise to their own defense when national security is not at issue, or face two more years of failed transactions.

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