



Huawei in the middle of the US-China Tech War

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OMNINVEST INDEPENDENT INSIGHTS

HUAWEI

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Introduction

As tensions between **China** and **the United States** increase, Huawei is caught in the middle of the rivalry between these two superpowers. More specifically, in an effort to curb the expansion of the Chinese techosphere, the US is putting in place several measures aiming to protect national interests, by hitting Chinese major players in the tech realm – primarily **Huawei**, which the administration of Donald Trump considers to be a threat to national security in virtue of links between the company and the Chinese government.

Even if the US administration has not provided with any evidence on the ties between the Shenzhen-based giant and Beijing, it continues to impose restrictions on Huawei and to endorse an international campaign to build a Western tech alliance formed by states in line with Washington's positions. In this framework, **Europe** is becoming a fertile terrain, where the US-China tech rivalry deploys itself looking for the support of trusted allies.

This is certainly possible because the EU lacks a common strategy toward Huawei 5G, in spite of the promotion of a related toolbox – a set of recommendations which met the agreement of state members to define rules, controls over suppliers, and share critical information. It is possible to argue that what the EU will decide to do in relation to Huawei, will affect the Sino-American competition, tipping the balance in favour of Beijing or Washington.



Chinese companies go global

In virtue of the 2008-2009 financial crisis, new opportunities have emerged for Chinese companies interested in expanding their business abroad. In particular, to stimulate the economy, Europe and the United States implemented less stringent approval procedures and supervision of overseas M&A initiated by Chinese enterprises.

The drop in the market value of many companies in the Western hemisphere, created the conditions for acquiring them at fire-sales prices. Even the trade barriers put in place to respond to the crisis did not stop Chinese exports manufacturers. They indeed incentivated the expansion of overseas direct investments (ODI) in order to circumventing tariffs.

These factors, along with the scale and resources which Chinese companies were equipped with and the foreign exchange reserves accumulated by China, provided additional elements to support national companies in the global stage.



Huawei: from rural to urban

The telecom infrastructure sector was one of the first areas of the Chinese economy to open up to foreign competition. In this specific sector, the 44-year-old **Ren Zhengfei** decided to explore new opportunities. This former Deputy Regimental Chief in the People's Liberation Army (PLA) and civil engineer, started Huawei in 1987, with headquarters in the city of Shenzhen. Initially, the company was focused on manufacturing phone switches to later expand to telecommunications networks, consulting services and equipment to enterprises.

Huawei had to face several contextual challenges: the spread of hundreds of Chinese telecom manufacturers, the difficulty in getting access to bank loans for private companies, and the presence of foreign multinational companies.

Nonetheless, Mr. Ren Zhengfei based the company's successful receipt on two important elements: the **staff share ownership structures** which made possible to raise capital offering shares to retain staff, and an ambitious vision which focused heavily on **R&D** following the example of US business giants such as IBM, PWC, Hay Group and others – this competitive spirit could be summarized with the Wolf Strategy absorbed within the company's halls.





Becoming a leader

When Huawei went global in 2000s only one per cent of the company revenue came from outside China. The turning point was made possible implementing a strategy focused on establishing Huawei's presence in "rural" markets such as **Russia, Southeast Asia and the Middle East**, which were underestimated by global competitors.

After having acquired the necessary expertise and developed its own technical system in these regions, the company entered developed markets in Europe and North America. **In 2013, about 65% of its revenue came from overseas markets.**

Today the company operates in 170 countries. According to the 2019 Annual Report, Huawei's global sales revenue in 2019 rounded off at CNY858.8 billion; the net profit reached CNY62.7 billion; and the cash flow from operating activities topped CNY91.4 billion.

In the same year, it invested **15.3% of the revenue into technological innovation and research**, which made possible to achieve a total of CNY600 billion in R&D over the past ten years.

According to the World Intellectual Property Organization, from 2003 to 2017 China deposited 20% of the international patent applications seeking to spread its dominance in the area of artificial intelligence, quantum computers, 5G technologies, and robotics. **Huawei is the company at the head of the Asian giant's race for the establishment of the red flag in the ITC industry.**



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FOCUS: The role of Chinese Communist Party Committees in the Boardroom

Corporate Governance with Chinese characteristics

China's Communist Party works hard throughout all levels of the society to improve its credibility and continuity. In this framework, the government expands its authority and supervision over companies through Party Committees. These are formed by a group of senior CCP members with a leading position within companies, finding the legal pillar in the 2012 Constitution of the Communist Party of China.

In the private setting, the Committee implements Party's policies and operates through the Trade Union and the Communist Youth League Organization.

More in general, it operates within three main areas:

1. The Party Committee makes the "Three Important, One Large Decisions" – which means being responsible for the allocation of funds related to important issues, cadres appointments or dismissals, and new projects.
2. Its members could be part of the board of directors or the executive team.
3. It oversees the appointment of executives.

The presence of these bodies is particularly relevant within strategic sectors. Many observers argue that they benefit production, long-term planning, and the fight against corruption.

Nonetheless, the role of Party Committees raised debates which see them as a source of political pressure, especially within important companies such as Huawei. The features of corporate governance with Chinese characteristics are indeed misunderstood by the West, which has demonstrated to be suspicious in front of certain dynamics.

In spite of an effective action plan, Huawei had to face several challenges in the well-established markets, especially in the United States, where the government is guarded when dealing with Chinese enterprises. A scheme could be provided here to track the most significant moments since 2001, when Huawei set up offices in the US:

- **2003:** Cisco Systems Inc. files a lawsuit against Huawei and its subsidiaries, claiming copying of intellectual property. The Chinese company is accused of having copied Cisco's IOS software, source code, documentations and copyrighted materials.
- **2003:** A joint venture between Huawei and 3Com Corp. is approved by China, the US and the UK to sell enterprise-class routers and Ethernet LAN switches in China and Japan.
- **2005:** Rand Corporation publishes a report commissioned by the US Air Force, noting that many private companies in China could have deep ties with the Chinese military, that could be an important customer of electronics firms.
- **2007:** Ren Zhengfei is interviewed by the FBI due to potential violations of US sanctions imposed on Iran.
- **2011:** According to the US Committee on Foreign Investments, Huawei must divest itself of the assets of 3Leaf Systems, a technology company. Following this move, the company's deputy chairman Ken Hu, writes an open letter to invite the US to investigate over concerns about security and intellectual property. In the letter, more details about Ren Zhengfei are provided in an effort to clarify Huawei's positions.

Huawei in the US

- **2012:** An investigative report on the US National Security Issues posed by Chinese telecommunications companies Huawei and ZTE is published, It emphasizes the threat posed to US national-security interests by vulnerabilities in the telecommunications supply chains. However, the document claimed that these companies did not provide evidence that satisfy the investigation – which appears not enough to prove that Huawei and ZTE are connected to the Communist Party of China.
- **2014:** Edward Snowden leaks NSA documents which reveal that the US has been spying on Huawei.
- **2017:** A jury in Seattle establishes that Huawei has stolen trade secrets from T-Mobile.
- **2018:** The administration of Donald Trump appears to be committed to counter Chinese tech influence by deploying nationwide 5G networks. Huawei is considered a threat, and the sale of its phones – as well as those of ZTE – are banned in stores on military bases.
- **2018:** Meng Wanzhou, Huawei's CFO and the daughter of its founder, is arrested in Canada following the request of the United States due to suspicion of violating trade sanctions on Iran.
- **2019:** US President Donald Trump signs an executive order, declaring a national economic emergency. The government bans the technology and services of foreign adversaries. Huawei and 68 of its non-US affiliates are added to the Entity List, which imposes a licensing requirement under the Export Administration Regulations (EAR) regarding the export, reexport, or transfer of any item subject to the EAR to any of these entities.



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2020: US President Donald Trump continues to pursue a **tough strategy toward Huawei**, putting in place different measures and mechanisms. Last May, ore specifically, the US imposed further sanctions on Huawei to prevent its acquisition of semiconductors that the company designs in overseas foundries using American technologies.

In addition, on June 30, the US Federal Communications Commission's Public Safety and Homeland Security Bureau formally designed Huawei and ZTE as covered companies.

On August 17, the US enacted new measures to further restrict Huawei access to American technology, expanding the Foreign Direct Product Rule with the goal to prevent the company from circumventing laws through alternative chip production and provision of off-the-shelf (OTS) chips made with tools which derive from the United States. 38 Huawei affiliates have been added to the Entity List by the US Commerce Department.

In November, the US presidential elections will be held calling American citizens to vote for Donald Trump or Joe Biden.

Even if Trump and Biden have different approaches to critical issues, it should not be taken for granted that a victory of the latter will result in a significant turning point in favor of China, and Huawei.

Indeed, the Democratic candidate has already spent severe words to talk about the Chinese counterpart, especially when issues related to technology and intellectual property were examined.

In addition, the new president will have to face problems at home caused by the COVID-19 emergency, the economic crisis and the divisions within the society. To show his political strength, and to acquire consensus, Biden will likely focus his efforts on protecting national interests in front of foreign actors.





Europe is the new battleground in the US-China tech war

A Western tech alliance

The US has enjoined its allies to not involve Huawei in the development of 5G networks in order to build a tech alliance able to counter China's influence in the tech realm. European countries are appearing as a game changer in the context of the US-China tech rivalry, having the power to tip the balance in favor of Washington or Beijing. Nonetheless, divergent opinions exist in the old continent – and within the European Union – when Huawei 5G is analyzed.

The United Kingdom: In January, London decided to allow Huawei to take part in the country's 5G development. However, as tensions between China and the US increased, the UK reviewed its positions. In July, the country banned Huawei due to security concerns related to the latest restrictions imposed on Huawei by the US, which could have led the company to use untrusted technology. Trump claimed credit for the UK backing out of the 5G deal.

The European Union: In January, the EU adopted a toolbox to mitigate risks associated to next-generation networks, and to identify a common strategies. Last July, the EU members – supported by the European Commission and the EU Agency for Cybersecurity (ENISA) – published a report on the implementation of the set of recommendations, indicating the areas within which progress must be made as well as the results already achieved. The goal is to make 5G networks more resilient, but works proceed slowly even in virtue of the different approaches that have been adopted by the countries.

Italy: In 2019, Italy signed a Memorandum of Understanding with China to officially adhere to the Belt and Road Initiatives. However, due to changes in the national political landscape the advancement of the Sino-Italian cooperation has been undermined. Huawei 5G constitutes a hot topic in the country, where Telecom Italia (TIM) has decided to exclude the company from a tender launched for its fifth-generation networks core equipment in Italy. TIM did not link the decision to political reasons, however it is important to note that the US hedge fund Elliott Management, whose executive is republican Paul Singer, is TIM's second largest shareholder. At the moment, the internal crisis and the political weakness of the government make difficult to believe that the country will opt to distance itself from the line preferred by Washington.

France: Paris decided to not ban Huawei 5G, but the National Cybersecurity Agency (ANSSI) is encouraging telecommunication providers to look for alternatives.



Germany: Berlin could become the game changer due to its weight in Europe. In spite of the concerns expressed by some important figures in the national political landscape – such as the Head of the Federal Intelligence Service Bruno Khal, the Chair of the Foreign Affairs Committee in the Bundestag Norbert Rottgen, the Secretary General of the CDU Paul Ziemniak, and the Leader of Alliance 90/The Greens Robert Habeck – Angela Merkel adopted a moderate approach. She does not want to ban Huawei 5G, threatening the relations with China.

The solution identified by the Chancellor consists in putting in place strict rules and control over suppliers, without excluding Huawei. Merkel probably recognizes the importance of maintaining ties with Beijing, especially in the light of the Neustaat Plan. This has been launched in 2018 with the goal to transform Germany in a digital state, embracing artificial intelligence, big data and blockchain following the Chinese successful story.

A second relevant reason which makes Angela Merkel more pragmatic is related to the EU six-month rotating presidency that Germany has took in July. Indeed, while within the national borders protecting trade relations with China is fundamental – as also indicated by the automotive industry lobbying – within the EU negotiations on the Comprehensive Agreement on Investments (CAI) between China and the European Union are even more significant.

Even frictions between Germany and the US over several issues (sanctions on Iran, the Nord Stream 2 gas pipeline, the US troops in Germany, etc.) make difficult to believe that Berlin will follow Washington on Huawei.

However, Angela Merkel is going to leave office in 2021, and a lot will depend on who will replace her.



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What Germany will do, will inevitably impact the course of action of the other EU actors. However, is it really possible to exclude Huawei? This implies costs which in the post-pandemic era, the EU cannot afford.

[A recent report published by Oxford Economics](#) analyzed the potential costs of restricting competition in the provision of 5G network equipment. Taking into considerations Australia, Canada, France, Germany, India, the UK, the US and Japan, experts modelled three alternative scenarios – low cost, central cost, and high cost.

They concluded that:

1. Restricting a key supplier of 5G infrastructures would increase the investment costs by between 8% and 29% over the next 10 years.
2. The higher costs would delay the access to millions of people.
3. The move would also result in slower technological innovation which, in turn, would reduce the national GDP in 2035.



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