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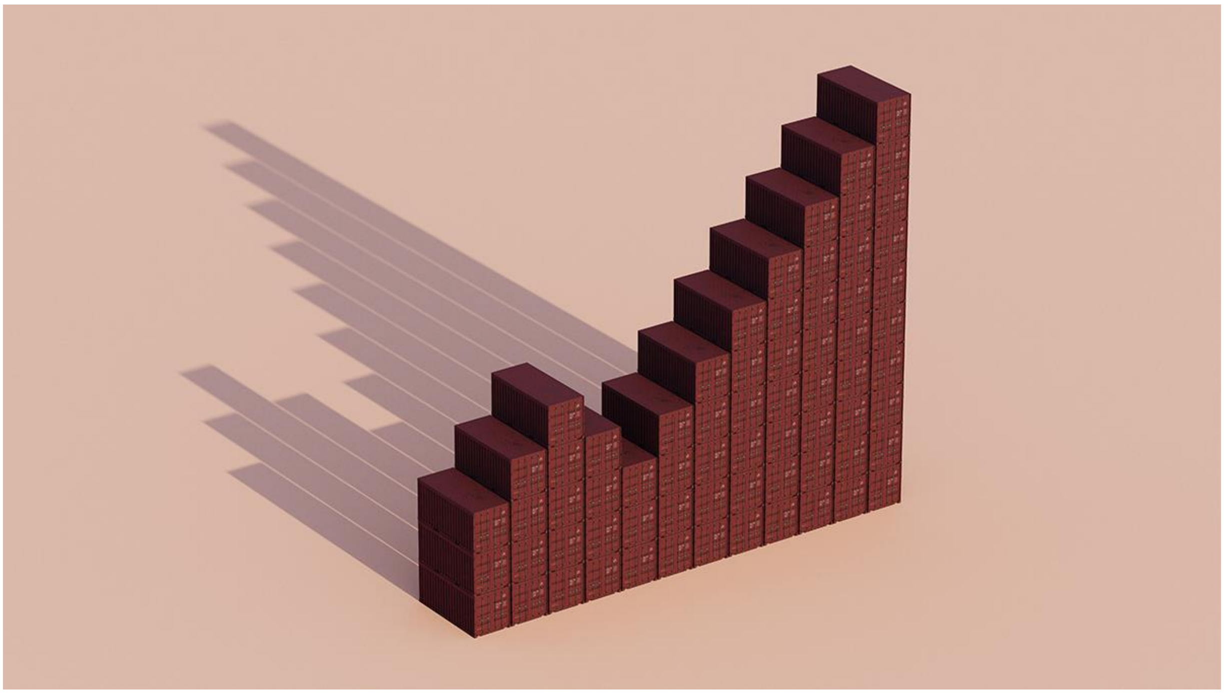

In 2018, the U.S. government levied tariffs on more than $250 billion of Chinese products. To avoid the significant new taxes associated with buying from China, many American buyers began turning to alternative suppliers — often at a significant cost to both U.S. companies and their Chinese counterparts.

But not all companies whose industries were targeted were affected equally.

Trade wars, a type of economic geopolitical conflict, are impacting a growing number of global supply chains. When facing them, how can leaders determine which kinds of companies they might engage with are most likely to weather the storm? And what steps can they take to boost their own resilience to these risks going forward?

To explore these questions, we analyzed transaction data for more than 300 pairs of U.S. and Chinese companies that were engaged in business with each other both before and after the trade war began, and that were in industries affected by the trade war tariffs. For each of the suppliers in our dataset, we tracked three key attributes:

- Innovation, which we measured by the number of invention patents the firm held
- Corporate social responsibility (CSR), which we measured using the Hexun database's aggregated CSR indicator (Hexun is one of the most authoritative rating agencies in China, and its CSR rating is informed by a combination of company reports and other data sources)
- Political ties, which we measured by the proportion of the company's equity that was state-owned

In addition, in follow-up analyses, we compared these attributes to similar metrics (utility model and design patents rather than invention patents, and charity spending rather than Hexun ratings), and we found that our results held.

Finally, for each pair of companies in our dataset, we used transaction data from the Bloomberg SPLC and CSMAR databases to calculate the value of the transactions they undertook before and after the trade war, and we compared that value to control pairs of similar companies that were not impacted by the tariffs. This enabled us to quantify the extent to which each of the three factors we tracked — that is, innovation, CSR, and political ties — affected companies' ability to continue engaging in business together after the trade war began.

Although we used the China–U.S. trade war as the empirical context of our study, we believe the lessons are broadly applicable to any business along the global supply chain facing trade policy changes — such as the tariffs Donald Trump has promised to place on goods from Canada, Mexico, and China in his upcoming second term — and/or other economic geopolitical conflicts with the trend of trade protectionism.

What the Research Shows About Boosting Resilience to Trade Wars

Through this analysis, we identified several key findings. First, we found that across the companies in our dataset, the value of transactions between U.S. buyers and Chinese suppliers fell by 18.42% after 2018. Next, we found that the more innovative or socially responsible a Chinese supplier was, the less the value of their transactions fell: Suppliers that were one standard deviation more innovative and socially responsible engaged in 32.48% and 28.58% more-valuable transactions, respectively. Finally, despite the advantages political connections may offer a business in general, we found that the more politically entangled a Chinese supplier was, the more the value of its transactions fell: Suppliers that were one standard deviation more politically entangled engaged in 32.65% less-valuable transactions.

So, what does this mean for leaders? At a high level, our findings illustrate that firms are not impacted homogeneously by trade wars. On the contrary, trade wars are likely to impact different firms differently in predictable ways, suggesting several practical takeaways for suppliers, regulators, and buyers.

Suppliers

First, our research demonstrates that to build resilience in an environment of expanding trade tensions, suppliers should prioritize innovation, invest in CSR, and exercise caution when becoming politically entangled.

Prioritize Innovation

On the innovation front, there are several strategies that can help firms become more innovative and thus boost their resilience to trade wars:

1. Invest in R&D. In the face of restrictions or increased costs associated with importing foreign technology, investing in local R&D capabilities can significantly reduce suppliers' dependence on foreign tech to maintain their own innovativeness. For example, after U.S. restrictions limited access to crucial components for the production of networking and telecommunications equipment, Huawei boosted its R&D spending, developing its own chipsets and working toward self-sufficiency in these critical technologies. Thanks to these investments, Huawei applied for more patents than any other company in 2018, surpassing key competitors such as Mitsubishi, Intel, and Qualcomm.

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2. Focus on advanced manufacturing technologies. In addition, when determining which R&D technologies to invest in, suppliers may benefit from prioritizing more advanced manufacturing systems and tools rather than sticking to traditional approaches. From automation and AI to digital manufacturing techniques such as 3D printing and smart robotics, strategically focusing on more cutting-edge options can enhance suppliers' efficiency and capacity for innovation. Midea Group, for instance, is a major Chinese electrical appliance manufacturer that has invested substantially in automation and robotics. It even acquired the German robot manufacturer Kuka, enabling the firm to leverage Kuka's innovative technology to transform its production lines.

3. Diversify technology sources. In addition to investing in their in-house capabilities, suppliers can also diversify by establishing partnerships with firms from other countries or investing in global tech hubs outside their traditional markets. This can be a practical way to gain access to a broader range of technologies and innovative processes. For instance, the Chinese drone company DJI has established R&D centers and operational teams in the U.S., Germany, and Japan, as well as engaging in strategic partnerships and collaborations with a wide range of international firms, research institutions, and universities. Initiatives like these have enabled DJI to access leading global experts and technologies, helping the firm retain its position as a global leader in drone innovation despite geopolitical tensions.

4. Leverage consumer data. Finally, suppliers can leverage big data analytics to better understand consumer preferences, optimize product designs, and tailor their offerings to different markets, thereby boosting their competitive advantage. For example, Alibaba uses big data from its e-commerce platforms to identify consumer behaviors and trends, enabling it to innovate quickly and efficiently across its diverse business segments. Indeed, our research shows that transactions between Alibaba and U.S. buyers actually increased after the start of the trade war, suggesting that the firm was well positioned to be resilient to the challenges posed by the conflict.

Enhance CSR

Of course, innovation is just one of the three factors our research identified as boosting resilience in the face of trade wars. Our research uncovered several strategies that suppliers that managed to do well in the trade war used to enhance their CSR performance. These strategies include::

1. Protect the environment. One key piece of CSR is environmental responsibility. To protect the environment, suppliers can explore opportunities to use more-sustainable manufacturing processes that reduce waste and improve energy efficiency, pursue certifications such as ISO 14001 to demonstrate compliance with global environmental standards, and develop products that are reusable, recyclable, or made from recycled materials. For example, Lenovo's focus on reducing greenhouse gas emissions throughout its operations and products, as well as its use of recycled materials in its packaging and manufacturing processes, have enhanced the company's global reputation as a leader in corporate sustainability, while also contributing to the mitigation of adverse impacts associated with trade conflicts.

2. Engage with the community. Another vital aspect of CSR is social sustainability, which is only possible through engagement with the community that a company hopes to serve. Whether by investing in community development programs; supporting educational, healthcare, and social projects in the communities where they operate; or engaging in partnerships with nonprofits and other organizations to broaden the impact of their own CSR initiatives, firms can boost their CSR performance by proactively engaging with their many communities. Alibaba, for instance, established a private charity known as the Alibaba

Foundation, as well as operating the Alibaba Poverty Relief Program, which aims to help lift people out of poverty through education and technological innovation. All that helped Alibaba report a slow sales increase, even in the face of trade conflicts.

3. Ensure ethical supply chains. Of course, suppliers aren't just responsible for themselves. It's also important for firms to ensure ethical business practices across their supply chain. That means implementing strict oversight to ensure all suppliers adhere to labor laws and human rights standards, engaging in fair trade practices to enhance the welfare of workers across the supply chain, and using traceability tools to ensure transparency in sourcing materials. Tencent's Supplier Management Policy, for instance, seeks to incorporate environmental and social criteria into supplier selection and evaluation, enabling the firm to better align its supply chain with international standards and expectations. Those environmental and social practices have enabled Tencent to effectively address the challenges posed by the trade war, and have even contributed to a notable increase in the performance of its subsidiaries, particularly within the fintech division.

4**. Uphold good governance and transparency**. Real CSR is impossible without good governance and transparent reporting. As such, to build and maintain stakeholder trust, firms should be sure to disclose all activities and data relevant to their CSR efforts in their financial reporting and business operations. For example, Huawei successfully navigated the challenges posed by the trade war, in part due to its strong commitment to social responsibility. Specifically, it publishes detailed annual CSR reports that outline its efforts and achievements in various CSR domains, from digital inclusion and environmental protection to health and safety measures.

5. Fight for employee rights and benefits. Finally, don't forget to fight for your people. To ensure employees have access to the rights and benefits they deserve, firms should work to improve labor conditions, offer competitive wages, invest in employee development, and foster inclusive workplace cultures that embrace diversity and provide equal opportunities for all. Haier, for instance, has been praised for its innovative management practices that empower employees at all levels, fostering an environment of inclusion and respect that significantly enhances both employee satisfaction and productivity, thereby mitigating the significant negative impacts of trade wars.

Exercise Caution When Becoming Politically Entangled
The last factor our research explored was political ties. We found that becoming politically entangled can come at a serious cost, as firms with stronger ties to the Chinese government were much more likely to lose business in the wake of the trade war. To address this risk and reduce their political ties, companies can consider taking the following steps:

1. **Restructure ownership.** On the one hand, changing its ownership structure to minimize state ownership or control can help a company appear more independent, thus reducing perceived political influence. This is especially important in industries with national security applications, as firms in these spaces may be especially nervous about buying from politically entangled suppliers. For example, China Unicom started out as a state-owned enterprise, but recently began taking steps to become more market oriented, including diffusing ownership by listing parts of its operations on public stock exchanges. Similarly, Chinese electric vehicle manufacturer NIO Inc. recently chose to list on the New York Stock Exchange. This not only diversified its investor base, but also subjected the company to rigorous U.S. regulatory standards, promoting transparency and reducing perceptions of Chinese government control.

2. Offshore operations. On the other hand, companies can also reduce real and perceived political influence by offshoring operations and expanding into international markets. Xiaomi, for example, incorporated in the Cayman Islands, distancing itself from direct Chinese governmental oversight (and tax obligations) and thus both smoothing its international operations and boosting its ability to attract global investment. Similarly, Baidu has established technology labs in Silicon Valley, enabling the company not only to harness global talent, but also to mitigate political risk by signaling a commitment to international collaboration (rather than responding solely to Chinese technological directives).

3. Globalize senior management. Finally, suppliers can mitigate perceptions of political entanglement by globalizing their senior management teams. Former Disney executive Kevin Mayer briefly served as CEO of TikTok in 2020 as part of a broader strategy by Beijing-based ByteDance to distance the platform from Chinese oversight. Similarly, against a backdrop of mounting U.S. technology export restrictions, Chinese semiconductor company SMIC appointed a veteran of the Taiwanese firm TSMC, Shang-Yi Chiang, as its executive director and vice chairman.

Regulators

Of course, there's only so much individual suppliers can do. To boost their local economic resilience, governments should also take steps to support suppliers' investments into innovation and CSR.

On the innovation front, there are several policies that the Chinese government has implemented that promise to boost local firms' capacity for innovation. One new program offers subsidies for companies leveraging new 5G technologies, and studies suggest that Chinese subsidies into green tech dwarf those of other leading manufacturers, such as the U.S. and Germany. China has also invested substantially in AI and robotics, and it has taken steps to incentivize patent quality over quantity by reducing financial aid for patent seekers.

Similarly, on the CSR front, China has implemented a number of policies designed to encourage greater social responsibility among its companies. For example, China's National Governance System and Governance Capability Modernization Plan pushes firms toward more sustainable practices and better corporate governance, emphasizing priorities such as aligning with global ESG standards, bolstering Chinese firms' international reputation, and increasing resilience against global economic shifts. China's 2021 Five-Year Plan also outlines significant commitments to environmental protection, targeting carbon neutrality by 2060 and encouraging investment in cleaner technologies and more sustainable practices. In addition, the China Securities Regulatory Commission substantially tightened its ESG disclosure requirements in 2020, insisting that listed companies disclose the environmental risks associated with their operations along with their mitigation strategies, while 2018's Environmental Protection Tax Law taxes companies for the pollutants they release into the environment.

Buyers

Finally, our research demonstrates that to more accurately assess their resilience to trade wars, buyers should incorporate a thorough analysis of their dependence on key suppliers into their risk assessments. While organizations often focus on risks related to their own capabilities and local business environments, many of today's firms are highly dependent on global supply chains, introducing a range of risks related to political instability, trade restrictions, and other international disruptions.

As such, to avoid overreliance on single-source suppliers, companies should prioritize diversifying their supply chains by sourcing materials and products from multiple suppliers across different geographic regions. By expanding their supplier base in this way, firms can reduce the vulnerability that comes with relying heavily on just one supplier. Of course, there are substantial benefits to working with a smaller number of highly innovative and socially responsible suppliers — but our research emphasizes the tradeoffs associated with becoming overly dependent on them in times of uncertainty, such as during a trade war.

Importantly, our analysis focused exclusively on the U.S.–China trade war — and so, while our findings are likely applicable to other types of geopolitical conflicts, further research is needed to confirm. In addition, we only studied large companies. While our findings are likely similarly applicable to smaller organizations, further research is also necessary to confirm their applicability to small- and medium-sized businesses.

That said, our findings indicate that in the wake of the trade war, Chinese firms that were more innovative or more socially responsible were more likely to retain their U.S. buyers, while buyers were more likely to distance themselves from Chinese suppliers that had stronger local political ties. As such, to boost their resilience in the face of trade wars, suppliers should prioritize innovation and CSR and exercise caution when entangling themselves in local politics, regulators should support these efforts, and buyers should consider their dependence on suppliers when conducting risk assessments and evaluating their own resilience.

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