**ZTE - A Pawn in the Trade War between the U.S. and China**

**Abstract**

ZTE, a Chinese telecommunications company, faced an existential threat in mid-April, 2018 when the U.S. Commerce Department banned it from purchasing components from U.S. suppliers. The case study delves into the causes and effects of the ban and its subsequent reversal in the same year. It sheds light on the interconnectedness and interdependency of today’s multinational corporations and the precariousness of their operations in the current environment of trade disputes. Discussion questions and teaching notes are provided.

Keywords: ZTE, microchips, ban, telecommunications, smart phone, trade disputes, macro environment, ethics, business-government relations

**Introduction**

In mid-April 2018, the Commerce Department announced that it would ban ZTE, a Chinese telecommunications company, from purchasing supplies from the U.S., such as micro processing chips, for seven years until 2025. ZTE had been accused of selling telecommunications equipment to Iran and North Korea, a violation of U.S. sanctions (Mozur & Swanson, 2018). The news sent the company in a tailspin and threatened its doom, as ZTE was reliant on American companies for their components (Zhong, 2018, May 9). ZTE launched an all-out campaign to fight for its survival, involving both presidents of the U.S. and China (Rappeport & Fandos, 2018). Less than two months later, with President Trump’s intervention, the ban was lifted: in its place, ZTE would pay a $1.4 billion fine (Ballentine, 2018). ZTE breathed a big sigh of relief

**The Company**

ZTE, known in China as Zhongxing (中兴, meaning “China Prospers”), started out as a joint venture between a state-owned aerospace factory and two other domestic firms in 1985. It started to expand into overseas markets in the 1990s. Headquartered in Shenzhen, China, it is now the fourth largest telecommunications equipment maker in the world and allegedly does business in 160 countries, employing 75,000 people worldwide. It also sells smartphones, among an array of other businesses (Zhong, 2018, May 9). In the U.S., it has become the fourth largest smartphone vendor in recent years, although meanwhile in China, its home country, it has slipped to the 10th place in sales (Strumpf, 2017). In 2017, its total sales reached $17 billion with a net income of over $723 million (Reuters, 2018). Together with Huawei, a more powerful competitor in China, it had pushed itself to the forefront of 5G, the next wave of wireless technology (Wei & Davis, 2018), vying with major Western players such as Ericsson and Nokia (Auchard & Nellis, 2018).

ZTE launched its smartphone business in the U.S. in 2011. Since then, its sales have been growing steadily and it has now become the No. 4 vendor of smartphones in the country, behind LG Electronics Inc., Samsung Electronics Co., and Apple Inc; it captured 11.2% of the market share, selling a total of 19 million phones in the U.S. in 2017. A key smartphone sold in the U.S. is the Axon M, a dual screen phone that folds in half. Its entry into the U.S. is an impressive success story, the envy of its major Chinese competitors, Huawei and Xiaomi, who were not as lucky in their U.S. foray; the success could be attributed largely to the latitude that it allows its managers in the U.S. to run the company. In Africa, together with Huawei, it helped link many countries; for instance, it put down thousands of miles of fiber optic cable in Ethiopia (Zhong, 2018, May 9).

The company, however, relies heavily on American components, notably Qualcomm’s microprocessors, for instance. The Commerce Department’s ban signaled nothing but a death knell for the company, as China provides only 10% of its needed microprocessors and for the remainder, the country’s technological know-how in the semiconductor sector has yet to catch up with that of the U.S., something that China is striving for (Li, 2018).

**The Cause of the Ban**

ZTE makes telecommunications gear, smart phones and other gadgets. As their products incorporate components made in the U.S., they are subject to U.S. export controls. As early as 2012, ZTE was probed by the federal government for its alleged violations of U.S. sanctions against Iran. In 2016, the Commerce Department uncovered two ZTE’s internal documents as evidence for its case: one described in detail its continuing projects in five sanctioned countries – Iran, North Korea, Sudan, Syria, and Cuba; another revealed a flowchart demonstrating an elaborate way to evade U.S. export controls. During the probe, ZTE continued shipping products to Iran. In 2017, as a result of the multi-year U.S. governmental probe, the company was fined $1.19 billion for violating sanctions and obstructing justice (Viswanatha, et al., 2017).

Following the fines in 2017, Zhao Xianming, ZTE’s Chairman and CEO, publicly stated that “ZTE acknowledges the mistakes it made, takes responsibility for them, and remains committed to positive change in the company” (Mozur & Swanson, 2018). However, the government found that it did not take actions that it said it would; in particular, it never reprimanded its executives involved in the sanctions – on the contrary, it rewarded them. As a result, the Commerce Department issued the ban. Repeated deception indicates that the company is “incapable of being, or unwilling to be, a reliable and trustworthy recipient of U.S.-origin goods, software and technology,” the order said (Zhong, 2018, June 6).

In short, the order was a breach of the 2017 settlement; its violations of the sanctions went years back.

**The Fallout**

Following the ban, ZTE’s major operations came to a halt. Many employees passed the time in training and team-building activities and singing motivational songs, such as “being together in the same boat” (Zhong, 2018, May 9). Demand for its products also suffered. In the U.S., where ZTE has established a brand through years of marketing campaigns and efforts to cultivate relationships with wireless carriers, T-Mobile U.S. Inc. retracted an agreement to distribute smartphones and other products in the U.S., an agreement worth more than a billion dollars. AT&T, the major distributor of ZTE phones, continued carrying its phones, but evaluated the impact of the government order on its business. For its millions of U.S. phone users, they were left with a device at risk of being inoperable. ZTE’s smartphones run on Google’s Android operating system. Following the ban, Google stopped updating its Android software and security patches on ZTE’s phones and halted technical support for its customers. Some frustrated users were contemplating switching to other brands (Strumpf & Khan, 2018).

In other parts of the world, disgruntled telecommunications network operators demanded penalty payments for stalled supply shipments. The Italian carrier Wind Tre SpA, one of ZTE’s biggest European customers, requested 100 million euros ($117 million) from ZTE for interruption of the construction and maintenance of its network. Paul Triolo, from the political risk-consulting firm Eurasia Group, observed, “If you’re a carrier in Europe that uses this company, and you’re uncertain about whether the denial order is lifted, you are going to be re-thinking our supply chain, particularly with things like 5G.” Testra Corp., Australia’s largest telecom operator, stopping selling ZTE smartphones due to uncertainty in supply. MTN Group Ltd., one of African’s largest network carriers, considered contingency plans (Strumpf & Ma, 2018)

**Fight for Survival**

Following the Commerce Department’s order, ZTE immediately fought for a reprieve from the ban. It hired Hogan Lovells, the main law firm that worked on its behalf, to lobby law makers, as well as handle negotiations with the Commerce Department. Hogan Lovells’ top lobbyist was Norm Colman, the former senator of Minnesota. The law firm employed various tactics to influence the outcome. Together with its political action committee, it made donations to legislators who could determine ZTE’s fate. It also threw a party, whose attendees included prominent senators. Over this short period, ZTE paid Hogan Lovells $1.28 million for its services (Swanson & Vogel, 2018).

ZTE also gained access to the officials in the White House and the Commerce Department. Through Hogan Lovells, ZTE retained Mercury Public Affairs, a lobbying and public relations firm, whose key lobbyist was a Trump campaign and transition official. ZTE paid the firm $75,000 a month for three months for help in setting up meetings with U.S. government relevant officials (Swanson & Vogel, 2018).

During this short period, ZTE USA, the company’s subsidiary, spent close to $1.4 million to fight the Commerce Department’s order (Swanson & Vogel, 2018).

Along with President Trump’s intervention, in early August 2018, the senate passed a watered-down bill, allowing ZTE to survive (Swanson & Vogel, 2018).

**A Blemished History**

A further examination of the company reveals that ZTE’s misconduct is not confined to violations of U.S. sanctions. In other parts of the world where it conducts business, ZTE also encountered its share of problems. In its own country, a manager at China Mobile - China's largest wireless operator - was found accepting bribes from several companies, including a ZTE subsidiary, in 2017. In the Philippines, ZTE caused an uproar – it was awarded a $330 million contract to build a broadband network, but was accused of inflating the price to pay kickbacks to the officials there, including then President Arroyo, in 2007. The contract was later cancelled. In Africa, two ZTE executives were convicted of corruption in Algeria in 2012. In Kenya, a contract with the local police was cancelled due to overbilling in 2013. In Ethiopia, a World Bank investigation found that the government awarded a contract to ZTE, which would give the company monopoly over supply of telecom equipment for several years, without competitive bidding, which a normal procurement process entails; yet the service it provides there can be irregular: network glitches are reported to happen frequently and smartphone users sometimes have to walk several miles to get a good signal (Zhong, 2018, June 8).

**A Pawn in the U.S. - China Trade Disputes**

Under normal circumstances, the Commerce Department’s ban on ZTE would strictly be a legal matter; however, it happened amidst an escalating trade war between the U.S. and China and the company soon found itself a bargaining chip in the trade disputes between the two countries. President Xi made a personal appeal to President Trump on behalf of ZTE and Mr. Trump intervened (Mozur & Granville, 2018).

For decades, China has benefited from the liberalization of global trade and rose spectacularly to be the world’s second largest economy, as early as 2010, behind the U.S. In 2015, China issued “Made in China 2025,” an ambitious, transformative strategic plan aimed at upgrading its economy into high tech sectors, such as robotics, microchips, aerospace, and self-driving cars, from its labor-intensive clothing, shoes, and consumer electronics industries. The plan positions China to compete head to head with U.S. and other developed economies, threatening the American dominance in many advanced technologies (Hopewell, 2018).

Mr. Trump has accused China of unfair trade practices. In particular, China would force American firms to transfer technologies to Chinese companies when they attempt to access the Chinese market. Besides, the trade deficit between the U.S. and China rose to a record $375 billion in 2017 (WSJ, 2018), compared to $347 billion in 2016.As a response to bilateral trade issues and the threat that “Made in China 2025” presents, in 2018, President Trump imposed tariffs on $250 billion worth of imported goods from China and threatened more tariffs to come. In return, China retaliated with tariffs on $110 billion in American exports to China, including whiskey, soybeans, pork, cranberry, products mostly produced in Republican- dominated states (Kiersz &Bryan, 2018).

Moreover, for years the U.S. officials have expressed unease that equipment made by ZTE and its Chinese competitor, Huawei, might be used for espionage or network disruption by the Chinese government (Woo, 2018). Consequently, large American mobile companies such as AT & T have practically been prohibited from buying equipment from these companies.

It was in the early stages of the trade tensions between the two countries in 2018 that the Commerce Department issued the ban on ZTE, over its breaches of sanctions - a blow to the company so severe that it practically crippled the company. It also exposed China’s gap in semiconductor technologies, spawning heated discussions and soul searching in Chinese social and traditional media; an urgency to speed up the development of China’s own micro-processing technologies was crystallized (Li, 2018).

Yet, in 5G technologies, ZTE and Huawei have pushed to the forefront, posing an existential threat to the U.S. dominance. The ban, therefore, is also widely construed as a way to thwart ZTE in the race for dominance in 5G. Yet American companies would not emerge from the ban unscathed, either. As it spurs China to accelerate its own semiconductor business, it would consequently narrow demand for American components. Currently China imports half of its microchips from the U.S.

At the time, Qualcomm, the leading provider of ZTE’s microchips, proposed a takeover of NXP, a Dutch-based chipmaker, to diversify its microchips into the automobile business. Both companies conduct business in China and thus the acquisition proposal needs to be approved by the Chinese government. Mr. Trump’s intervention, after Mr. Xi’s personal plea, was expected to generate a quid pro quo from China, who would give Qualcomm’s bid a green light (WSJ, 2018).

Besides, Mr. Trump’s intervention would also supposedly help ease tensions with Mr. Xi and give Mr. Trump leverage in the country’s trade disputes with China, Also at the time, Mr. Trump was planning a summit with Kim Jung Un, North Korea’s leader, in Singapore in June; the summit would be the first to be held by sitting leaders of the two countries. However, Mr. Trump needed to rely on China to facilitate the meeting (Rappeport & Fandos, 2018).

Eventually, China did nothing to approve Qualcomm’s bid, and it fell apart. However, in the midst of the ZTE saga, China awarded Ivanka Trump seven new trademarks, in addition to the 27 trademarks she had already received in the country; these trademarks include books, house ware, cushions, snacks, spices, etc. The timing of these awards raised questions whether China gave the Trump family extra consideration (Ramzy, 2018).

**Caught in the Crossfire**

The ban aimed at punishing ZTE caught its American suppliers in the crossfire. It disrupted their strategic goals and put a dent on their sales in China. The acceleration of its own homegrown semiconductor industry that the order has spurred would also eventually significantly dwindle the American suppliers’ Chinese market.

More than a dozen U.S. companies provide components for ZTE. For Qualcomm Inc, the San Diego-based chipmaker, the Chinese market accounts for nearly two thirds of its revenue. The company supplies at least eight of the 25 components on the ZTE device’s main circuit board, including modem and the power-management unit. The company would stand to lose half a billion of sales from this ban - about 2-4% of its total revenue - an amount that alone would be relatively insignificant (Greene, 2018)

Acacia Communications Inc., a Mass.-based maker of fiber- optic networking components, is another company that was adversely affected by the order, as ZTE accounted for 30% of its $385.2 million in revenue in 2017. NeoPhotonics Corp., the San Jose- based maker of optical gear was hoping that its revenue from ZTE would jump from 4% in 2017 to 5% in 2018, a hope that is likely to be dashed by the ban (Greene, 2018).

**ZTE’s Future**

Mr. Trump’s rescue allowed ZTE to resume its operations. However, ZTE, its customers, and suppliers will continue to be subject to the vagaries of the trade conflicts between the U.S. and China. The meeting between Mr. Trump and Mr. Xi, at the G-20 summit, held in Buenos Aires, Argentina, toward the end of 2018, resulted in a temporary cease-fire of the trade war, a promising sign for ZTE and its American suppliers. Yet, the relief was short-lived and soon replaced by another alarming news: the arrest of a top official of Huawei – the daughter of the founder of the company in Canada at the behest of the U.S. government. It sent the U.S. stock market plummeting and does not bode well for ZTE, Huanwei, and their American suppliers in the near future.

**Appendix A Discussion questions for Strategic Management**

***Macro Environment***

* Identify relevant macro environmental factors that directly impacted ZTE’s operations and strategic directions.
* How did the Commerce Department’s ban affect ZTE specifically?

***Industry Environment***

* Identify relevant suppliers. Based on Porter’s five-forces model, explain the importance of suppliers for ZTE.
* How does the ban affect the competitive dynamics in the U.S. and Chinese markets in the smart phone industry?

***Internal Analysis***

* What lessons do you think ZTE has learned from this regarding expansion into an international market? What sort of weaknesses does the ban expose the company to? Which (competencies) does the company need to build?
* What recommendations do you have for the company with regard to ethical decision-making and law compliance?
* How can the company build an ethical culture?

***Strategizing***

* What does this case teach us about strategic management?
* How have the trade disputes between the U.S. and China evolved since the case was written? How should ZTE respond to these developments?

**Appendix B Discussion questions for Business, Government and Society**

***Stakeholder Analysis***

* Identify relevant stakeholders of ZTE in this case and describe how each stakeholder was affected by or affected ZTE.
* Draw a stakeholder salience map to illustrate the removal of the ban.
* The government’s ban on ZTE can serve as an example of the company’s poor stakeholder management. Explain why.

***Ethical Decision-Making***

* What did the company do wrong ethically speaking?
* Use the four ethical reasoning approaches and determine if the company acted ethically. (You may want to address the depicted conduct in different situations separately.)

***Corporate social responsibility***

* Based on ZTE’s conduct, was ZTE a socially responsible company? Explain.
* Was ZTE a good corporate citizen? Explain?

***Business-Government relations***

* The case illustrates the intertwining business-government relationship in the U.S. context. Describe how lawmakers were lobbied. Should President Trump get involved in this? Do you think the Commerce Department’s ban should be enforced, instead of being lifted? What does the case teach us about law-making and law enforcement?

**Teaching Notes**

The author thinks that the topical, Trump-Xi -era case serves as a fitting example to illustrate concepts discussed in Strategic Management, Business, Government, and Society, and International Management. It will open the eyes of the students to a Chinese company conducting global business, including in the U.S. and to the interconnectedness and interdependence of businesses around the world in this new global age. In the following part, I illustrate how to teach the case in Strategic Management and Business, Government, and Society, respectively.

***Strategic Management***

The case is particularly relevant for use in demonstrating the impact of external factors on a company’s operations, performance and strategic direction (See Appendix A for discussion questions).

The prominent macro environmental force for this case is the political -legal factor. ZTE violated the U.S. trade sanctions as it shipped products with U.S. components to Iran. It is subject to U.S. legal penalties. However, the ban also laid bare another macro environmental force, namely the technological force, particularly in comparison between the U.S. and China. The gap in micro processing technologies between the two countries means that ZTE would not be able to function without supplies from the U.S., at least for now, as China has yet to catch up in the industry. In short, the two general environmental factors turned out to be fatal for ZTE.

Within the industry environment, the cutoff of access to U.S. suppliers speaks loudly the critical role a supplier plays in a business. Further, the enforcement of the ban would change the competitive dynamics of the industries the company is in: ZTE will accede its market share to its competitors, such as Apple, Samsung, and Huawei, in the smart phone market in different countries.

The case also serves as a good example to study strengths and weaknesses of a company. The crisis exposed ZTE’s weak leadership and culture in ethical decision-making and law compliance. To build a stronger company, ZTE needs to strengthen those areas. Students can work in small groups to think of ways to improve the company.

In short, the case demonstrates the constraints that ZTE faced in the pursuits of its goals: namely the threats from the external environment arising from its own internal weaknesses. The last exercise will guide students to take an interest in current affairs, relate them to business, and apply strategic thinking in real time.

***Business, Government and Society***

At the core of the case are issues related to concepts discussed in the Business, Government and Society course, such as stakeholder management, ethics, legal compliance, corporate social responsibility and citizenship, and business government relations (see Appendix B for discussion questions).

The most relevant stakeholders include the U.S. government, suppliers, and customers. The U.S. government’s order brought ZTE to its knees, estranged its customers, and cut the suppliers off from it; all this was brought on by its illegal conduct. Most importantly, ZTE failed in its relationship with the U.S. government, by breaching its laws. Though the government later reversed the ban, ZTE will need to make great efforts from now on to assuage government distrust that its actions have engendered. The case thus illustrates the government as a salient stakeholder of a company and its potent political power; it serves a company poorly to ignore relevant laws created by the government.

With regard to ethics, ZTE’s actions were wrong. It engaged in deception, misinforming and misleading the regulators. This violates Kant’s notion of the universal rule, of truth telling in this case, and respect for inherent human dignity. In particular, the regulators have a right to truth and deception violated this right. ZTE’s illegal actions also defied the justice principle, as it gained an unfair advantage through its illegality over law-abiding companies. Finally with regard to virtue ethics, deception and scheming are not honorable conduct; a virtuous organization will avoid such behavior. To summarize, ZTE violated the ethical principles of rights, justice, and virtues; its actions were unethical.

Further, it is reckless for ZTE to sell products to a sanctioned country because the country may pose a potential threat to mankind. In that regard, ZTE did not seem to have a sense of social responsibility; it was primarily motivated by profit. Further, to be a good corporate citizen, the very minimum a company can do is to comply with justified laws. ZTE failed in this regard and therefore could not be regarded as a good corporate citizen.

Finally, ZTE’s effort to influence lawmakers and government officials reveals the extent to which the business sector can shape the law making and enforcement process in the U.S. Eventually, the millions of dollars that ZTE spent on the law firm and lobbying firm that it retained seemed to have paid off: the ban was lifted; this was done of course in the context of delicate U.S.- China trade relations.

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