

They Call It "Tsunami"

China Adapts to the Financial Crisis

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Many people are asking about the impact of the financial crisis on China. To what extent will this enormous, fast-growing country be affected? Could China act as a “stabilizer”—a point of financial equilibrium—to the rest of the world? What implications might there be for foreign companies doing business in China and for Chinese companies themselves?

The financial crisis (which is commonly called the financial tsunami in China) originated from the U.S. As in many other parts of the world, the Chinese were caught by surprise. This is already affecting their world view. For a long time, the leaders of China have keenly studied the development patterns of other, more developed countries—recognizing that their situation is unique but looking for models all the same. And the U.S. has been a key model for some time. The financial tsunami has caused the Chinese to reconsider their view of the U.S. model and the extent to which it applies to China.

Meanwhile, from a macroeconomic standpoint, China's growth has been affected. China is now highly integrated with the rest of the world; it can no longer be “decoupled.” For example, because of the economic slow down of its major trading partners, China's exports are expected to suffer. And indeed, a large number of exports-oriented businesses (mostly small and medium-sized enterprises) have gone bankrupt or significantly reduced their operations.

However, while important, exports constitute only about one-third of China's GDP. And China's financial and banking systems are relatively stable and well regulated. This gave China a sound starting place in the crisis relative to the starting points of the U.S. and western Europe. China also benefits from its “rich” government (maintaining a surplus) and from the relatively high savings culture of its population.

Over half of China's GDP has been derived from fixed asset investments; the Chinese government has already made it clear that it will continue investing in building infrastructure, such as railroads, to aid further GDP growth. The government is also aiming at driving domestic demand through the lowering of interest rates and reducing stamp duty for stocks. For example, the Chinese government's approval in November 2008 of a 4 trillion yuan (US\$588 billion) stimulus package represents a major commitment for boosting China's domestic demand. And the Chinese government has also implemented macroeconomic controls in 2008 on the grounds that the economy was becoming “overheated.” Taking all of this into account, predictions suggest that China's GDP growth could drop from some 11 to 12 percent to around 9 percent or even 8 percent. This is a marked drop, but compared to the U.S. and parts of western Europe, where people expect a negative growth, China is probably still coming out ahead on a relative basis.

Global Context

The financial crisis is causing global business boundaries to be redefined. Capital flows are traveling from places like the Middle East and Japan, driving changes of corporate ownership at some of the most significant enterprises. With its large reserve, people are expecting China to be more assertive and make more acquisitions. On their own part, Chinese leaders seem to see this as an important time to learn and to act. There is a will for the Chinese to take on more responsibility in helping the rest of the world in transitioning through this crisis, but the Chinese recognize that they still lack experience.

When he received U.K. Prime Minister Gordon Brown on October 14, China's Premier Wen Jiabao said, "The international community should strengthen cooperation to fight the crisis. China will continue to play an active role with a responsible attitude. [But] for China, what counts the most now is to successfully address its domestic affairs. China will adopt flexible and cautious macroeconomic policies to make the macro control more targeted and flexible. China will also maintain stability in its economy, finance, and capital market to promote steady, rapid economic growth. This will be our largest contribution to the world."

Other Chinese senior leaders such as Hu Jintao and Xi Jinping have made similar remarks in the public. Most likely, China will continue to gradually step up its role in the world as it gains more confidence and knowledge in a way that is commensurate with China's own view that it is still a developing country.

Many leaders of multinational companies recognize that China, despite its slowing in GDP growth, is still a high-growth market on a relative basis. For example, one company's China business currently represents less than 5 percent of its global business today. After a comprehensive review of the Chinese market potential, it is now aiming at growing its China business to reach 20 percent of its global business in less than five years.

In addition, many companies are finding that integrating their global value chains with their China operations makes business sense—given the potential of the domestic market and China's role in global sourcing. And many companies have moved or established their R&D and product development centers in China so that they can be close to and responsive to the market. The 4 trillion yuan stimulus package announced in November will tap into 10 areas that include budget housing and key infrastructure construction, medical system improvements, environmental protection, industrial innovation, and raising people's incomes. These incentives will certainly provide more opportunities for both local and foreign enterprises.

For Chinese enterprises themselves, the financial crisis presents an opportunity to gain ground. Many Chinese companies are watching merger and acquisition opportunities—especially opportunities overseas— closely, as asset values have come down. Expect to see some moves.

The financial crisis represents an opportunity for China to learn to increase its soft power. This will be manifested at the government level and also increasingly at the enterprise level. Leading Chinese enterprises, such as China Mobile and Industrial and Commercial Bank of China (ICBC) are making building soft power an explicit part of their strategy. This will make them competitive not only within China but increasingly outside—not as combatants, but potentially as allies of select other companies. Leaders of multinational companies should take note of this trend: the Chinese company they fight today could be their ally in the future, or vice versa.

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