

China's Future, Your Strategy
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9th March 2006

The Asian Development Bank has forecast that China could be the world's largest economy as early as 2025. Given an event horizon of less than 20 years, how should we be responding?

Could 2006 be the year when individuals, companies and governments across the planet will start to embrace the likely breadth, depth and style of long-term impact China could have on everything from investment flows through to scientific research and voting models for the United Nations?

I'm in the midst of writing a book on China's future and thought I'd take the opportunity to draw on the interviews and research to date to share some of the key views emerging. In the thought piece below I've tried to outline some of the key perspectives emerging on China's future and posed a series of critical starter questions for those charged with developing China Strategies for their organisations.

A Nation on the Move

The question should not really be "why take notice now?" – but rather "Why have you taken so long?" Wherever one looks, the evidence is inescapable that China is a country on a rapid development path. When reviewing official statistics, government plans, investment commitments, analyst projections and company forecasts, three key macro drivers emerge:

1. China's growing economic power and presence in global markets
2. Development of domestic consumption
3. An increasing capacity for innovation.

A number of key trends and long term plans underpin these macro drivers, for example:

- China has experienced a period of prolonged GDP growth – reaching 9.9% in 2005. In 2000 China set a goal of raising GDP from one trillion (US dollars) to four trillion by 2020. Current estimates suggest this could be achieved as early as 2015¹
- Continued economic growth is estimated to have taken over 200 million Chinese people out of poverty in the last 20 years
- In 2004, per capita income in China was \$1290 – compared to \$41,400 in the USA²
- A goal has been set of achieving technological self-sufficiency within 15 years
- China plans to spend \$17.4Bn constructing airports in the next five years and predicts that its aircraft fleet will rise from 863 today to 1580 by 2010 and 4000 by 2020³
- China's share of world exports is due to rise from 6% to 10% by 2010⁴
- China's luxury goods market is forecast to grow 10%-20% annually until 2015 – overtaking the USA to become either the largest market (Goldman Sachs) or second largest (Ernst & Young) after Japan, with 29% of total world luxury sales⁵
- By 2020 the Chinese middle class is forecast to double to over 40% of the 1.3 Bn population e.g. 520M people – almost twice the size of the USA.⁶

Clearly, it would be misleading to focus only on the positive indicators and assume that China's path to progress will encounter few obstacles. In practice the next twenty years

are likely to be the most challenging for China's leaders. The way in which they plot and navigate the course will have profound implications across the globe.

So what could the next 20 years look like? In researching China's possible trajectory, summarised below are three dominant stories that prevail on China's future – the government view, the doomsayers' perspective and the business pragmatists' outlook.

The Government View

The line adopted by most government officials is that whilst the pace of change may not slacken, the focus will shift. Many, particularly in central government, recognise that a more sustainable approach is required and this is a key pillar of the latest national five year plan. Key priorities include reducing environmental damage, addressing the social concerns that led to over 87,000 incidents of unrest in 2005 and tackling the growing income gap between rich and poor – this has risen to 0.4 on the Gini scale.

At the same time, they argue that a pace of change that delivers around 8% GDP growth will be critical to taking more people out of poverty and driving domestic demand. Around 25% of all China's exports are sent to the US and the threat of punitive import tariffs is a growing cause for concern. Hence a policy priority is to reduce GDP reliance on exports. This year will see the start of a concerted set of initiatives to grow domestic demand sustainably over the next 10-15 years.

Should China give in to US pressure to revalue the currency, most believe this could significantly impact global demand for Chinese goods and services. However, they feel it would also create inflationary pressures in the US in particular. Furthermore, a cheaper dollar could accelerate the rate at which Chinese companies acquire foreign assets.

Doomsayers

The Doomsayers perspective argues that, in the worse case scenario, China is heading for a collapse far longer and deeper than that which affected Japan in the 1990's and early 2000's. Critical concerns are social unrest and the sheer scale of environmental degradation – encompassing air pollution, deforestation, acid rain and large scale river contamination. Politically, they argue that concerns on human rights, limited democracy and censorship will prevent the economy realising anything like its full potential. Operationally, the concern is that bureaucracy, corruption, inefficiency, poor resource utilisation and general underperformance of State-Owned Enterprises represent a time-bomb which - when it goes off - will act as a long term drag on China's performance.

Economically, the view is that historically, no country has been able to sustain such growth on a long term basis, and eventually China's bubble will burst. Concerns are also raised about the robustness of China's financial infrastructure and the relative immaturity and volatility of its financial markets. For example, the Financial Times recently offered a relatively bleak outlook on China as an investment market: "...China is still a market for the brave. It still has underdeveloped capital markets. There remain concerns about the banking systems. Corporate governance worries persist. And there is the ever-present concern about a flare-up in relations with Taiwan⁷."

Business Pragmatists

Most of the business people interviewed whether Chinese or expatriate expressed a mixture of disappointment and surprise at quite how negative some of the China commentary has been - particularly from the US. A common perception was that while all of the issues raised are very real, the Chinese government is aware and talking quite openly about most of them. Indeed, many expressed a high level of faith in the ability of the current government to deliver. There is also a growing perception that the analysis models and assumptions being applied by western economists may not be appropriate for China and may need to be reworked.

Very few expected a smooth journey and most expected one or more fairly severe but short recessionary periods over the next twenty years. Energy supply was seen as a major potential hurdle along with rising traffic congestion and air pollution. Strong concerns also exist about rising labour costs and a shortage of well trained Chinese senior and middle management. However, the general sense was one of real optimism based both on their own business outlook and that of those around them. A number of people raised the point that over \$170Bn of foreign direct investment (FDI) has gone into China in the last three years and this is starting to pay significant dividends. Most expected the annual level of FDI to remain at \$50M or more for at least the next decade.

On a twenty year timescale, despite rising income levels, most expect China to remain a relative low cost economy with average earnings at least 50% lower than those of the USA. The opening up of the domestic market and growth of the innovation and knowledge economy were seen as major opportunities and growth drivers. All sectors of the economy are expected to experience significant growth with areas such as education, healthcare, leisure, transportation, energy, environmental technologies and personal financial services expected to see particularly strong growth.

Most believed that for those not already in China, there was a relatively limited window of opportunity to start learning about and acting on the China opportunity. Those who delay were expected to find increasingly strong Chinese competitors and face much higher costs of entry and bigger survival risks.

Conclusions

Faced with these differing perspectives, for those responsible for China, the priority should be to focus on accelerating the internal learning process, with the aim of answering at least the following five questions:

- What are the size, shape and outlook for our sector in China?
- What are the relevant government plans and policies that apply to the sector?
- What are the broader 'environmental' factors that could affect our business and our ability to operate in future?
- What have we learned from our own experience in China? / Who do we know with experience of the China market that we can learn from?
- How do we create a learning dialogue on China inside the organisation?

There may be an understandable temptation to start with an analysis of competitor activity in China. However, a broader analysis of the market and operating environment may provide useful lenses through which to assess competitor actions.

Entering the Chinese market may feel like trying to mount a moving train while blindfolded. Developing early insight may just free up one eye!

Take part in a survey on China's Economy

Fast Future has just launched an online survey on the future of China's Economy. This is being conducted in conjunction with the Global Future Forum (GFF). We'd be grateful if you could complete the survey and pass it on to colleagues interested in China. In return for completing the survey you will receive a complimentary copy of the findings. The survey covers three key topics:

- *The future of China's economy*
- *China's impact on global business*
- *Organisational strategies for China*

The survey should take less than 15 minutes to complete, you can answer only those questions you have a view on and you do not have to do it all in one session. The system will remember where you left off. All responses will remain entirely confidential To complete the survey please write to rohit@fastfuture.com to request an electronic link or visit: <http://clicktools.com/dashboard/survey/go.jsp?iv=b4109b68369efc6>

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⁴ "China could become world's largest exporter by 2010" Reporting on OECD Economic Survey of China 16/09/05 http://www.oecd.org/document/15/0,2340,en_2649_34673_35363023_1_1_1_1,00.html

⁵ Goldman Sachs / Ernst and Young reports 16/12/05

⁶ China Academy of Social Sciences quoted in "Middle class society a long way off in China" 18/02/05
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⁷ "Investors would prefer year of the bull to year of the dog." Christopher Brown-Humes, Financial Times p41 13/01/06