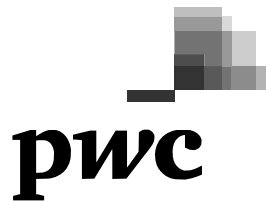


# *What Really Ails China*



Closing Address – China Business  
Challenge competition

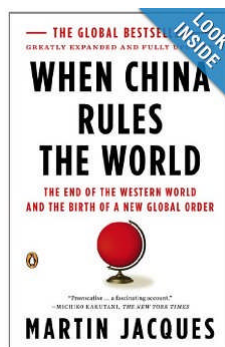


## *China pundits tend to come in two distinct flavors – True Converts and Apocalyptic Non-Believers*

### “True Converts”

- View China’s re-emergence as an economic and geopolitical superpower as more or less inevitable and with a sense of awe – and sometimes more than a little fear as well

**Martin Jacques**  
“When China Rules The World”

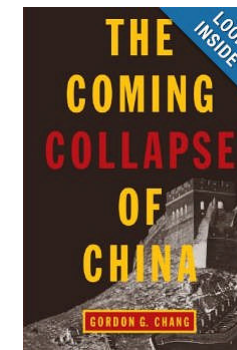


**Versus**

### “Apocalyptic Non-Believers”

- Believe that China’s “economic miracle” is nothing more than a Beijing-led Ponzi scheme that will soon collapse in spectacular fashion

**Gordon Chang**  
“The Coming Collapse of China”



Source: “China—The Mother of All Black Swans”, Jullens, Strategy+Business, Jun 2013

*After market meltdowns last summer and again earlier this year, the non-believers have clearly gained the upper hand*

The Economist

World politics

Business & finance

THE WALL STREET JOURNAL.

OPINION

OPINION  
**The Twilight of China's Communist Party**

President Xi Jinping may be gathering unprecedented power in China—but perhaps it is more the flaring of a candle before it gutters.

Open the door to green

# China's stockmarket crashes—again

ESSAY

## The End of China's Economic Miracle?

Debt and corruption are hobbling the Asian giant.

Harvard Business Review

China stock trading abruptly halted after 7% plunge

FINANCIAL MARKETS

# Why China's Market Crash Is So Unsurprising

by Linda Yueh

JANUARY 12, 2016



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***In reality, China's markets are largely disconnected from the real economy and a poor leading indicator***

**China's Stock Market and the Rise of the “Pyjama Traders”**

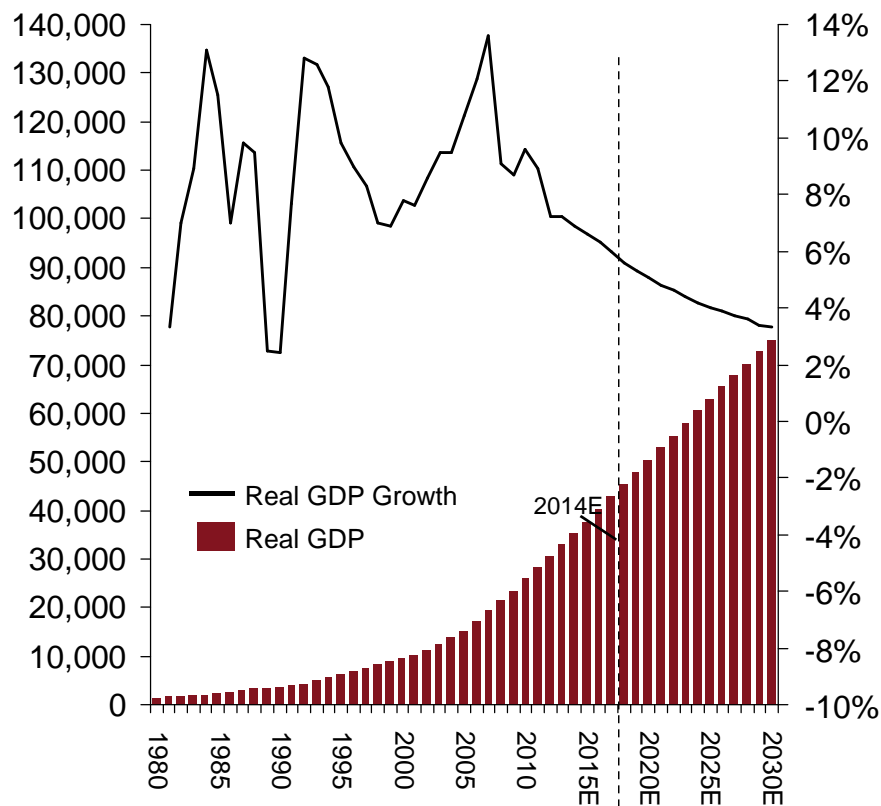


- Total market value represents only ~40% of GDP
- Individual retail investors account for as much as 90% of daily transactions
- Traded stocks are heavily skewed towards the manufacturing and construction industries
- Chinese firms rely far more on the banking system to raise capital

Source: “What Really Ails China’s Economy”, Jullens, Strategy+Business, Jan 2016, BBC News

## *The real issue is that China is in transition and faces significant economic, social, and political challenges*

Chinese Real GDP, 1980 – 2030E, RMB, bn



Source: The Economist Intelligence Unit, Strategy& analysis

### Major Challenges

- **Economic**
  - Potential GDP growth rate declining
  - Increasing structural imbalance
  - Slow recovery elsewhere (e.g., EU)
- **Social**
  - Rising inequality (Gini coefficient)
  - Pollution / Environmental degradation
  - Safety issues (e.g., food)
- **Political**
  - Endemic corruption at all levels
  - Domestic unrest (e.g., HK, Xinjiang, Tibet)
  - Geopolitical tensions (e.g., Taiwan, Senkaku / Diaoyu islands, South China Sea)

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***In fact, China has no choice but to implement a challenging reform program – the next 3-5 years will likely be decisive***

**Slow Down**

Further investment-led growth will only exacerbate China's financial, environmental, natural resources, and other problems

**Clean Up**

While highly successful, China's current growth model also produced numerous negative side effects - including endemic corruption, rising inequality, safety issues, severe pollution, and environmental degradation

**Implement Structural Reforms**

The role of the government must change from direct intervention to facilitating the ongoing transition to a more market-based economy

**Increase Domestic Consumption**

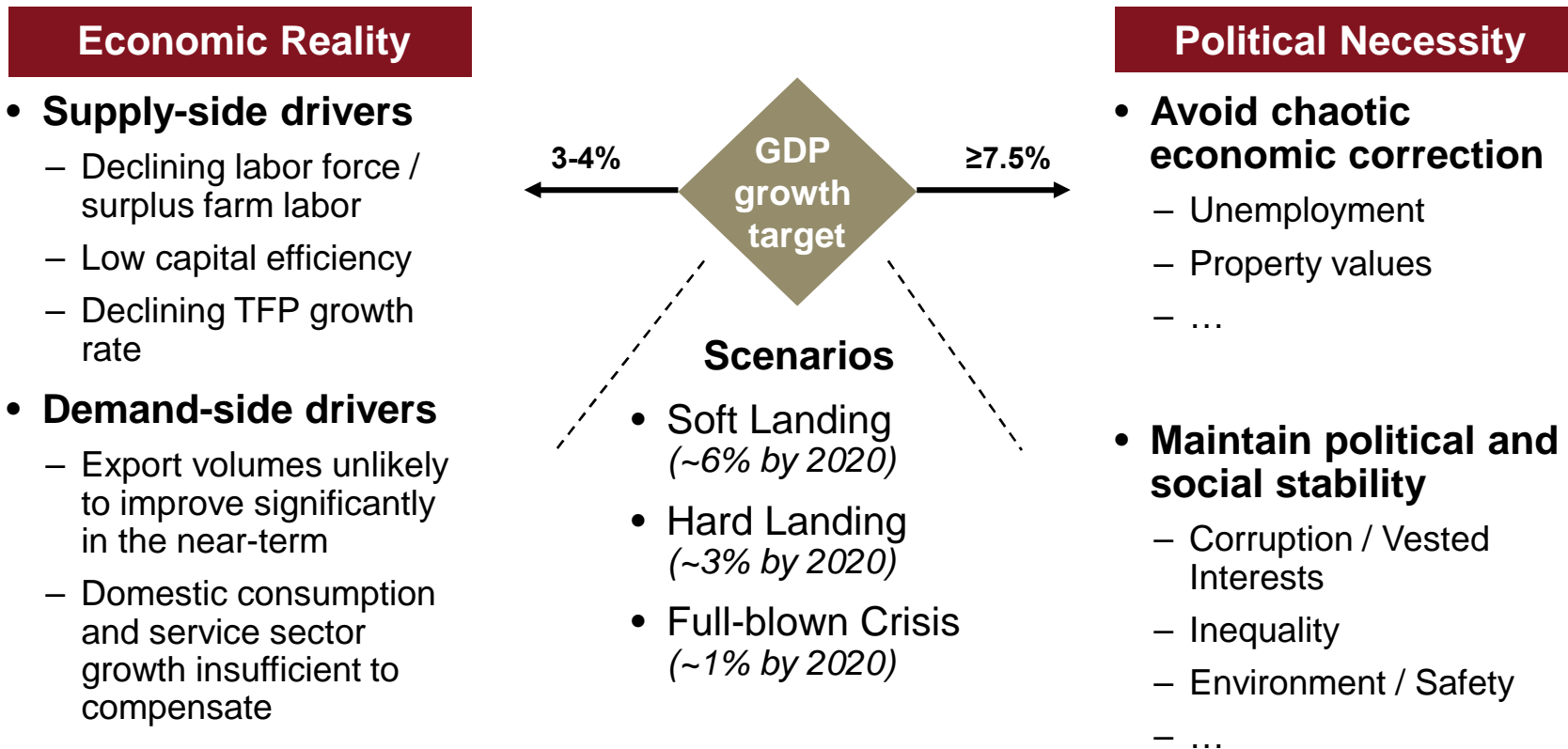
While domestic consumption has actually grown at a healthy rate, much more must be done to free up latent disposable income

**Upgrade Industrial Base**

China must become more competitive in higher value-added industries through top-down policy and bottom-up firm-specific initiatives

Source: "Will China's New Leaders Step Up to the Plate?", Jullens, Strategy+Business, Nov 2013

# *Beijing's dilemma is how to balance the political necessity of high growth with the economic reality of low(er) growth*



Source: "Will China's New Leaders Step Up to the Plate?", Jullens, Strategy+Business, Nov 2013  
"Avoiding the Blind Alley" – Rosen, Asia Society Policy Institute / Rhodium Group, Oct 2014

*In truth, there is little consensus on how to best solve these economic and political challenges – even in China itself*

### Schools of Thought Within the Chinese Elite

#### Economics

**New Left** - challenge neoliberal economics and call for a return of the state (e.g., Cui Zhiyuan)

vs.

**New Right** - Pioneered gradualist reforms of the '80s and '90s and favor restarting pro-market reforms (e.g., Justin Yifu Lin)

#### Politics

**Neocons** - Feel that limiting the state leads to collective government, unable to take tough decisions or challenge vested interests (e.g., Pan Wei)

vs.

**Liberals** - Want to place limits on the power of the state, either through elections, the rule of law, or public participation (e.g., Sun Liping)

#### Foreign Policy

**Internationalists** - Want China to merely play a role in existing global institutions and emphasize prudence (e.g., Wang Yizhou)

vs.

**Nationalists** - Want China to (re-)assert itself on the global stage (e.g., Yan Xuetong)

Source: "What Does the New China Think?", Leonard, ECFR Policy Report, Nov 2012



***However, the new leadership team's own perspective under President Xi Jinping is becoming increasingly clear***



Economic Reforms

+

Political Stability

+

The Chinese Dream

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## ***The implications of China's "New Normal" economy will be somewhat different for domestic firms and foreign MNCs***

### **Domestic Firms**

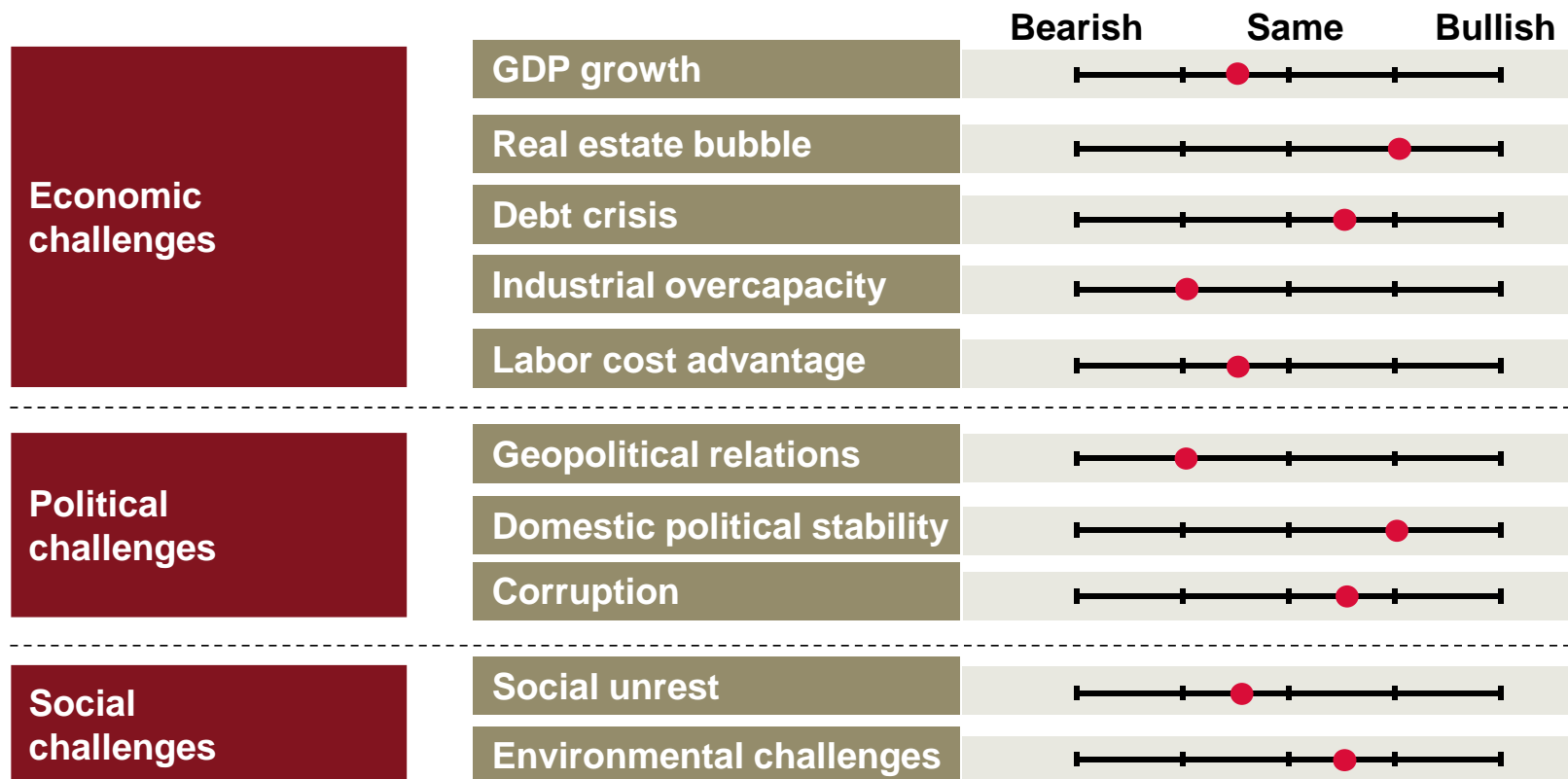
- Improve core capabilities and move up the value chain
  - *Innovation, Operational Excellence, Go-To-Market*
- Start expanding into international markets
  - *Market access*
  - *Technology / know-how transfer*
  - *Exposure to world-class performance levels*

### **Foreign MNCs**

- Develop much more granular understanding of growth opportunities and challenges
- Re-assess domestic operations to improve productivity and efficiency
- Significantly tighten operational control
- Defend position against increasingly capable Chinese competitors - both in China and elsewhere

## *In summary, the outlook for China is decidedly mixed*

**Personal view**  
Next 1-3 years, Oct '13



Source: "China – Recent Developments and Mid-Term Outlook", Jullens, Kellogg School of Management, Oct 2013

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## ***Contact information***

**John Jullens**  
**Partner, PwC Strategy&**

One Detroit Center  
500 Woodward Avenue  
Detroit, MI 48226  
U.S.A.

Telephone: +1 313 394 3622  
[john.jullens@strategyand.pwc.com](mailto:john.jullens@strategyand.pwc.com)  
[www.johnjullens.com](http://www.johnjullens.com)

## **Relevant Publications**

### **Harvard Business Review**

- *“How Emerging Giants Can Take on the World”*-- Harvard Business Review, Dec 2013
- *“Is China the World’s Next Rust Belt?”* -- Harvard Business Review China, Apr 2013

### **CEIBS Business Review**

- *“Choose Your Capability Path”* -- CEIBS Business Review, Mar 2014
- *“Modern Zorro is Out”* - CEIBS Business Review, Feb 2014

### **Strategy+Business**

- *“It’s No More BRICs as Usual”* – Strategy+Business, Mar 2016
- *“What Really Ails China’s Economy”* – Strategy+Business, Jan 2016
- *“Why China’s Stock Market Crisis Spread”* – Nov 2015
- *It’s a Race to the Bottom in China’s Auto Market* – Strategy+Business, Sep 2014
- *“China’s Mid-Market: Where “Good Enough” Just Isn’t”*– Strategy+Business, Jul 2013