

China Remembers Those Who Deliver in Difficult Times

There was never a better time to make money in China than from 2003 to 2007. The economy grew by double digits annually, its stock market quadrupled, and property prices soared. In 2008, however, government policies to cool the economy began to take hold, and the global financial crisis brought the era of easy money to an abrupt end. Like a river where the water level has receded, exposing the rocks lying just beneath the surface, China's economy has now become more treacherous.

By Jack Perkowski



No one realised how fast China was growing. When revised figures were released earlier this year, we all learned that China's economy had grown by a blistering 13 per cent in 2007. The precipitous drop from that elevated level to 6.8 per cent in last year's fourth quarter has presented new challenges to everyone doing business in the country, including the Chinese government.

With a rapidly decelerating economy, the risk of social instability is paramount in the minds of party and

124 billion) over the next three years to upgrade the nation's health care system. Under the new plan, the government will put in place a network of hospitals, clinics and community health care centres covering both rural and urban areas and improve insurance coverage by increasing subsidies for premiums. With a stronger social safety net underneath, the government hopes that individuals will save less and spend more. Given the state of the global economy and China's reaction to it, what should foreign companies and investors expect to see in 2009?

the year. New funds allocated for infrastructure projects and other stimulus measures are being injected into the economy quickly. The head of a large state-owned company told me his company had received funding for several projects on the condition that spending begin within a month.

“The head of a large state-owned company told me his company had received funding for several projects on the condition that spending begin within a month”

government officials. That is why the government acted so quickly in announcing an RMB 4 trillion (USD 586 billion) stimulus package in November, primarily targeting large infrastructure projects. China wanted to reverse deteriorating psychology in the country – and to do it quickly – so that private consumption, along with increased government spending, would have a chance to offset the expected loss in exports.

Concerned that the November package was not enough, China announced in January that it would spend an additional RMB 850 billion (USD

■ A possible “V” shaped recovery: The first quarter of 2009 is likely to be a mirror image of last year's fourth. The Spring Festival holiday, coupled with the continued effects of the global economic crisis, will result in slow economic growth in the early months of the year. Given the depressed statistics, it's understandable that many are predicting a long and slow recovery. However, there is growing opinion that the impact of China's stimulus package could begin to be felt as early as the second quarter, setting the stage for an economic recovery that gains momentum throughout

■ Continued competition for loans: Although China has lowered interest rates and increased available credit, new bank loans are likely to favour large state-owned companies and infrastructure projects. Private companies, small- and medium-sized enterprises, and foreign invested enterprises have historically had trouble obtaining bank financing, and this situation is likely to continue into 2009.

■ Increased scrutiny by the government: The global economic crisis caught everyone by surprise, including the Chinese government. China's leaders are very concerned about the potentially destabilising effects of unemployment, particularly among the country's large migrant population, and will keep a watchful eye on the employment plans of all companies doing business in the country. China passed a new labour law at the beginning of 2008 designed to protect workers' interests. In order to maintain stability, government

leaders will be sympathetic to their concerns and quick to intercede on their behalf.

When the dust settles, and companies and investors once again look to expand their businesses, identifying growth opportunities will be one of the few ways to increase investment returns. Even at the lower eight per cent rate of growth which the government is projecting for 2009, China remains one of the few large, growing economies in the world. Rather than cutting back on China plans, foreign companies should consolidate what they have in country and prepare to take advantage of the new opportunities that may arise from the current crisis.

The decline in China's stock markets, for example, should lead to more realistic expectations on the part of Chinese companies seeking investment. Publicly traded companies, no longer able to sell their equity at prices well above those prevailing in the global markets, may now be more receptive to private equity valuations. Companies that have not had the benefit of issuing shares in Shanghai or Shenzhen are likely to do the same. Capital is now in much shorter supply and cash is king. Companies in need of it are likely to be more willing to negotiate attractive terms.

What should foreign companies and investors do to navigate China's more difficult economic waters?

- **Be flexible:** Forecasting market trends in China is difficult in any year. With little reliable empirical evidence in recent months to serve as a guide, this will be a particularly challenging exercise in 2009. While caution dictates

that companies adopt conservative sales, production and expansion plans for the year, it will be more important than ever to closely monitor and adjust to actual experience in the marketplace. A quick turn in the economy could present unexpected opportunities.

“If a company is planning an expansion in China, it should make the most of such plans by publicly and privately announcing them”

- **Be cautious in extending credit:** Many seemingly healthy Chinese companies derived a significant portion of their profits in past years from stock market and real estate gains. Others that have borrowed heavily against property and stock portfolios may now find themselves under pressure from banks to repay these loans as the value of the underlying collateral shrinks.

Falling profits and cash flows, as well as loans being called in by nervous lenders, are hurting company balance sheets. As companies facing liquidity issues try to shift their burden to trading partners, receivables are lengthened and a return to the days of “triangular debt” becomes a greater possibility. In today's environment, extra caution in extending credit and increased vigilance in collecting receivables is essential.

- **Communicate employment plans with local governments:** Slower market growth may justify downsizing, but companies should be sensitive to the concerns of local governments. Every other issue in the country will be subordinated in 2009 to the closely related issues

of creating and keeping jobs and maintaining stability. Now may not be the time to press aggressively for labour-saving measures to increase the efficiency of operations in China. If companies find that they must lay off workers, they should communicate those plans ahead

of time to the local government to eliminate surprises.

- **Advertise expansion plans:** If a company is in the fortunate position of planning an expansion of its current business or making new investments in China, it should make the most of such plans by publicly and privately announcing them. China has a long memory and remembers companies and individuals who come forth in difficult times. Now is an ideal time to stand out in a positive way.

Ever since China went the way of economic reform 30 years ago, the direction of its economy has been clear. Nonetheless, there have been a number of bumps along the way – rampant inflation in the mid 1990s and the Asian Crisis in 1997, SARS, and many others – and there will be plenty more. Companies and investors that can clear this hurdle and successfully navigate the current economic crisis will be tomorrow's winners, not just in China, but also in an increasingly integrated global economy. ■

Jack Perkowski is the founder of ASIMCO Technologies and a Wall Street veteran. He is the author of Managing the Dragon: How I'm Building a Billion Dollar Business in China and runs the blog managingthedragon.com.

Econet AD