Resetting Your China Strategy and Operations: Navigating the New Normal

April 2024

China macro-economy outlooks and implications for MNCs doing business in China
Executive Summary

“The Next China is China” amidst evolving macro-environment dynamics

- Lower-than-anticipated figures have led to widespread concerns, primarily among the Western media, over the prospect of China’s economic development
- China’s post-COVID economic recovery has coincided with a critical period of economic transition, which poses multiple challenges simultaneously to China’s economic growth
- China’s contribution to world GDP is anticipated to remain significant, making substantial contributions to future global GDP growth
- The Chinese government has implemented a series of monetary, fiscal and commercial policies to ensure high-quality economic growth and still has “ample policy space”

We see fundamentals and opportunities in place from mid to long term, underpinned by new macro-environment dynamics in China

- Three enduring trends: China continues to be an appealing narrative for MNCs, remains a critical player in the global value chain, and is evolving into a premier global learning hub
- Three emerging shifts: China’s growth trajectory is transitioning towards a slower yet qualitative pace, undergoing structural transformations, while global geopolitical tensions are on the rise

Opportunities always come with challenges for MNCs in China. MNCs now must make careful choices to re-adjust their China strategy. Strategic implications for MNCs are in the new era: 3 dimensions and 4 decisions

- MNCs meticulously evaluate three pivotal dimensions in their China strategy: Transnational benefit / risk, Sector attractiveness and dynamics, and Ability to win / ability to contribute
- Depending on their position within these 3 dimensions, MNCs can choose from 4 strategic options to navigate their business in China – Localize to thrive, Carve out to compete, Diversify from China, and Exit China. Leading MNCs have been recalibrating their China strategies
- Each decision underscores the imperative for MNCs to realign their equity structures, decision-making and governance, brand positioning, product innovation, supply chains, talent management, technology and data strategies in China
China’s post-COVID economic recovery has coincided with a critical period of economic transition, which poses multiple challenges simultaneously to China’s economic growth.

**Short-term:** The government aims to avoid unsustainable growth through credit-driven real estate sector and tightening financing conditions.

- **Lower growth of disposable income and less optimistic about future financial situation**
- **Rising unemployment among young population**
- **Growing saving rate** due to inadequate social security measures and uncertain future prospect

**Gloomy Consumer Sentiment**

- **Weak demand** due to slowdown of world economic growth and increased Fed rates
- **Geopolitical tension**

**Property Downturn**

- **Weakened consumer demand** and over-stockpiling by MFRs/retailers
- **Pay cuts/Headcount reduction**

**Depressed Private Sector Confidence**

- **Reduced investment** leads to contracted demand in related industries, incl. construction, home appliance, etc.

**Tumbled Exports**

- **Diversification of global value chain** leading to transfer of low value-added supply chain
- **Decline in exports** leads to a contraction in demand for manufactured goods

**Long-term:** Population decline in major cities in 2022, and working age population declined since 2016

- **Scarring effect of COVID** reduced risk tolerance and lowered expectation for future growth
- **Regulated corporate ecosystem** on industries related to people’s livelihood and national security, incl. education, healthcare, real estate, data economy and media
- **Unpredictable regulation,** such as crackdowns on major tech companies, raises concerns about policy transparency and stability

**Mid-term:** Slowdown of economic growth and household disposable income

- **Property constitutes the most significant portion** of family wealth, and a decrease in its value will undermine consumer confidence
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China's contribution to world GDP is anticipated to remain significant, making substantial contributions to future global GDP growth.

China has grown into the world’s second-largest economy with GDP and consumer market comparable to US.

Looking ahead, China continues to make a substantial contribution to global GDP growth.

The Chinese government has implemented a series of monetary, fiscal and commercial policies to ensure high-quality economic growth and still has “ample policy space”

<table>
<thead>
<tr>
<th>Unveiled economy growth stimulus</th>
<th>Future policy space</th>
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| **25 basis point cut** announced for the five-year loan prime rate (LPR) in February 2024. Cash requirement ratio reduced in March and September 2023, and in February 2024, providing **1 trillion RMB** liquidity for commercial banks. Structural financing tools provided for lower-cost financing to support target industries like agriculture, green economy, and technology. | Interest rates can be further reduced to boost investment and consumption.  
- Near-zero inflation allows for controlled inflation, maintaining a higher real interest rate than Western countries.  
- China’s major banks have a 10.5% cash requirement ratio, higher than Western counterparts, and can be **further reduced for liquidity**. |
| **Tax reductions** for small businesses and individuals extended until 2027, with further structural tax reductions expected post the central economic conference. Approval granted to issue an additional **1 trillion treasury bonds** in October 2023 and another **1 trillion** in 2024 for natural disaster reconstruction and catastrophe prevention. | **China’s government debt** remains low compared to Western countries, indicating room for growth financing.  
- Based on BIS\(^1\), China general government debt-to-GDP ratio is around 79%, while western countries (US 110%, UK 101%, other EU around 92%) and Japan (229%). |
| China lifted foreign investment restrictions in 2021, removing barriers in auto, telecom, and planning to do so in manufacturing, medical, and professional services. **The 24-Point Guidelines and Action Plan** aim to attract foreign investment, facilitate data flows, and business travel. Efforts to promote **industrial innovation, digital economy, AI, and bio-manufacturing** are underway. Measures to boost domestic demand include **shifting consumption to tourism, entertainment, smart homes, and NEVs through tax reductions and fund withdrawals**. | **Focus on promoting 'New Quality Productive Forces,'** especially in tech industries like AI, biotech, and green development.  
- Government aims to streamline the Law of Government Procurement to **facilitate MNCs in securing government contracts**.  
- Efforts to align with **high-standard international economic and trade agreements (CPTPP)** include further removing barriers to foreign investment, reducing tariffs and subsidies for fair competition, and relaxing data security regulations for foreign investment flexibility. |

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Notes: 1) Bank for International Settlement  
Source: China Government Websites, CITIC Securities reports, A&M analysis
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### Enduring trends...

<table>
<thead>
<tr>
<th>China is still your APPEALING STORY</th>
<th>China is still playing a vital role in GLOBAL VALUE CHAIN</th>
<th>China is evolving into a GREAT GLOBAL LEARNING GROUND</th>
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<tbody>
<tr>
<td>Vast consumer market, rapid urbanization, government support, and a significant P&amp;L contribution</td>
<td>Global value chain still highly relies on China’s supply chain, technology and raw materials, particularly under government’s promotion of “new quality productive force”</td>
<td>The Chinese market has a huge consumer base, and the intense competition is a test field and playing field for innovative ideas and business models</td>
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### Emerging shifts

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<th>China will experience SLOW BUT QUALITY GROWTH</th>
<th>China is undergoing STRUCTURAL CHANGES</th>
<th>Globally GEOPOLITICAL TENSIONS are on the rise</th>
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<tbody>
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<td>As China's economic size grows, economic growth will inevitably slow down, as reflected by the Japan and Korea’s growth pattern</td>
<td>China is undergoing structural changes marked by a transformation from Quantity to Quality growth, which will reshape the business environment for MNCs</td>
<td>US-China decoupling, Taiwan tensions, Russia-Ukraine war, Israel-Hamas war, energy crisis, China's unique positioning in a multi-polar world</td>
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</table>
MNCs must carefully assess three key dimensions in their China strategy

**Transnational Benefit / Risk**

- **Geopolitical and Economical tensions:** Trade restriction, tariff and cross-border capital flows across sectors
- **Consumer behavior:** The rising importance of reciprocal perception and corresponding behavior between China and foreign consumers toward each other's products
- **Technology transfer / data privacy:** Restrictions on core tech collaborations, cybersecurity and data transfers
- **Cross-border capital outflows:** Challenges in capital exchange affecting MNC financing

**Sector Attractiveness and Dynamics**

- **Regulatory environment:** Government regulations on foreign ownership, technical standards, supply / demand dynamics, and investment restrictions
- **Sector attractiveness:** Diverse sector behaviors in market size, growth levers, Chinese ecosystem and competitiveness
- **Unique “rule of games”:** China's distinctive success factors, business culture, and regulatory environment compared to other countries

**Company’s Ability to Win / Ability to Contribute**

- **Strategic position:** MNC strategic positioning based on market share, margins, brand leadership, competitiveness, and financial strength
- **Local empowerment:** HQ empowers local offices with a China-centric operating and governance model
- **Resilience and active risk management:** Ability to adapt to challenges and prepare for uncertainties
- **Corporate citizenship:** Contribution to the Chinese government's agenda through taxes, job creation, R&D, and ESG initiatives
Depending on their positioning within these dimensions, MNCs have four strategic options for managing their China operations

### STRATEGIC OPTIONS

**Localize to thrive**
- **Transnational Benefit / Risk:** Low risk / More favorable
- **Sector Attractiveness and Dynamics:** Highly attractive with minimal regulatory/market constraints
- **Company’s Ability to Win / Ability to Contribute:** High
- **SCENARIOS:**
  - **Act Locally:** Scale to become leader through organic growth, JVs, and tech investments; Establish full China P&L
  - **Benefit Global:** Leverage China experience for global market benefits

**Carve out to compete**
- **Transnational Benefit / Risk:** Medium risk / less favorable
- **Sector Attractiveness and Dynamics:** Moderately attractive with some regulatory/market constraints
- **Company’s Ability to Win / Ability to Contribute:** High
- **SCENARIOS:**
  - Carve-out part / all the operations and preserve business value
  - Sufficient autonomy to think, act and compete like local companies

**Diversify from China**
- **Transnational Benefit / Risk:** High risk / least favorable
- **Sector Attractiveness and Dynamics:** Moderately attractive with some regulatory/market constraints
- **Company’s Ability to Win / Ability to Contribute:** Medium
- **SCENARIOS:**
  - Refocus business as a niche player with a meaningful China presence
  - Reduce capital risk through JVs with local partners; Consider HKEX/China-A listings
  - De-risk supply chain with a "China+1" strategy

**Exit China**
- **Transnational Benefit / Risk:** High risk / least favorable
- **Sector Attractiveness and Dynamics:** Least attractive with unique regulatory and market constraints
- **Company’s Ability to Win / Ability to Contribute:** Low
- **SCENARIOS:**
  - Regulatory barriers discourage foreign investment
  - Domestic competition intensifies, impacting competitive advantage
  - Limited HQ management capacity and reach
  - Consider majority stake sale to domestic firms or private equity
  - Closure of China operations
China has been the MNC story over the past two decades. Now is the time to rethink holistically about **navigating a profound shift** in Chinese business landscape.

- **Assess your starting line**
  Analyse your strategic position, opportunities and risk exposure in China, considering dynamic shifts in your sector in real time

- **Refine your ambition and approaches**
  Redefine China’s role in your global strategy and align your goals, capabilities, and operations with current realities

- **Plan and execute the implementation**
  Take a future-focused lens to sequence proactive measures and invest for long-term growth
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