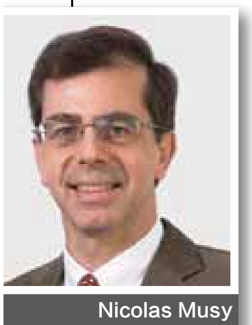
More than just GDP

China is facing problems and complexities but it is still good for business and outperforming just about everywhere



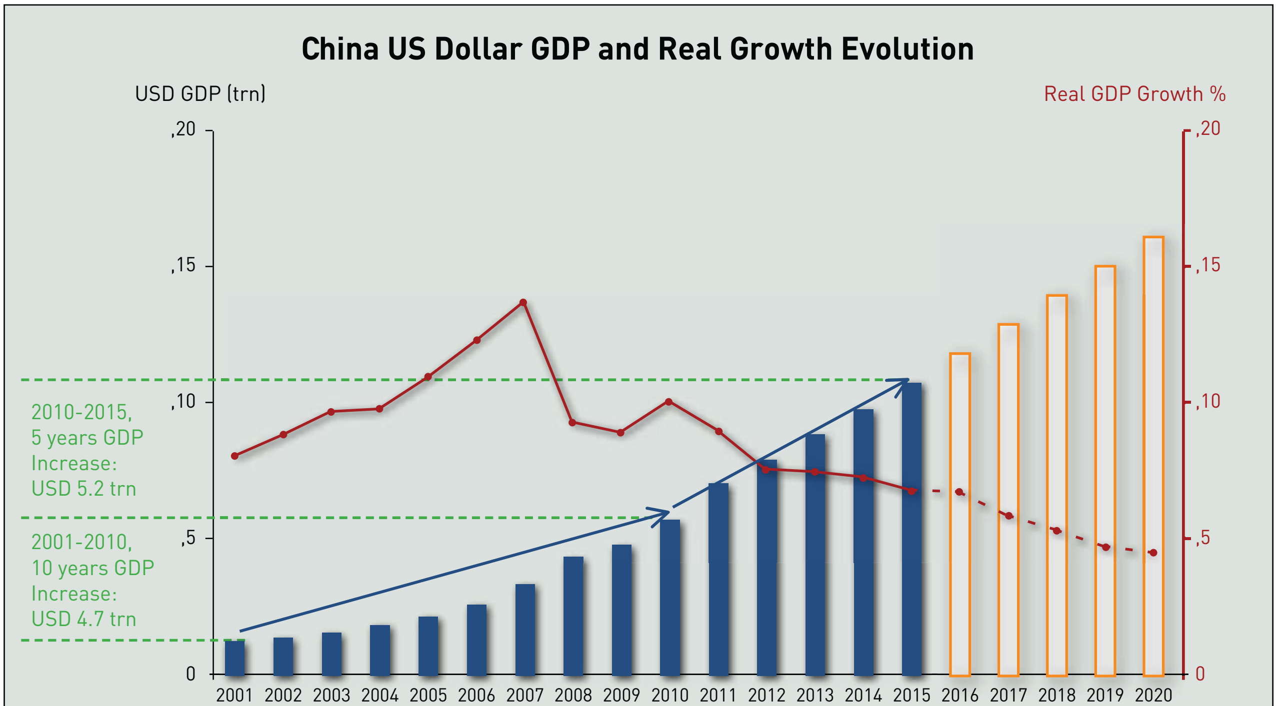
Much has been made of the restructuring of the Chinese economy at the cost of fast economic growth. This has created fears in the international business community that companies are likely to see a slowdown in what has become a hugely important market. But while it is true that China's real GDP growth is not any more in the double digit range and that it is likely to decrease from 7.7% in 2013 to 7.5% in 2014 and 7% in 2015, GDP growth, as a macro-economic measure, does not actually capture China's business potential for foreign enterprises.

Indeed, what matters to companies doing or intending to do business in China, is the amount of GDP the economy will be adding in the coming years in terms of euros or dollars. To understand China's business potential better and how it is changing, one must first compare how much GDP the Chinese economy is projected to add in the future with the amount it has added in the past. To get a global picture, it is also useful to compare this absolute increase with the amount of GDP growth generated by other countries in home currency values.

As with every other country, China's real GDP is reported as the added growth in economic value in the yuan, minus local inflation. This growth rate makes complete sense, in as much as it captures the real economic progress (with inflation deducted) that the country is making with respect to its previous year's performance.

This said, because companies throughout the world account for their growth in their local currencies, without deducting inflation from their performance results, they measure a country's market potential in absolute volumes and not in growth percentage.

To illustrate this, take the case of Mongolia. With a 2013 real GDP growth rate of 12.5%, Mongolia is considered by the IMF to be "one of the fastest growing economies of the world." This growth, however, is based on a 2012 GDP of about US$10 billion. Taking inflation (approximately 10%) and currency devaluation (approximately 27%) into consideration, in 2013, Mongolia only added slightly more than US$1 billion to its economy. In comparison, the US, which only grew by 1.9% in



Source: Wikipedia: 2001 - 2013. UBS forecast: 2014-2015. China Integrated estimates: 2016-2020.

the same year, added about US$500 billion to its GDP.

Ultimately, when managing a company, the absolute growth of a market is the useful figure to evaluate how much more business can be generated in the future.

Most important, between 2011 and 2015, China is projected to add more than US$5 trillion to its GDP, compared with US$4.7 trillion in the whole decade of 2001 to 2010. In terms of business opportunities and in dollar terms, this means that China is growing on average twice as fast today as it did in the previous decade.

When compared to other countries, China, which is adding approximately US$1 trillion more per year to its GDP, represents by far the greatest business growth opportunity in the world. In 2013 alone, the business opportunities offered by China were twice as large as the US, which is the second-biggest growing market in absolute terms.

If we are to apply the same GDP calculations to other countries such as India, Brazil or Russia, it becomes clear that China's economy is the largest business opportunity in today's globalised world. Ultimately, the Chinese economy keeps accelerating in absolute GDP terms and this is what actually matters to businesses.

This business acceleration has been confirmed by the initial results of a new survey of foreign companies: Sales, profits, and worldwide share of sales for foreign companies in China grew faster in 2013 than in 2012 and are generally expected to grow even higher in 2014.

Now what are the implications for businesses and how can they benefit from these trends?

International companies may not be ambitious enough in China. If accounted for in dollar terms, business in China should have grown by 13.4% only to keep up with market growth, without gaining any market share. (This figure is obtained by taking 7.7% growth, plus 2.7% inflation, plus 3% currency appreciation). By comparison, business in the US would have had to grow by only 3.4%, or 1.9% growth plus 1.5% inflation to keep up with the market growth in the US.

INTO THE FOLD: Musy says a real valuation of the Chinese economy requires looking at how much GDP growth China is projected to add compared to what it has added in the past - it's a lot

For those measuring China's GDP in euros, there is a 2 to 3% difference that must be accounted for due to the appreciation of the euro, which would bring the average market growth of China to 11%.

In 2014, the minimum rate of business growth necessary to keep up with China's expanding market will stand at approximately 10.5% in dollar terms. (Growth will still differ across industries and that is just a general average.) This figure takes into account a 7.5% economic growth, an expected inflation rate of 3% and a 6.2 dollar-yuan exchange rate.

Another important point to keep in mind is that the expected growth will come more from the private than the state-owned sector. Indeed, the Chinese government will be providing incentives to the private sector, as a measure to increase domestic consumption and productivity.

While an increasingly privatized Chinese market with greater domestic consumption will be a welcome development for the world economy, it also means that competition in China will intensify. Local market players will therefore become more efficient and resourceful.

In fact, initial results from the survey already point to the fact that international companies in China perceive local players as their greatest competitors. This is a marked shift from the past years where such companies reported international companies as posing the greatest competition. In other words, opportunities will increase considerably, as will competition.

Under these circumstances, managers have two paths to follow: Improve operational efficiency to deliver more with the same resources and move up the local value chain to improve products and technologies to command better margins. Harnessing the productive potential of technology will be a crucial step towards achieving these goals. Indeed, for companies to improve internal efficiency, it will be essential for them to implement greater automation.

Moreover, in this very competitive environment, improving or adjusting products and services to sell with higher margins will also require, more often than not, the use of technology. However, in the context of such a competitive Chinese environment, being successful will also mean having the right mix of imported and locally developed products, equipment and IT.

China's economic growth is slowing in terms of the relative measure that economists track. Of that there is no doubt. But that should not blind businesses to the huge opportunities the country offers and will continue to offer. In terms of absolute dollar GDP China, is growing more every year than it ever did before. ◆