



China in the Global Economy

- Moderator: **William C. Kirby**, Spangler Family Professor of Business Administration, HBS; T.M. Chang Professor of China Studies, Harvard University
- Panelists: **Victor Kwok-King Fung**, Group Chairman, Li & Fung Group
John M. Stropki, Chairman, President, and CEO, Lincoln Electric Holdings Inc.
G. Richard Wagoner Jr., Chairman and CEO, General Motors
Marjorie M.T. Yang, Chairman, Esquel Group

Overview

China's economy has transformed from an export-driven economy to a domestically driven economy. While the global economic downturn will affect China's exports, the domestic economy is expected to remain strong. Given its size, the Chinese domestic market is strategically important for all global companies striving to maintain their global positions.

In the short term, companies doing business in China will face challenges such as an underdeveloped infrastructure, unfamiliar business structures, and limited skills among middle- and upper-level managers. Despite these obstacles, the current and long-term potential in China is immense.

Context

The panel discussed the economic outlook for China, as well as the opportunities and challenges related to doing business in the country.

Key Takeaways

- **Economic growth will continue in China, driven by domestic consumption.**

Although China's economy will probably not grow in 2008 at the rate predicted by the government, the prognosis is still for stable and significant growth. China will likely manage 9% growth in both 2008 and 2009.

The largest driver for this sustained economic growth is domestic consumption. Last year China experienced 11% growth. This was comprised of 5% growth from domestic consumption, 4% from investment, and 2% from net trade.

"I see China as in a period of stable growth."
— Victor Kwok-King Fung

In recent years, the Chinese economy has transformed away from an export-driven economy towards a domestic-consumption-led economy. That trend is expected to continue. Net trade is decreasing as a driver of growth for a few reasons. There has been a surge of imports, and the global economic downturn has dampened demand for exports. At the same time, the government has de-emphasized export processing (i.e., importing raw materials, adding a small amount of value, and then exporting) in favor of more value-added exports.

"China will not be insulated from the global economic downturn but the slowdown will be mostly on the export side."

— Victor Kwok-King Fung

It is important to recognize that China's economy is closely integrated with other Asian economies. Companies are increasingly developing dispersed supply chains with operations in China and other Asian countries.

- **To retain global leadership, foreign companies must win Chinese consumers.**

The domestic consumption estimates for the Chinese market are staggering. The automobile market provides an excellent illustration. In 1997, there were 1.5 million automobiles sold in China. By 2007, annual auto sales had grown six times, to over 8.5 million. With annual growth in the 20% to 25% range, in five to ten years China will be the largest auto market in the world.

Foreign companies recognize that the Chinese market is a critical source of growth.

— *General Motors*. General Motors first entered the Chinese market through a partnership with Shanghai Automotive Industry Corporation (SAIC) in the mid-1990s. GM's sales in China have been steadily growing ever since. In 1997, GM sold 50,000 cars in China. In 2007, GM, with its partners, sold over 1 million cars. GM is also working on a venture to produce a car at a \$3,500 to \$5,500 price point. Almost all of the cars that GM makes in China are sold in the country. The company's primary interest is in the massive domestic market.

"We sell more Buicks in China than we do in the U.S."
— G. Richard Wagoner Jr.

— *Lincoln Electric*. Lincoln Electric is the world's largest manufacturer of welding equipment. Because China is the world's largest market for welding products, China is strategically important to the company's future. The amount of building in China, particularly for infrastructure, has driven Lincoln's investment in five Chinese plants. Just a small amount of the products that Lincoln produces in China are exported outside of the country.

"China is the #1 market for welding products. If we aren't #1 in China, we can't be #1 globally."
— John M. Stropki



- **The experience of Esquel Group over the past 30 years reflects China's evolution from a planned to a market economy.**

Today, Esquel Group is a multibillion dollar vertically integrated global manufacturing company. But that hasn't always been the case. The company started in 1978 as a small shirt manufacturer. When the company started, there were no export quotas, as there were no exports.

In the late 1980s the company produced shirts for clients such as Ralph Lauren and Nordstrom. These clients wanted to maintain high quality while keeping their retail prices flat. Esquel couldn't meet these goals by continuing to purchase fabric from Japan as it had done. In response, the company built its first woven fabric mill to manufacture its own high-quality, low-cost fabric.

Once the company operated its own mill, it experienced another challenge: The quality of the cotton being grown in China was not adequate. The reason: In China the cotton market is government controlled. The prices set by the government were low, which incited farmers to create cotton for high yield, rather than for high quality. Out of necessity, Esquel has entered cotton farming to grow high-quality cotton. The government encouraged Esquel to make this move. These events—and more—reflect China's evolution from a country of low-cost manufacturing to a country of value-added solutions. This path and evolution have been supported by China's government.

"Esquel became cotton farmers and the government encouraged us to do it. They want to introduce the private sector into government-controlled markets."
— Marjorie M.T. Yang

As Esquel and China matured, export quotas were established. To navigate in this environment Esquel has established operations elsewhere around the globe.

In addition, Esquel participates in an industry association of textile companies that engages in a dialogue with the government about the economy, even at times advocating against state-owned enterprises.

- **Although the future looks bright for business in China, challenges still exist for foreign companies.**

Despite China's sustained growth, significant challenges still exist for the country and for foreign companies wanting to do business there.

— **Infrastructure.** The Chinese infrastructure is still not what it needs to be to support an industrial economy of the scale of China's. There is tremendous investment in infrastructure of all types (roads, railroads, airports, ports, etc.); China is investing the highest percent of GDP in infrastructure of any country in the world. While much of this investment is occurring in the major cities, farther west and in rural areas much work remains to be done.

"The infrastructure is still not what it needs to be. The cost and time to ship products is high."

— John M. Stropki

While progress is being made in improving the "hard" infrastructure, Mr. Fung believes that the soft infrastructure, such as inconsistent licensing requirements and laws across provinces, still must be improved.

- **Unfamiliar business structures.** In the United States, companies are accustomed to competitors who are focused on profit. In China, the environment can be very different. There is a mix of private companies, state-owned companies which lack a profit motive, and hybrid businesses. Government businesses exist to provide employment, rather than to create profits.
- **Limited management skills.** Although the quantity and the quality of the human capital in China is very strong—with abundant skills and a strong work ethic—the country is lacking good middle- and upper-level managers. This lack of managerial expertise is due in part to the cultural revolution which shut down universities for a ten-year period. Because of the shortage of good managers, foreign companies often must bring in large numbers of expatriates to support operations. This can be expensive.
- **Corruption.** There remains a great deal of corruption in all elements of Chinese business. It is considered the norm, but slowly that is beginning to change.

Concerns mentioned by the panelists that could negatively affect China's sustained growth include: if China were to move away from an outward orientation to an inward focus; if there were a shift breakdown in U.S./Chinese relations; and if China were to fail to establish a social safety net for its citizens.

Other Important Points

- **Urbanization.** The Chinese government has a goal of moving 1% of the population to cities each year, which represents 13 million people per year moving from rural to urban locations. At the same time, the country wants to avoid urban sprawl. The goal is to create high-density urban centers that are connected by a high-speed rail.
- **Use of English.** Mr. Fung believes that the language used in China for software will be a telling sign regarding if China is inwardly or externally focused. In his view, use of English is needed to sustain an external focus.
- **China and alternative energy.** Mr. Wagoner said that in 20-30 years, the likely fuel source for cars will be hydrogen. Evolving to hydrogen will require a public/private partnership. This will be difficult in many countries, but due to the heavy involvement of the government in the economy, China may be well positioned to pull off such a partnership.



Speaker Biographies

William C. Kirby (Moderator)

*Spangler Family Professor of Business Administration, HBS;
T.M. Chang Professor of China Studies, Harvard University*

William Kirby is the Spangler Family Professor of Business Administration at HBS and the T.M. Chang Professor of China Studies at Harvard University. He is a Harvard University Distinguished Service Professor. He serves as director of the Fairbank Center for Chinese Studies and chairman of the Harvard China Fund.

A historian of modern China, Kirby examines China's business, economic, and political development in an international context. He has written on the evolution of modern Chinese business (state-owned and private); Chinese corporate law and company structure; the history of freedom in China; China's environmental challenges; relations across the Taiwan Strait; and China's relations with Europe and America. His current projects include case studies of contemporary Chinese businesses and a comparative study of higher education in China and the United States. He is an honorary visiting professor at Peking University, Nanjing University, Chongqing University, and Fudan University.

Kirby has also held appointments as visiting professor at the University of Heidelberg and the Free University of Berlin. Before coming to Harvard in 1992, he was professor of history, director of Asian studies, and dean of University College at Washington University in St. Louis. At Harvard, he has served as chair of the History Department, director of the Asia Center, and, most recently, dean of the Faculty of Arts and Sciences. As dean of Harvard's largest school from 2002 to 2006, he initiated major reforms in undergraduate education in Harvard College; enhanced Harvard's international studies at home and abroad; substantially increased financial aid in the College and the Graduate School of Arts and Sciences; supported the growth of the Division (now School) of Engineering and Applied Sciences; and oversaw the construction of major new buildings in the life sciences, engineering, and the arts. During his tenure the faculty expanded at its most rapid rate since the 1960s.

Kirby holds degrees from Dartmouth College and Harvard University, and an honorary doctorate from the Free University of Berlin. He is a fellow of the American Academy of Arts and Sciences.

Victor Kwok-King Fung

Group Chairman, Li & Fung Group

Victor Fung is the group chairman of the Li & Fung Group of companies, which includes major subsidiaries in trading, distribution, and retailing, including publicly listed Li & Fung Ltd., Integrated Distribution Services Group Ltd., and Convenience Retail Asia. He is also chairman of the Hong Kong University Council and the Greater Pearl River Delta Business Council.

Fung was chairman of the Hong Kong Trade Development Council (1991–2000), the Hong Kong representative on the APEC Business Advisory Council (1996–2003), and chairman of the Airport Authority Hong Kong (1999–May 2008). He is now chairman of the International Chamber of Commerce and a member of the Commission on Strategic Development.

On the Chinese mainland, Fung is a member of the Chinese People's Political Consultative Conference and the International Business Leaders Advisory Council for the Mayor of Beijing and an economic advisor to the People's Government of Nanjing. He is also an honorary trustee of Peking University, and a member of the advisory board of the School of Economics and Management at Tsinghua University.

Fung is chairman of the Asia advisory board of Prudential Financial Inc. (U.S.A.) and an independent nonexecutive director of Bank of China (Hong Kong) Ltd., Orient Overseas (International) Ltd. in Hong Kong, Baosteel Group Corporation in the People's Republic of China, and CapitaLand Limited in Singapore.

In 1995 Hong Kong Business Awards named Fung Businessman of the Year for his entrepreneurial success and his contribution to Hong Kong's economic development. He was also chosen as Hong Kong Leader of the Year in 1998, and *BusinessWeek* named him one of 50 Asian leaders leading the region out of economic crisis. He was made a commander of the Order of the British Empire in 1993 in recognition of his commitment to public service. In 1997 the University of Hong Kong awarded him an honorary doctor of laws degree, and in 2001 he was awarded the Harvard Medal for outstanding service to Harvard University. In 2003 the government of the Hong Kong Special Administrative Region awarded Fung the Gold Bauhinia Star for distinguished service to the community.

Fung holds bachelor's and master's degrees in electrical engineering from MIT and a doctorate in business economics from Harvard University. He also taught for four years as a professor at HBS before returning to Hong Kong in 1976. Fung is married with three children.

John M. Stropki

Chairman, President, and CEO, Lincoln Electric Holdings Inc.

John Stropki is chairman, president, and CEO of Lincoln Electric Holdings Inc., where he has been a director since 1998. He was named president and CEO in June 2004 and elected chairman of the board in October 2004. From May 2003 to June 2004, he served as Lincoln's COO.

Headquartered in Cleveland, Ohio, Lincoln Electric is a global manufacturer and market leader of welding, cutting, and joining products. Lincoln has 38 manufacturing locations, including operations and joint ventures, in 20 countries and a worldwide network of distributors and sales offices covering more than 160 countries.



Stropki started at Lincoln more than 35 years ago, working summers in the factory of the Cleveland operations while an engineering student at Purdue University. After graduating in 1972, he joined Lincoln full-time as a sales trainee and later worked in the Indianapolis, Fort Wayne, and Chicago district offices. He also served as district manager for the offices in Columbus and Cleveland. He was national sales manager for Canada from 1992 to 1994, when he was named senior vice president of sales, U.S. and Canada. In 1996 he was appointed EVP and president, North America.

Stropki earned a bachelor's degree in industrial engineering from Purdue University and an MBA from Indiana University. He is a recipient of Purdue's 1998 Outstanding Industrial Engineer Award.

In 2002 the board of directors of the American Welding Society elected Stropki an honorary member for serving the welding community with great distinction, citing his expertise and knowledge of the science and application of welding. Stropki now serves on the board and executive committee of the Manufacturers Alliance/MAPI and is a member of the Gas and Welding Distributors Association. He is on the executive committee of the National Electrical Manufacturers Association board of governors and on the board of the Greater Cleveland Partnership.

Stropki is active in the American Lung Association and the Juvenile Diabetes Research Foundation (JDRF). He was the honoree at the JDRF Greater Cleveland chapter's gala and fundraiser in 2007. He also served as the honorary chairman of the Greater Cleveland Council of the Boy Scouts of America's annual Good Scout Luncheon in April 2008. Stropki and his wife have two adult children and two granddaughters.

G. Richard Wagoner Jr., MBA 1977
Chairman and CEO, General Motors

Rick Wagoner was elected General Motors chairman and CEO on May 1, 2003. He had been president and CEO since June 2000.

Wagoner was elected president and COO in 1998 and had been EVP of GM and president of North American operations since 1994. He served as EVP and CFO from 1992 to 1994 and also had responsibility for worldwide purchasing from 1993 to 1994. Wagoner was president and managing director of General Motors do Brasil (GMB) in 1991 and 1992. Before that, he was vice president in charge of finance for General Motors Europe based in Zurich, Switzerland, in 1989 and 1990.

Born in Wilmington, Delaware, in 1953, and raised in Richmond, Virginia, Wagoner received a bachelor's degree in economics from Duke University in 1975 and an MBA from HBS in 1977.

Wagoner began his GM career as an analyst in the Treasurer's Office in New York in 1977. After several promotions there, in 1981 he became treasurer of GMB in São Paulo and, in 1984, GMB's executive director of finance.

He moved to GM of Canada Ltd. in 1987 as vice president and finance manager. In October 1988, he became group director, strategic business planning, for the former Chevrolet-Pontiac-GM of Canada Group.

Wagoner is a member of the board of trustees of Duke University, the Tsinghua School of Economics and Management advisory board, the Board of Dean's Advisors of HBS, and the boards of directors of Catalyst and the Detroit Country Day School. He is chairman of the Society of Automotive Engineers' A World in Motion executive committee and a member of the Business Council, the Business Roundtable, and the Detroit Renaissance executive committee.

Marjorie M.T. Yang, MBA 1976
Chairman, Esquel Group

Margie Yang is chairman of Esquel Group, a leading textile and apparel manufacturer with operations throughout the world.

After growing up in Hong Kong, Yang attended MIT, where she earned a BS in pure mathematics. In 1976 she received an MBA from HBS. In 1978 she returned to Hong Kong and became a founding member of Esquel. She was named chairman of the group in 1995.

Under Yang's leadership, Esquel has become vertically integrated. Its operations comprise cotton farming; yarn spinning; fabric, apparel, and accessories production; R&D; and design and merchandising services. Esquel's 47,000 employees across the world provide one-stop cotton-shirt solutions to Abercrombie & Fitch, Brooks Brothers, Hugo Boss, Next, Nike, Nordstrom, Polo Ralph Lauren, and Tommy Hilfiger. Esquel produces over 65 million shirts a year.

Yang sits on the boards of Novartis International AG., Swire Pacific Ltd., the Hongkong and Shanghai Banking Corporation Ltd., and CLP Holdings Ltd. She is also a member of the MIT Corporation and an honorary member of the Court of the Hong Kong University of Science and Technology.

Yang is a member of the National Committee of the Chinese People's Political Consultative Conference. She has a strong interest in conserving the country's environment and culture, especially in Xinjiang, western China. Yang has been chairman of the textile and clothing sector committee of the China Association of Enterprises with Foreign Investment (CAEFI) since 2003 and vice chairman of CAEFI since 2004. She is dedicated to strengthening cooperation among foreign-invested textile firms and enhancing communication with the Chinese government.

Yang is also interested in promoting education, particularly the development of young managers. She has been very involved with the MBA programs at Harvard, MIT, Tsinghua, Fudan, and Lingnan universities and sits on various advisory boards of these institutions.