ON RED ALERT

IAN HARPER ASSESSES THE BUSINESS OPPORTUNITIES AVAILABLE IN THE BURGEONING CHINESE MARKET

CHINA LOOKS destined to become the world's largest economy in the not too distant future. That is likely to be achieved by the end of this year, according to the new purchasing power parity indices published by the International Comparison Program hosted by the World Bank. However, if you still consider US dollar GDP to be the best guide, parity is still a few years away.

But what does this situation hold out for the stagnating economies of the West, and for UK plc in particular? And what of Hong Kong – the gateway to China? Gripped by unrest, is its future in doubt? And what opportunities does Chinese growth offer for CAs?

First of all, just how big is the Chinese economy? We asked Anil Gupta, professor of strategy and globalisation at the Smith School of Business, University of Maryland, the author of *The Silk Road Rediscovered* (reviewed by this magazine, September 2014).

Gupta's view is: "Two excellent indicative measures are GDP and the auto sector. China's GDP is now US$9.2trn, which makes it 55 per cent as large as the US economy and two and a half times that of the German economy. China's auto sector is now the largest in the world. In 2013, China produced 22m vehicles (passenger plus commercial). That was twice that of the US, which produced 11m vehicles."

In terms of future prospects, Gupta says: "My five to 10 year forecast for China is a growth rate in real GDP of about 6 per cent a year. Given the level of China's economic development, sustaining a 7 per cent growth rate on an ongoing basis would be almost impossible. The days of investment- and export-driven growth are over. Future growth would depend heavily and largely on growth in productivity. As for Hong Kong, it's a mature developed economy. Thus, I expect HK to grow at about 2-3 per cent a year."

Ken Morrison CA of Mazars in Hong Kong, who chairs the ICAS members' group there, notes that the Chinese economy has grown at just under 10 per cent per annum for the past 32 years. Looking ahead, however, he is cautious: "China's business model is changing from an export led, low-cost 'manufacturer to the world', to one where an increasing proportion of production is being diverted to domestic consumption. One of the key challenges facing China in the future is demographics – an increasingly ageing population."

Morrison says that China has a "20 year window of opportunity before this demographic burden bites" and whether it takes this hinges on the ability of President Xi

Jinping to address such key issues as the environment, education, and corruption.

Andrew Ross CA, MD of Baker Tilly in Hong Kong, says China is entering a new phase: "Sustainable economic growth is now recognised as the most important long-term economic objective, and a series of economic and financial reform measures are being implemented to achieve this objective."

THE ROLE OF HONG KONG

And what of Hong Kong, where prosperity is increasingly intertwined with that of the mainland since the transfer from British rule in 1997?

Morrison says: "One of the key competitive advantages [Hong Kong] has long enjoyed has been the rule of law. In addition, the absence of overly bureaucratic controls and a stable political environment have been significant to its past success. However, increasing civil unrest, the struggle for democratic reform under the 'one country two systems' formula, and a lack of leadership on the part of the Hong Kong Government has had a detrimental impact on the 'can do' spirit of the territory. Going forward, this will need to change if Hong Kong is to maintain its position as an international financial and logistics centre within Greater China and Asia."

Morrison adds: "Companies and investors are increasingly going direct to the key centres of business in the mainland and thereby bypassing Hong Kong as the intermediate step in their China developments."

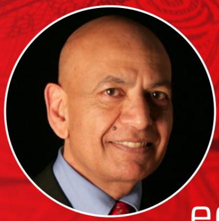
Stephen Mercer CA, a partner with KPMG in Hong Kong, believes the territory will continue to thrive: "It plays a key role as a financial centre and there continue to be many foreign companies with their China and regional offices and headquarters in Hong Kong."

Simon Lance, regional director of Hays in China, agrees: "Hong Kong is still one of the most important financial markets in Asia and its dynamic economy will continue to influence the region. It will also continue to attract multinationals looking for a base for their Asia Pacific headquarters."

OPPORTUNITIES FOR UK BUSINESS

The faster growth opportunities in China, Professor Gupta argues, will be in those sectors that address the unique challenges that China now faces: "[including] health care, elder care, child care, all types of professional services, tourism and recreation, energy efficiency, shale oil and gas, renewable energy, industrial automation and pollution control."

Baker Tilly's Ross says: "British firms, with experience in development of alternative energy, environmental protection products, modern service industries such as design, brand development, medical research and financial services will have ample opportunities for business development in China."



"China's GDP is now US$9.2trn which makes it 55 per cent as large as the US economy and two and a half times that of the German economy"

Anil Gupta

Lance notes: "After the launch of the Shanghai Pilot Free-Trade Zone in August 2013, the government issued a 'positive list' of 18 service industries to receive more relaxed policies in the Zone, including medical services, value-added telecommunications, ocean freight and international ship management, and banking."

According to Jamie Paton CA, managing director of First Reserve Asia, the Hong Kong-based arm of the international energy specialist and private equity firm: "I believe London's international stature and the universe of services and products that have made it such will continue to be relevant going forward. Britain also excels in an enormous array of creative consumer brands, the arts, highly skilled manufacturing and food and beverage products that are sought after globally – the higher the quality, the better."

Morrison also points to opportunities in telecommunications, media and technology; financial services; and consumer products.

But as Susie Walker, head of tax at Johnston Carmichael in the UK, points out, opportunity is a two-way street. She cites China Britain Business Council figures for 2013, which show that while British investment has gone into more than 1,200 projects in Jiangsu province alone, Jiangsu companies are increasingly establishing themselves in the UK.

"Companies including Bosideng, Phoenix Publishing & Media, Sanpower and CSUN have all set up UK operations in the last few years," she says.

However, opportunities come with challenges. Gupta says: "Virtually all of the world's big companies are present in China. In addition, you have well-capitalised Chinese players. Thus, the degree of competition in China tends to be brutal. Just 'playing' in China – without clarity about how you will win – can be an extremely high-risk strategy. Also, competing in China often requires working with a joint venture partner. Thus, the company needs to be very smart about how to build and manage effective partnerships."

Morrison agrees: "To succeed, international companies need to have a very clear strategy and an ability to implement and adapt. They need to be very clear on why they are in China and in what segment(s) of the market they wish to compete."

He adds that there are also significant regulatory challenges: "Officials do not always apply the regulations in a consistent manner. Relationships with officials are often key in navigating through the relevant regulations."

"Virtually all of the world's big companies are present in China. In addition, you have well-capitalised Chinese players. Thus, the degree of competition in China tends to be brutal"

Susie Walker

Ross adds: "The past experience of British companies which have entered the Chinese market highlighted challenges in understanding consumer behaviour, corporate managerial and cultural differences. These were the same issues faced by Glaxo and KFC, McDonald's and Nike when operating in China."

Mercer cites a number of other challenges: "Consumers are increasingly sophisticated, with the use of mobile devices being very high. Margins are also under pressure due to rising labour costs. Recruiting and retaining the right talent and managing compliance with China's regulations remain major challenges faced by international companies. To be successful, international companies need to have a very clear strategy and an ability to implement and adapt. They need to be very clear on why they are in China and in what segment(s) of the market they wish to compete."

OPPORTUNITIES FOR CA FIRMS

So what does this spell in terms of opportunities for CAs? Gupta says: "As Chinese companies become larger, get publicly listed and go global, the need for professional auditing and advisory services will continue to grow rapidly. The big western accountancy firms are all present in China and will continue to benefit from this opportunity. However, as in other industries, they face growing competition from domestic Chinese firms. Also, there is a regulatory tussle going on between Chinese and US regulators. The US SEC [Securities and Exchange Commission] wants any firm listed on the US stock exchanges to be professionally audited. However, the Chinese Government prevents certain audit-relevant data from leaving China. Hopefully this conflict will get resolved but we need to wait and see."

Morrison points out that while there was once a shortage of local expertise, the landscape is changing: "In recent years, the Ministry of Finance has been keen to see 'home-grown' accounting firms develop and expand and for them to go out into the international markets beyond China, accompanying the outbound investments from China that are gathering pace. It is increasingly important to be regarded as a 'local but international' firm rather than 'foreign'."

China has changed dramatically in recent years, thanks to sensational economic growth. But the real opportunities ahead lie more with those companies best equipped to understand and help manage the problems that accompany such growth. CA

IAN HARPER IS A FREELANCE BUSINESS JOURNALIST

A CA IN HONG KONG

CA MAGAZINE MEETS SANDY DUDGEON, MANAGING DIRECTOR OF CAZENOVE CAPITAL MANAGEMENT ASIA

CA SANDY DUDGEON and two colleagues from his former employer, Martin Currie, had been running Thornhill Investment Management until 2010 when it was taken over by Cazenove Capital Management. Dudgeon joined the firm's management committee as business development director and, subsequently, became MD of Hong Kong-based Cazenove Capital Management Asia.

The CA: ***How does working in HK compare to working back home?***
Sandy Dudgeon: The first thing, bearing in mind that I've been out here for less than two years, is that HK is a very energetic place. Secondly, for people looking to set up a business this is an incredibly welcoming place if you have a positive message to give about yourself. Everybody will give you a hearing and there's absolutely no difficulty at all in getting a meeting. Thirdly, the more senior people are, the more they appear to open their own emails, which would seem to contrast somewhat with the general situation. Fourthly, HK and the Far East are still growing. There's been a difficult four or five years in emerging markets, but there are so many more things happening here.

The CA: ***What skills and knowledge would a person working in the Far East acquire that would be of value back home?***
Dudgeon: The first thing is they would get a great perspective on the rest of the world, including the UK and Europe. It's very cosmopolitan here and people know the world well.

Secondly, they'd learn not to be shy of travelling, and another thing is that when you return home you'll have learned not to accept a single general statement about a country. You also learn that the world's a small place.

The CA: ***What's your message to anybody who has the chance to work in the Far East?***
Dudgeon: For the CA looking for opportunities, I think the situation increasingly out here is that you need to have language skills.

I think there's nothing to lose [about working out here]. It's a great experience, but it's getting more competitive and difficult to get a job and language skills count for a lot.