

Business Execs Assess China's Reform

■ By Professors Xu Bin and Zhou Dongsheng



China's policy makers have been faced with a difficult dilemma in recent years. On one hand, long-standing problems such as overcapacity have become so severe that they threaten the long-term health of the economy and highlight the need for deep-level structural reform. On the other hand, mounting pressure to maintain middle-high economic growth has resulted in the use of short-term stimulus and the delay of supply-side reform. Over the past few years, we have seen policy priority swinging between reform-promotion and growth-maintenance. The impact, according to our poll of 1,300 executives from companies doing business in China, has been mixed feelings of high anticipation for deep-level reform and low satisfaction with what has actually been done.



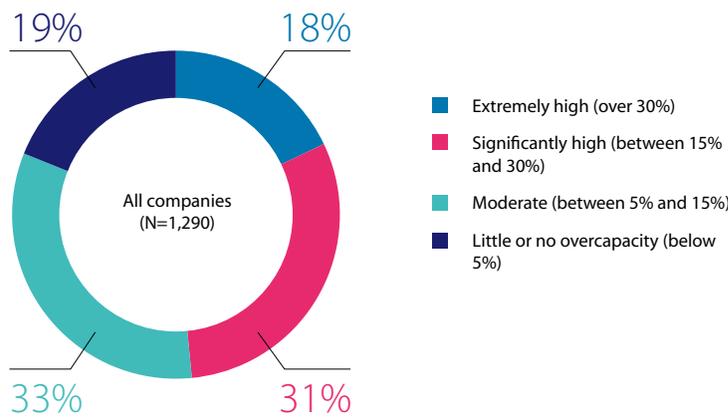
Chinese and foreign executives who participated in the *CEIBS Business in China Survey* over the past few years had high expectations for structural reform. In the 2014 Survey, a poll of 1,017 executives from companies doing business in China responded very positively to the reform initiatives laid out by China's new leadership, including the establishment of a free trade zone in Shanghai. In the 2015 Survey, participating executives

anticipated that the new round of economic reform which got underway in 2014 would help establish "the decisive role of the market in resource allocation". In the 2016 Survey, we found that the business confidence levels of both Chinese and foreign executives reached their lowest levels in late 2015, which partially explains the shift of policy focus from reform to stimulus in that year. In spring 2016, the Chinese government, through the voice of an anonymous "authoritative person" in *People's Daily*, expressed

its strong will to pursue structural reform, and started to implement a policy labelled “cutting excess capacity, reducing inventory, and deleveraging”. It is against this background that

1,300 executives (65% from Chinese companies and 35% from foreign companies operating in China) answered our online questionnaire in late 2016. In this article, we summarise the findings on their views on how their companies had been affected by the reform policies. By comparing the results with those from previous surveys, we find that the results from this year are particularly revealing.

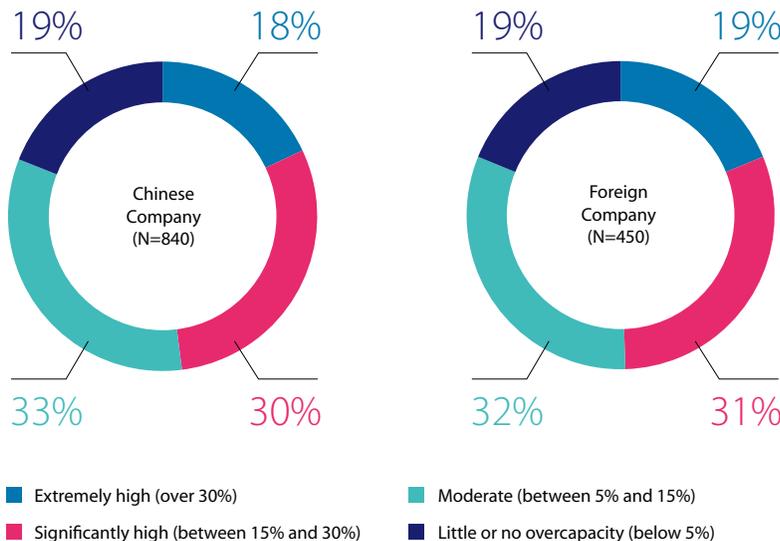
Chart 1a: What is the degree of overcapacity in the industry of your company’s main business? (2017 Survey)



OVERCAPACITY: SEVERE PROBLEM, POLICY SEEN AS WEAK

When asked about how serious a problem overcapacity is in the industry of their main business, about half of the surveyed executives considered it serious. Out of the 1,290 company executives who answered this question in late 2016, 18% of them claimed that the degree of overcapacity was “extremely high (over 30%)”, and 31% said that it was “significantly high (between 15% and 30%)” (see chart 1a). Similar statistics are found from the subsamples of 840 Chinese companies and 450 foreign companies. Only 19% of the surveyed executives did not see overcapacity as a problem in the industry of their main business (see chart 1b).

Chart 1b: What is the degree of overcapacity in the industry of your company’s main business? (2017 Survey)



The Chinese government implemented a policy dubbed “cutting excess capacity, reducing inventory, and deleveraging” in 2016. The 2017 Survey asked the executives how

their companies were affected by this policy. Out of the 1,290 executives who answered this question, 45% and 36% said – respectively – that this government policy did not affect or mildly affected their companies, and only 16% said that this policy had a large effect on their companies (see chart 2a). Not surprisingly, this government policy had more effect on Chinese companies than foreign companies. Meanwhile, 56% of executives from Chinese companies reported that their companies were at least mildly affected by the policy, compared to 46% of executives from foreign companies. Overall, the effect of the policy on overcapacity was only weakly felt in 2016 by both Chinese and foreign companies in our sample, as 44% of Chinese company executives and 54% of foreign company executives said that their companies were not affected by this policy (see chart 2b).

SHANGHAI FTZ: HIGH EXPECTATION, LIMITED IMPACT

In the 2014 Survey, participating executives expressed high expectation and strong interest in the Shanghai Pilot Free Trade Zone (FTZ), which was officially launched on September 29, 2013. In November/December of 2013, when answering the survey question “What is your expectation of the Shanghai Free Trade Zone?”, 31% of Chinese company executives and 21%

of foreign company executives had high expectations and considered it a model for China’s economic reform. In addition,

Chart 2a: How is your company affected by the Chinese government’s policy of cutting excess capacity, reducing inventory, and deleveraging? (2017 Survey)

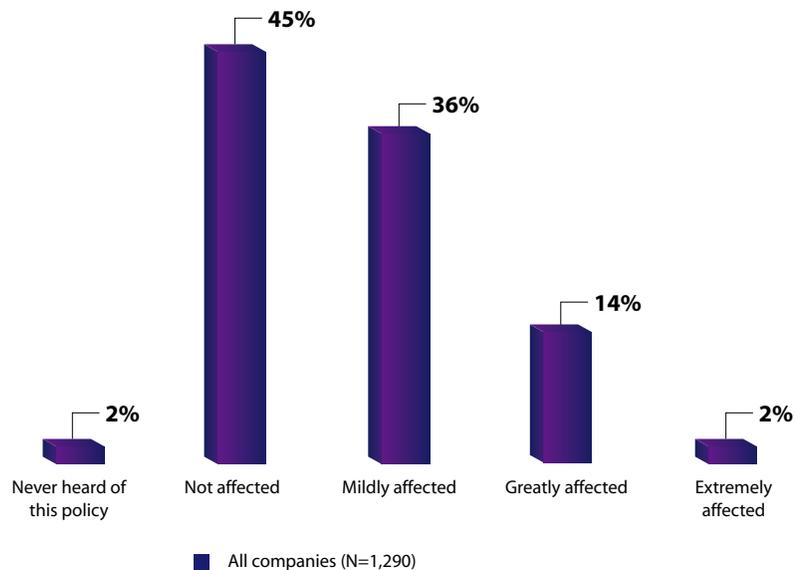
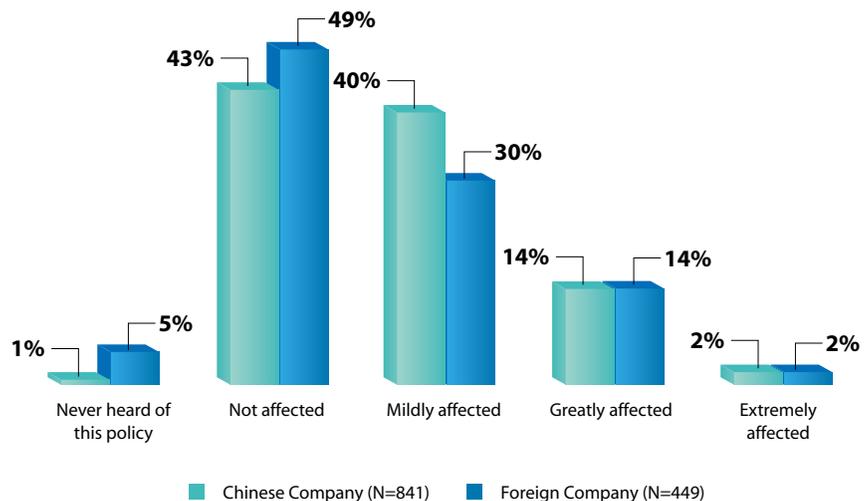


Chart 2b: How is your company affected by the Chinese government’s policy of cutting excess capacity, reducing inventory, and deleveraging? (2017 Survey)



55% of Chinese company executives and 56% of foreign company executives had moderate expectations and were waiting to see how far the policies in the Zone would go (see chart 3a). In answering the question “Does your company have an interest in the Shanghai Pilot Free Trade Zone”, 59% of the state-owned companies and 50% of the privately-owned Chinese companies expressed an interest. Understandably, many

executives, especially those from foreign companies, felt that there was not enough information available in order to judge if the Zone would be of interest to their companies (see chart 3b).

September 29, 2016 marked the third anniversary of the Shanghai Free Trade Zone. In the 2017 Survey, we ask the question “How is your company affected by the establishment of the Shanghai Free Trade Zone?” Out of the 1,289 executives who answered this question in late 2016, 79% said that their companies had not been affected by the establishment of the Shanghai FTZ, and only 19% reported a positive effect from the Zone (see chart 4a). It is worth noting that there are 24% of executives from foreign companies who reported a positive effect on their companies from the Zone, which is much higher than the 16% of executives from Chinese companies (see chart 4b).

Chart 3a: What is your expectation of the Shanghai Free Trade Zone? (2014 Survey)

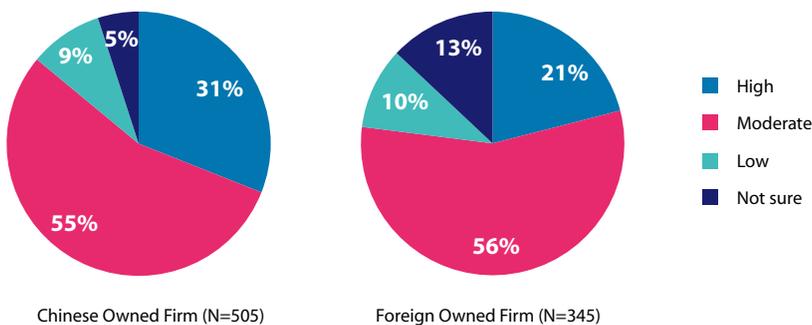
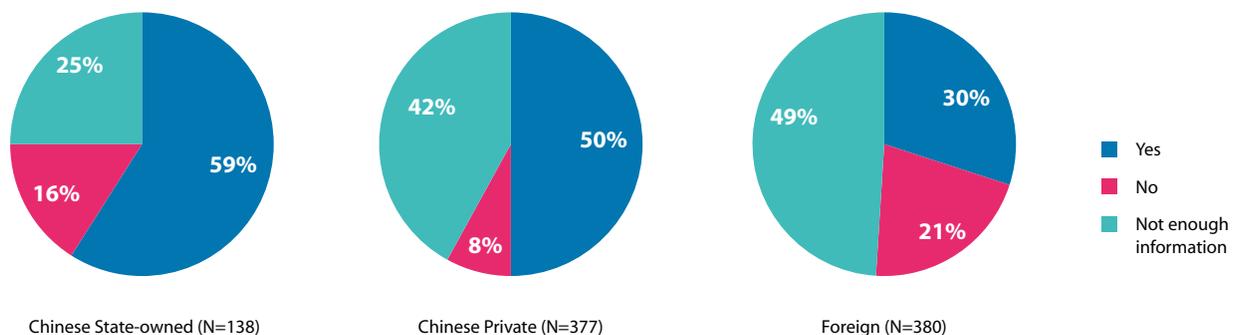


Chart 3b: Does your company have an interest in the Shanghai FTZ? (2014 Survey)



STRUCTURAL REFORM: HIGH EXPECTATION, PERCEPTION OF SLOW PACE

Shanghai Free Trade Zone is not the only reform policy that was perceived to be not as effective as hoped for by executives. When asked “How do you feel about the pace of economic reform in China in 2016”, only 11% of the 1,291 executives chose “Good progress”, compared to 55% who chose “Slow progress” and 17% who chose “No progress”. There were even 16% who chose “Going backwards” (see chart 5a). When we break the sample into 841 Chinese company executives and 450 foreign company executives, we find that only 9% of executives from Chinese companies felt that there was “Good progress” made in economic reform in China in 2016, compared to 13% from executives of foreign companies. In contrast, more than half of the surveyed executives, with 57% from the subsample of Chinese company executives and 50% from the subsample of foreign company executives, felt that there was only “Slow progress” on economic reform in China in 2016; and around one-third of the surveyed executives, with 31% from the subsample of Chinese company executives and 35% from the subsample of foreign company executives, felt that economic reform in China could best be described as “No progress or going backwards” in 2016 (see chart 5b).

Chart 4a: How is your company affected by the establishment of the Shanghai Free Trade Zone? (2017 Survey)

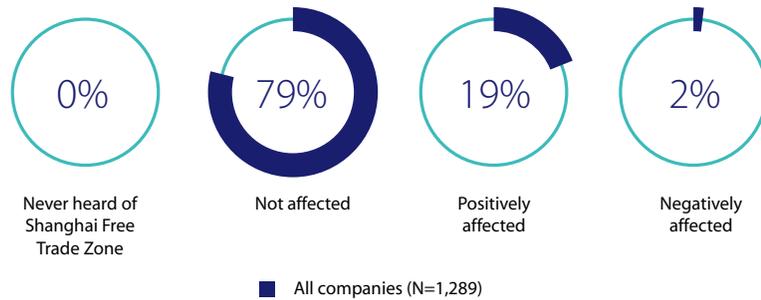
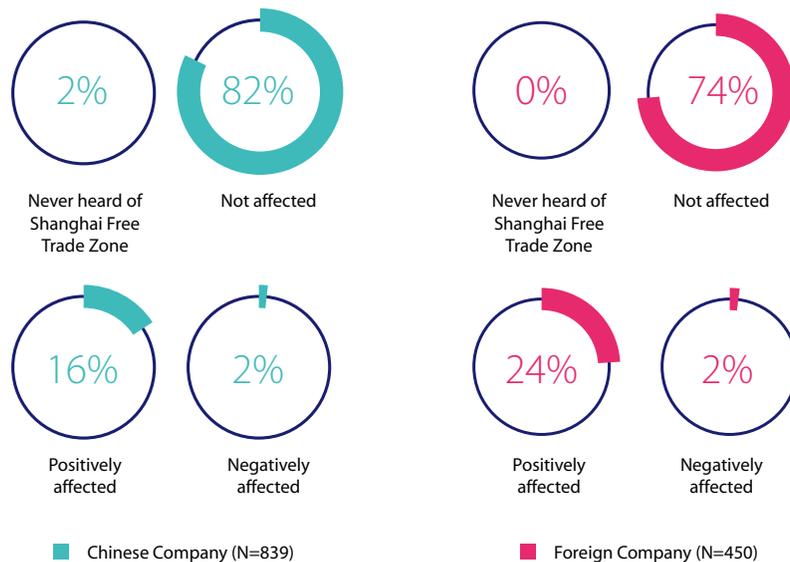


Chart 4b: How is your company affected by the establishment of the Shanghai Free Trade Zone? (2017 Survey)



It is not entirely surprising that the effects of economic reform policies were not strongly felt in 2016. In recent years, there has been high uncertainty surrounding the effects of economic

reform policies as perceived by the executives. In the 2015 Survey, we asked the question “Do you think your company will benefit in the future from current reform policies?” Among

the 731 executives who answered this question, 43% of Chinese company executives and 57% of foreign company executives said that they were not sure (see chart 6).

Chart 5a: How do you feel about the pace of economic reform in China in 2016? (2017 Survey)

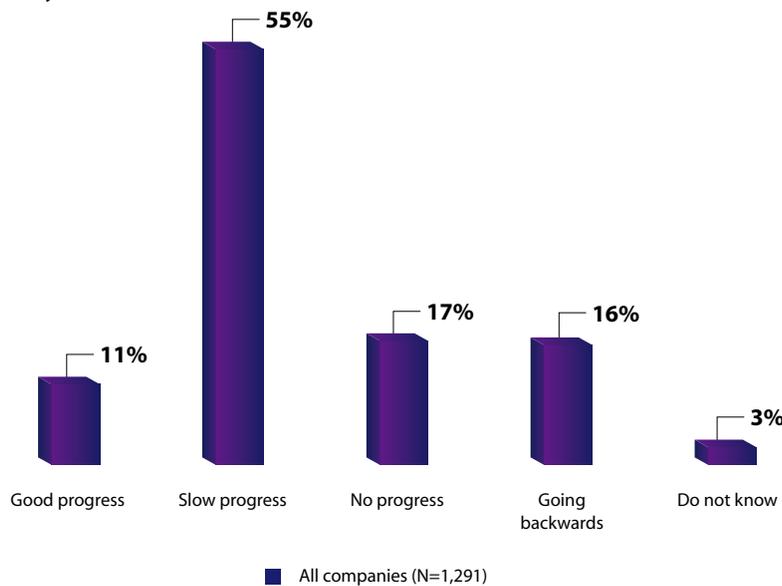
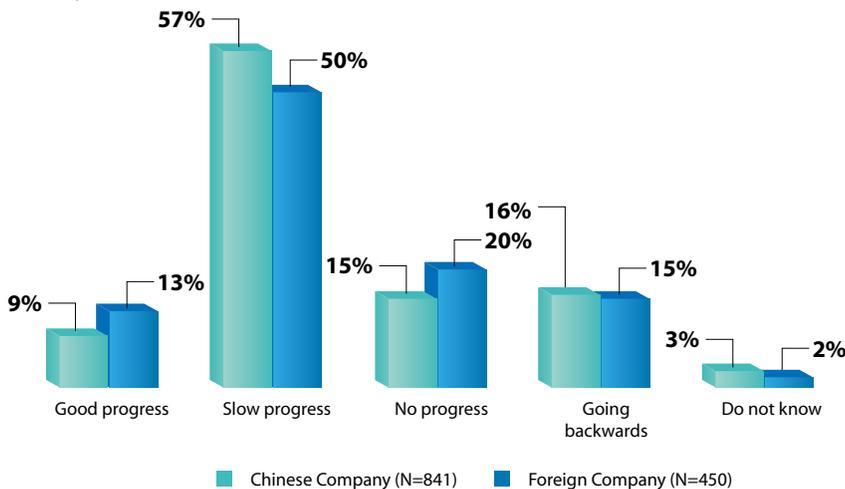


Chart 5b: How do you feel about the pace of economic reform in China in 2016? (2017 Survey)



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GETTING THE POLICY PRIORITY RIGHT

The type of economic reform longed for by the executives is supply-side reform. In the 2015 Survey, we asked a follow-up question to the 136 company executives who said that they had already benefited from new reform policies implemented in 2014. Their answers reveal the areas of reforms that companies prefer. For the 99 Chinese company executives who answered the question, 28% listed “reduction of administrative regulation” as the number one benefit from new reform policies implemented in 2014. For the 37 foreign company executives who answered the question, 41% listed “increase of market openness” as the number one benefit (see chart 7). These answers indicate that companies prefer supply-side reform policies that increase the role of the market and decrease the role of the government.

As discussed earlier, China’s policymakers face a difficult choice between promoting structural reform whose effects are usually not immediately felt, and maintaining middle-high economic growth which is a mandate for the Chinese government in order to fulfil its promise to the Chinese people of doubling their real income in ten years (from 2010 to 2020). In the second half of 2015, pressed by the rising pace of economic slowdown, the Chinese government’s policy priority shifted towards short-

Chart 6: Do you think your company will benefit in the future from current reform policies? (2015 Survey)

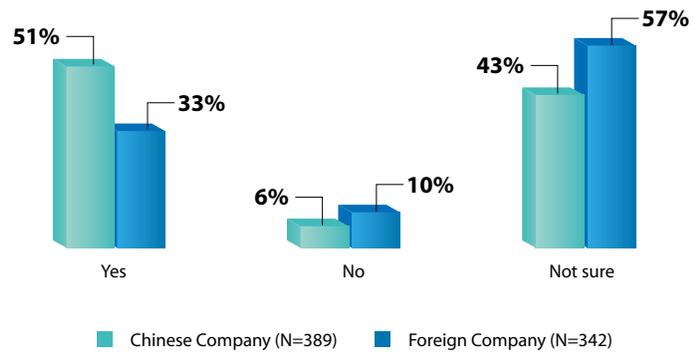


Chart 7: Which reform policy benefited your company in 2014? (2015 Survey)

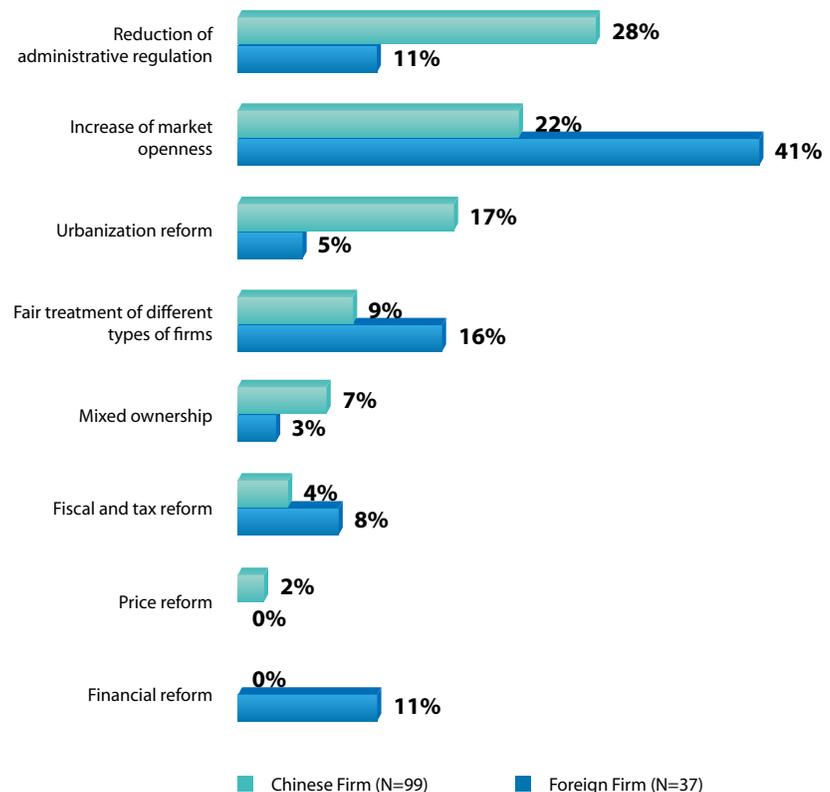


Chart 8a: How is your company affected by the roller-coaster changes of China's real estate market? (2017 Survey)

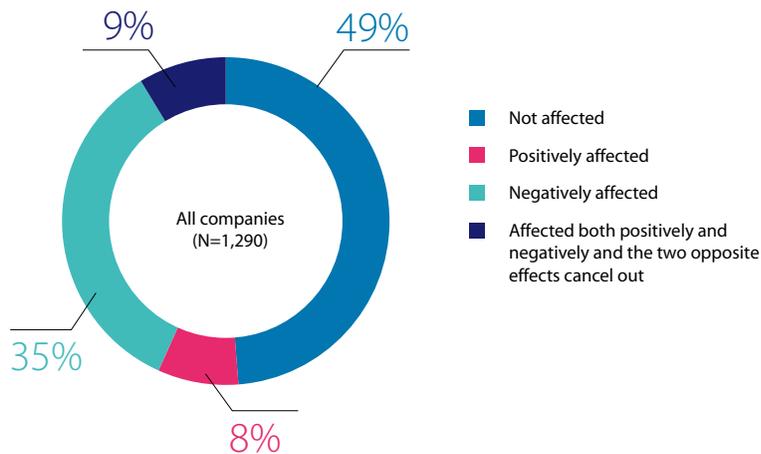
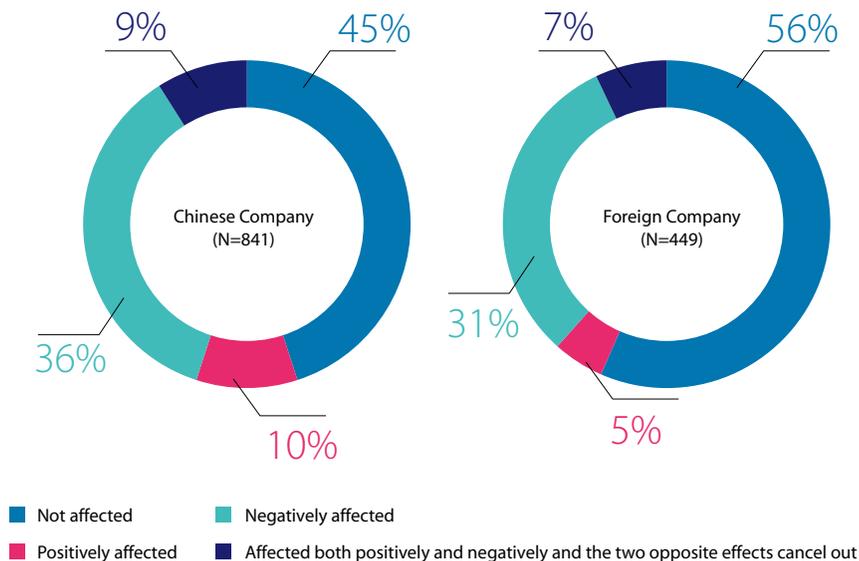


Chart 8b: How is your company affected by the roller-coaster changes of China's real estate market? (2017 Survey)



term stimulus, notably in the real-estate market, which led to a significant increase of the already-high housing prices in late 2015 and in early 2016. As the skyrocketing housing prices looked to threaten economic and social stability, the Chinese government reversed the policy direction and introduced strong administrative methods to cool down the real estate market in mid 2016. Thus people in China had a rollercoaster experience in 2015-2016 in the real estate market.

In the 2017 Survey, we asked the question “How is your company affected by the roller-coaster changes of China’s real estate market?” Out of the 1,290 executives who answered this question, 35% claimed that their companies were negatively affected, compared to only 8% of executives who claimed that their companies were positively affected (see chart 8a). In addition, we find that the real-estate policy’s effects, whether negative or positive, were more pronounced on Chinese companies than on foreign companies. Among Chinese company executives, 38% reported negative effects and 10% reported positive effects. By contrast, among foreign company executives, 31% reported negative effects and 5% reported positive effects (see chart 8b). Despite the percentage differences, it is clear that the roller-coaster changes of China’s real estate prices negatively affected most companies doing business in China.

CONCLUSION: NOTE AND CAVEAT

We would like to end with a note and a caveat. First, the note: It is important to understand that it takes time for supply-side reform to be fully implemented, and hence our finding that reform effects were weakly felt by the executives surveyed in 2016 does not necessarily mean that reform policies are not effective. The perception of weak reform impact found in our survey may come partly from the slower-than-expected implementation of reform policies, and partly from the fact that some of the reform policy effects will take a longer time to be felt. Take the Shanghai FTZ as an example. There is no denying that some of the policies created in the Zone, such as Free Trade Bank Accounts, have been put on hold due to the changing macroeconomic environment both in and outside China. However, it is also true that some other reform policies created in the Zone, such as the “negative list” policy, are in the process of being tested and improved; and the fact that their effects are yet to be felt does not imply the ineffectiveness of these policies.

Second, the caveat: The sample of executives who participated in our survey has some unique features that may affect the interpretation of the results. The majority of our survey participants are alumni or students of China Europe International Business

School, and most of them come from companies ranked high in their respective industries. Taking the 2017 Survey as an example, the companies of the surveyed executives are mostly in the mid- and high-end of their respective



It takes time for supply-side reform to be fully implemented.



markets. In the sample of our 2017 Survey, 48% of the companies operate mainly in the premium segment of their business areas, another 48% in the middle segment, and only 4% in the low-end of their respective market. Moreover, 34% of the companies identify themselves as market leaders for their main business line and 43% consider themselves to be in the Top 5 of their main business line. Given this “upward bias” of the sample, one needs to interpret the results from the research more carefully. For example, the policy of “cutting excess capacity, reducing inventory, and deleveraging” may be implemented unevenly across different types of companies. It is possible that this policy has been applied more frequently in companies which are more poorly managed and thereby are targeted by the policy. If this is the

case, then our result that companies did not feel much effect from this policy warrants a re-examination.

ABOUT THE SURVEY:

The 2017 CEIBS Business in China Survey was completed by 1,300 executives between October and December 2016, with 843 (65%) from Chinese owned companies (defined by 50 percent or more Chinese ownership) and 457 (35%) from foreign owned companies (defined by majority foreign ownership). Among them were 558 CEOs, GMs, and company owners; 414 Vice Presidents, Deputy General Managers or Directors. The rest represented all the remaining business functions: HR, Finance, Marketing, Sales, Operations and Research & Development. Of the respondents, 88% are from the Chinese mainland, 2% from Taiwan, Hong Kong or Macao, and 10% from other countries. Most of them (above 90%) have more than 10 years of work experience, with 55% of them having more than 20 years of work experience. In terms of business activity, the sample is well balanced with 48% of firms having their main activity in manufacturing and 52% in services. 75% of the total sample of firms are B2B companies, having other businesses as main clients, while 25% are B2C companies, offering products and services directly to consumers. This broad and experienced sample added rich and valuable perspectives to the survey.