# A return to the post-war boom

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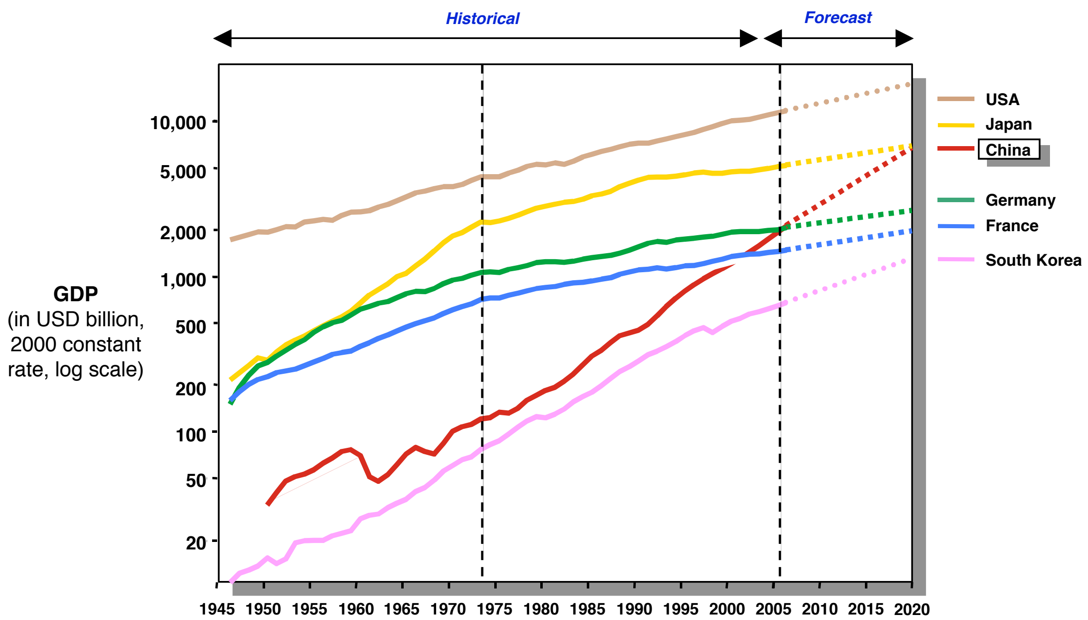
Just for a moment, let's look beyond the current and inevitably transient crisis. After all, we have the next best thing to the post-war boom to look forward to. Strong growth, higher spending power for wage earners, infrastructure expansion, household appliances, a modern and growing retailing network, growth in financial services and favourable demographics going forward… but all of these good things are happening in China! Today's Europe is little more than a wagon pulled along by the exceptional economic take-off seen in the Chinese economy.

**- Table 1 -**

**World economic growth is now driven by China and the emerging countries of Asia**

**GDP 1950-2020**




**Annual GDP growth ($ constant)**

| | 1946-1973 | 1973-2006 | 2006-2020 |
|---|---|---|---|
| **USA** | 3.5% | 3.0% | 2.8% |
| **Japan** | 9.0% | 2.6% | 2.0% |
| **China** | 5.7%(1) | 9.0% | 8.5% |
| **Germany** | 7.5% | 2.0% | 1.8% |
| **France** | 5.6% | 2.3% | 2.0% |
| **South Korea** | 7.6% | 6.8% | 4.8% |
| **World ($ constant)** | **5.0%** | **3.0%** | **3.5%** |
| **World ($ current)** | **8.6%** | **7.4%** | **6.6%** |

(1) 1950 - 1973
Sources: World Bank, OECD, Statistics Bureau of Japan, US Department of Commerce, GGDC and Estin & Co analyses

### *The post-war boom*

On the basis of like-for-like spending power, the standard of living in China is now equivalent to that of Germany and France in 1955, Japan in 1965 and South Korea in 1985. China's GDP is forecast to grow at between 8% and 10% per year between now and 2020. It has already overtaken that of France and Germany, and will catch up with Japan's GDP by 2020. In less than 15 years from now, China will be the world's second most powerful economy (cf. Table 1).

At that time, labour costs in China will still be between four and five times lower on average than those of Europe, and the Chinese population will still be growing.

The growth rate of every industry in China is reasonably predictable, since the country is following the classic take-off curve, similar to that seen in Europe during the post-war boom (with marked acceleration in some areas and major disparities between regions) and Japan in the 1960s, 70s and 80s. In 2020, China will be the world's largest or second largest market for most industries, and will account for between 20% and 40% of their total market.

These forecasts constitute only one scenario among many, but barring any major unforeseen disaster (global conflict, massive pandemic or the return of 1930's-style protectionism in western countries, for example), it is the most likely to become reality, regardless of the crises that will inevitably occur in the interim, and despite the tensions it will create over scarce resources.

Given the massive transfer of production facilities involved, the fundamental changes in strategy it will mean for western corporates, and the emergence onto the global scene of powerful Chinese competitors, it could be seen as a threat. In reality, it can only mean a more "rosy" outlook for the world economy, and for those companies that can really grasp it as an opportunity, since its scope and positive effect will be comparable only with that of the post-war boom experienced by Western Europe in the 1950s, 60s and 70s.

Its effects will, quite clearly, be amplified by the growth of the other emerging Asian economies, because the Indian, Indonesian and Vietnamese economic trains are already powering along the tracks.

### *Growing in China*

What will the effects be from the point of view of western companies?

- A strategy for establishing leadership in the Chinese market is vital. For most US and European companies, the main (only?) source of growth today and for many years to come is China. Over the next fifteen years, this country will represent between 40% and 70% of total global market growth across all industries;
- In terms of growth and competitiveness, the gap will grow between those leading western companies capable of developing a winning strategy in China, and those that follow in their wake because such strategies are too risky or are impossible to fund; the financial markets value growth, so the gap between the two groups can only widen;
- Growing in China is not a method or a simple communication channel to the financial markets. The risks associated with pursuing a strategy of growth in China are high, as they are in any long-term competitive battle. Of the fifteen or twenty major competitors now operating in each Chinese market – regardless of whether they are western or Chinese businesses – only one or two will establish strong, profitable long-term positions. Too great a focus on short-term technical problems (like the difficulty of doing business in China, product and technology copying, etc.) poses the risk of missing the major strategic challenge: market-for-market, there will be only one winner and lots of losers. A clear understanding of the right market positioning and success factors is therefore critical

So what are the right foundations on which to build market leadership, given that local competition is ferocious, and that Chinese companies have no intention of waiting for western leaders to develop their market for them?

- Certainly not the competitive abilities of western production resources, with the exception of those serving a very few niche markets (such as luxury goods, and capital goods and exclusive technologies in the transition phase). In most cases, these resources will be developed locally (either organically or by acquisition) by transferring western skills and experience;
- Not *solely* technological advancement. This often exists, but is only temporary, as the leading Chinese companies rapidly make up lost ground in most areas. In many industries, this gap was only ten to fifteen years in 1995. It was around five to ten years in 2000, is now around three to five years, and in certain areas (like coal-fired boilers), China now enjoys joint technological leadership (cf. Table 2);

**- Table 2 -**

**Trend in the technology gap between the leading Chinese companies and the leading western companies (in years)**

| | 1995 | 2000 | 2007 |
|---|---|---|---|
| **Photovoltaïc power** | No Chinese | 12 | 7 |
| **Integrated circuits** | No Chinese | 6 | 3 |
| **Telecoms hardware** | 15 | 7 | 3 |
| **LCD TFT screens** | 12 | 8 | 3 |
| **Coal-fired boilers** | 10 | 5 | Joint technology leadership |

Source: Estin & Co research and analyses

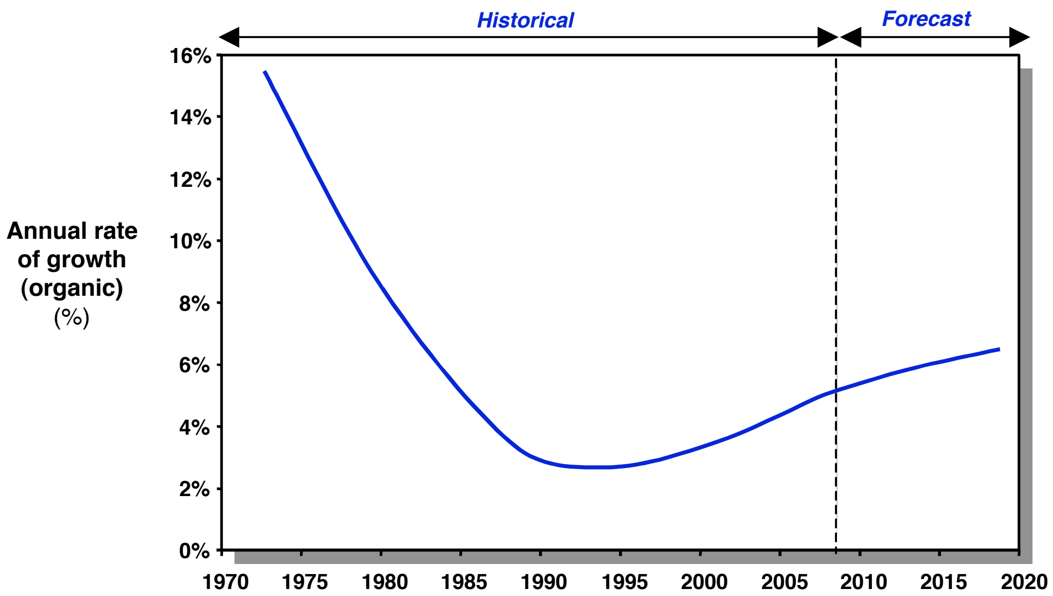
- In most cases, the replication in China of the business model that has proved so successful in the USA and Europe is the decisive factor. A western company that has established a clear leadership within its own field of expertise over a 10-20 year period has every chance of being able to reproduce that success in a large new market (given the ability to make local adaptations) using the same mix of products or services, market position, sales proposition and targeting and economic trade-offs that proved their worth in its country of origin. In the 1950s, 60s and 70s, the leading companies of North America succeeded very well in establishing leading positions in many different European markets simply by reproducing their established business models;
- Such deployment is effective only when it is achieved with speed and strength. China is no different from any other large, fast-growing market inasmuch as the ability to secure dominant market share in the shortest possible time is the imperative condition of a winning strategy. Adapting the business model to suit local conditions, size of investment and speed of execution are all vital factors. Most of China's markets are still significantly fragmented, with market leaders (Chinese and western) holding only between 5% and 20%. Within ten years, these same markets will probably be structured in the same competitive way as those of Europe and North America (where market leaders hold between 20% and 40% market shares);
- One of the key factors governing success is the ability to reposition the business model at the heart of Chinese markets by adapting functions and costs, and by stripping out all the complexities and variants developed over the last twenty years to serve the mature markets of Europe and North America. In these countries, western players have microsegmented their markets by differentiating and complicating their ranges of products and services to the ultimate degree as part of maximizing margins. But in the

world's less developed, but fast-growing, markets, market share is won by offering competitive products tailored to core markets (with very few variants), and building rapidly on the powerful effects of scale and mass-production.

**- Table 3 -**

**Those major leading western companies that have been too successful in their original markets inevitably experience low growth short- and medium-term rates unless they make fundamental changes to their country business mixes**

**- Example of disposable diapers -**




| | | | | |
|---|---|---|---|---|
| **Organic growth rate** | | | | |
| Developed countries | 15% | 3% | 1% | 1% |
| Emerging countries | n/a | n/a | 55% | 15% |
| **Proportion of business portfolio accounted for by emerging countries** | <1% | <1% | 5% | 35% |

Source: Estin & Co analyses and research

## *The impact on value*

Who will profit from this new global boom? Well, Chinese companies, of course, but also those western and Japanese companies that succeed in establishing positions of leadership in the Chinese market *on condition* that the proportion of revenue and profit generated in the Chinese market represents a significant part of their total business.

This is a paradox overlooked by the major corporate groups of the west, which implement ambitious growth strategies in China and secure significant market shares, and even profits, but find that the financial markets do not seem to value these strategies as fully as they should (cf. examples include Procter & Gamble, Carrefour and Wal-Mart).

The problem is that the volume of their business and profits in China is still small compared with that of their European and North American operations. The more successful these companies are in Europe and the US, and the higher their market shares, the worse the problem becomes. At the present time, China-based business represents no more than 2%-5%

of revenue for most large western corporate groups. The impact of the growth delivered by their China strategies is therefore temporarily diluted in a vast sea of non-growth (cf. Table 3).

Even so, should they abandon a strategy that will not be reflected in their market valuation until five or ten years down the line? No, of course not. But those western groups that have succeeded too well in their original markets and do not redeploy fast enough and strongly enough in the world's emerging countries are now in a vulnerable position, because their value is stagnating.

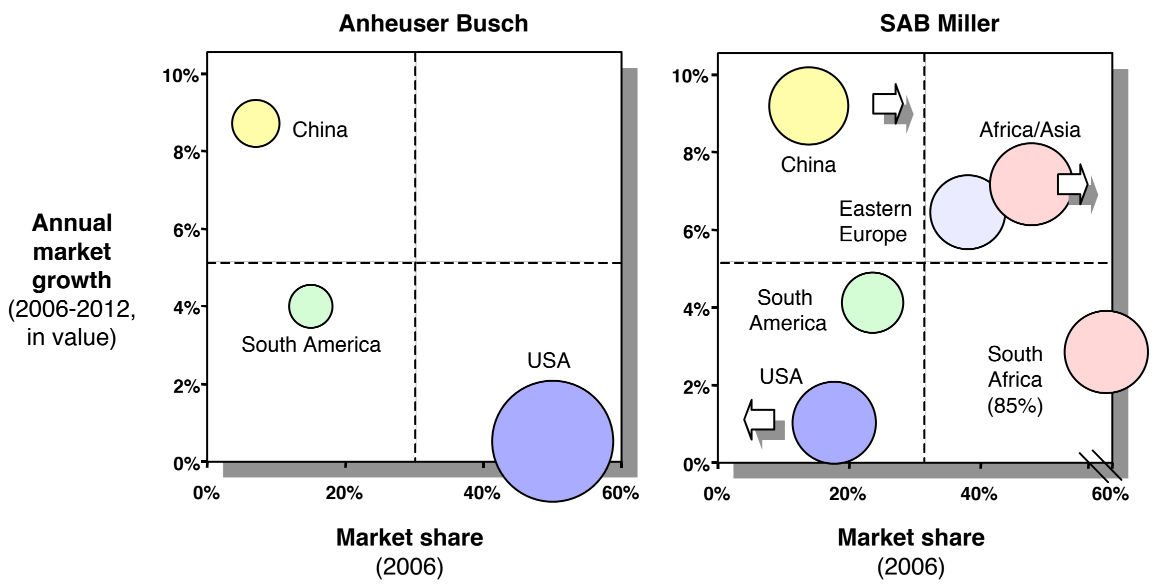
The outlook is different for those Chinese companies whose forecast growth is fully, and sometimes overly, valued by the financial markets. It is also different for those western companies that are second or third in their markets, have distanced themselves from their original markets and have invested in China and/or other emerging countries ahead of, or more heavily than, their competitors (the same applies to niche market players).

**- Table 4 -**

**In a non-growth industry sector, it is the portfolio strategy of the challenger that makes the difference**

**Example of the beer market**

**The business portfolios of two market players**




**2001 - 2007**

| | Annual revenue growth | Total Shareholder Return (TSR) (1) |
|---|---|---|
| **SAB Miller** | **31%** | **32%** |
| **Anheuser-Busch** | **4%** | **4%** |

(1) TSR: Total Shareholder Return (including dividends, rights issues, share purchases, capital gains, etc.).
Source: Estin & Co analyses and research

For these companies, the proportion of their overall business generated in emerging markets is much more favourable, and the impact of growth is more significant. These secondary (or niche) players, which have a relatively strong presence in emerging countries therefore now enjoy a level of TSR[1] higher than that of the major leaders in their market sectors (cf. Table 4 showing the example of SAB Miller v Anheuser Busch in the beer market). Growth from emerging markets is giving them a second chance of establishing long-term world leadership despite having "failed" in the major western markets, and this strategy is highly valued by the financial markets in the short- and medium-terms.

***What conclusions can we draw from all this?***

A rapid refocusing of their business portfolios on the major emerging markets and, simultaneously, on the still-growing niche markets of mature countries seems to be a winning medium-term strategy for major western corporates.

Nevertheless, this is not easy to achieve. It requires the ability to adapt and transfer their historic core market business models to China, reduce the *relative* proportion of business done in the core markets of mature countries and define new business models to exploit growth niche markets in Europe and/or the USA... and to do all these things at the same time.

But great opportunities for sustained growth do not occur very often. They must be grasped if value creation is not to become history.

*April 2008*



[1] TSR: Total Shareholder Return (including dividends, rights issues, share purchases, capital gains, etc.).