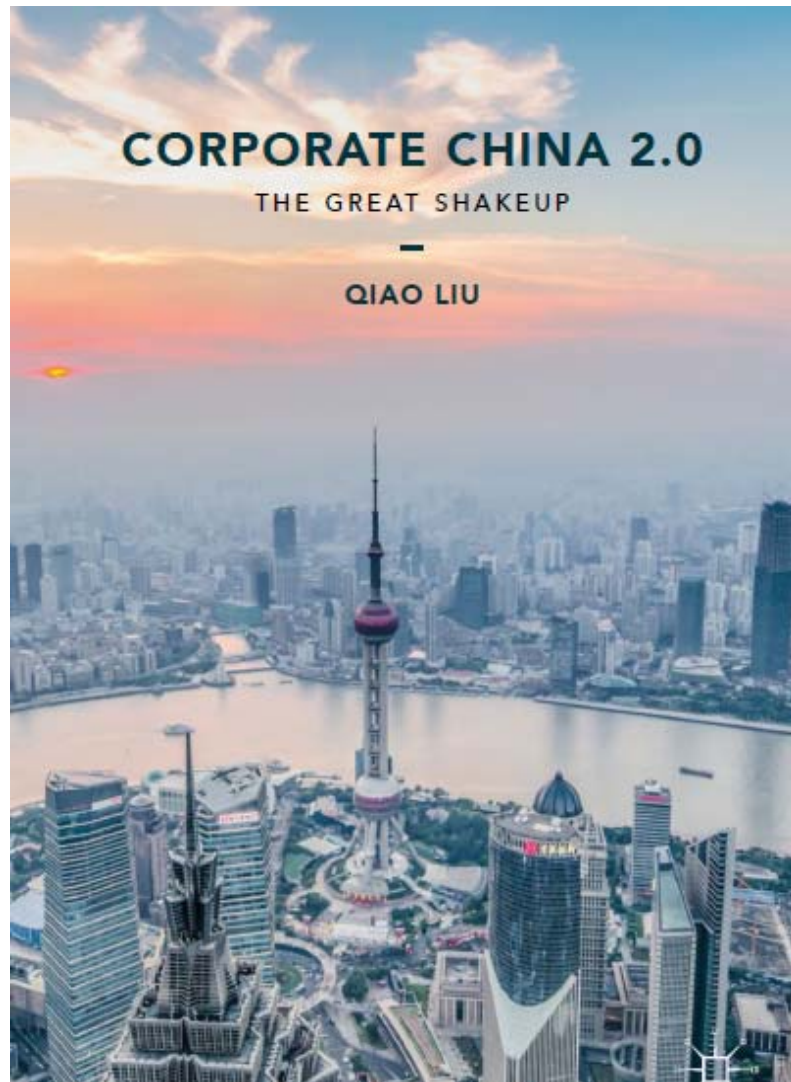


The Great Shakeup and Implications for Cross-Border M&As

**Professor Qiao Liu
Dean, Professor of Finance
Guanghua School of Management
Peking University
October, 2017**

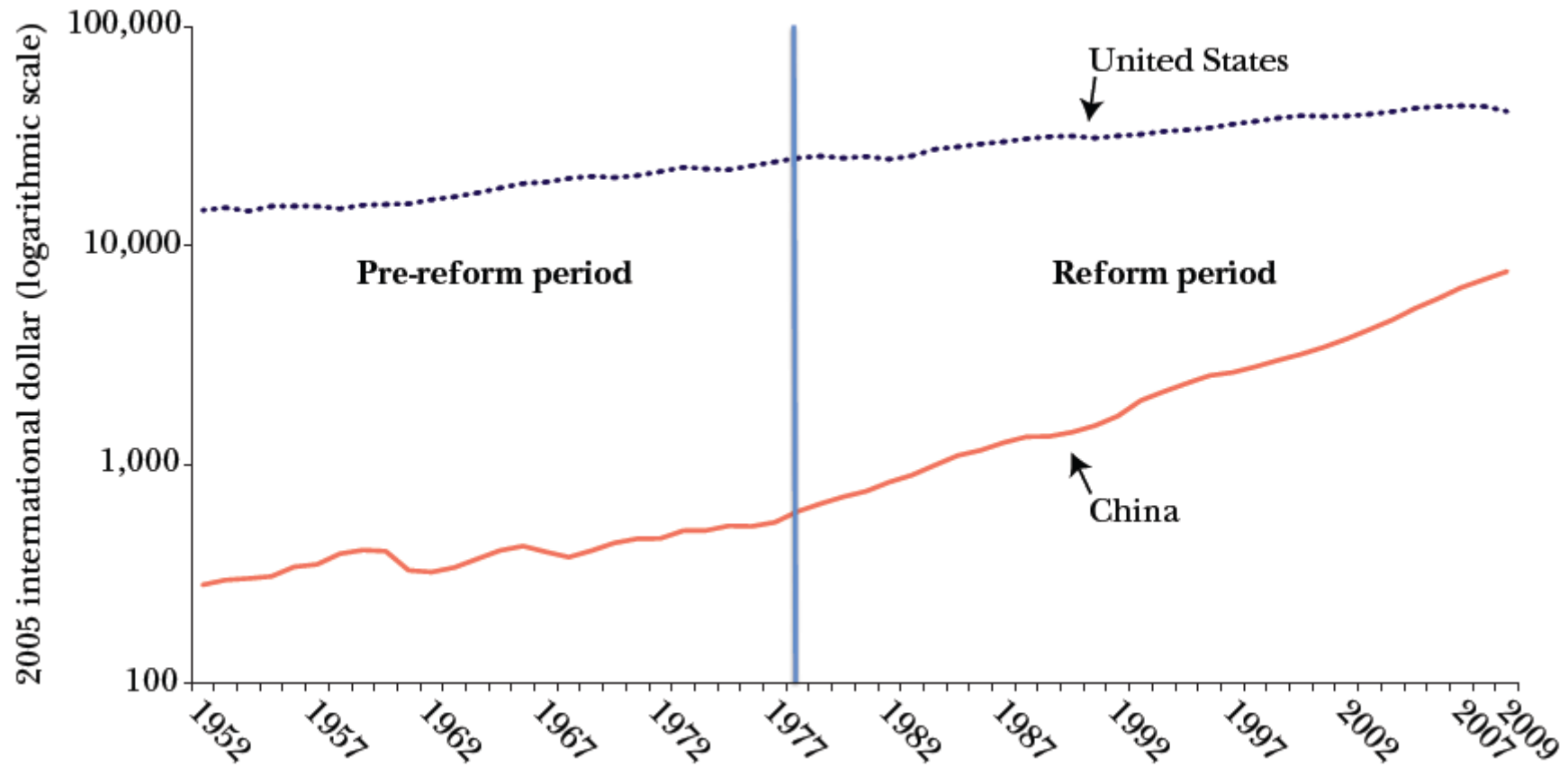
Agenda

- **Sources of China's future growth**
- **The next big things**
- **Implications for XBMA**



Published by Palgrave
Macmillan in Early
2017.

During China's Reform Era



Source: Zhu (2012).

The Chinese Economic Miracle During Its Reform Era

- In less than forty years, China's real GDP has increased more than thirty times, which has lifted 620 million people out of poverty;
- Made-in-China has increased from 1% of the world total output to 25%; China has become the absolute manufacturing power for the world;
- From 2010 to 2015, the high-rise building (skyscrapers) completed in China outnumbered the aggregate of all capitalist world in the past two centuries;
- From 2011 to 2013, China had consumed more cement than the US in the past century;
- With 6% water and 9% arable land of the world, China produces 50 billion T-shirts, 10 billion pairs of shoes, 50% steel, 60% cement, and nearly 25% automobiles of the world;
- "Rome was not built in one day!" However, China is building Rome in two weeks-- the floor area of real estate completed in China within 2 weeks equals the urban area of Rome.
- As of 2017, there are 115 Fortune Global 500 companies in China, second only to the US, and 251 billionaires (according to Forbes).....

What Account for China's Success?

- High savings rates that result in high levels of investment
- Export-oriented growth strategy
- Generally disciplined fiscal, monetary, and exchange rate policies
- Abundant low-cost labor
- Continuing gains in productivity

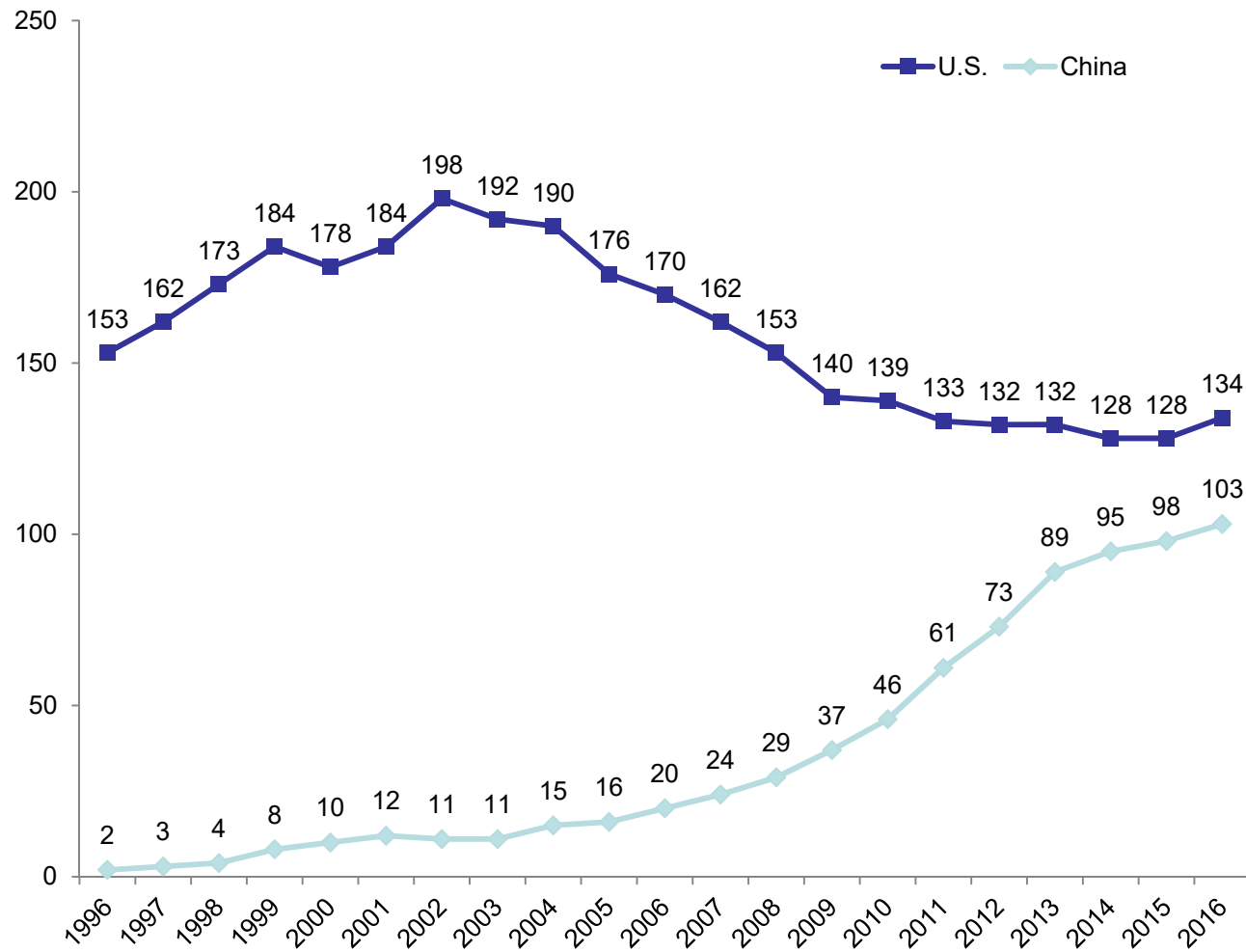
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Political centralization + Economic decentralization

**Implications for Corporate China:
The Surge of Corporate Giants, Especially in the
state sector and factor sectors**

- **The feature of an investment led growth model**
- **The Chinese companies, state-owned or private, tend to put size far ahead of value creation (measured by Return of Invested Capital).**

The Result of China's Economic Growth: the Surge of Corporate China in Size

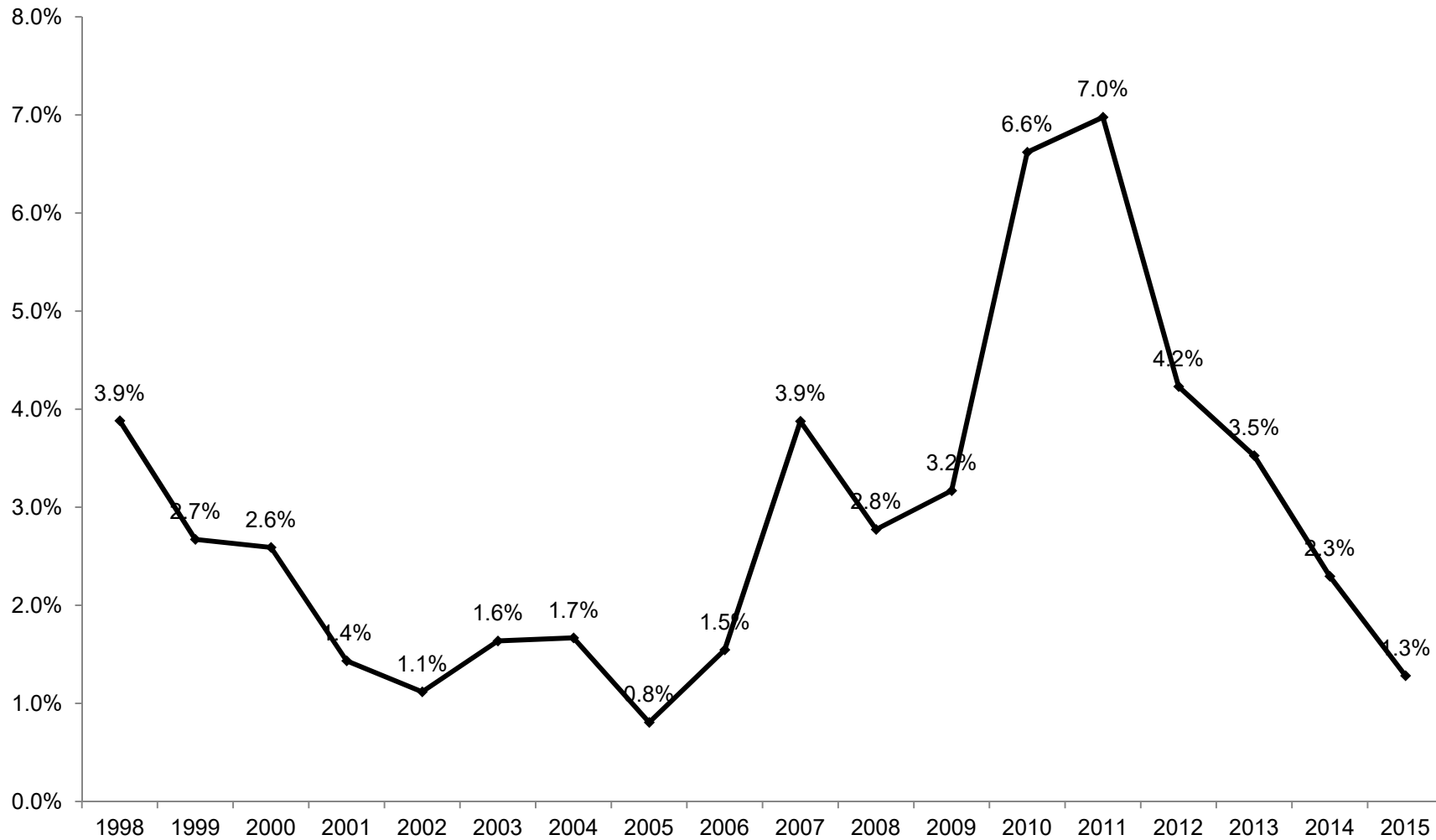


103 **mainland** Chinese firms appeared on Fortune 500 firm list in 2016. China tops Japan and ranks as No. 2 in the world, second only to US.

The Ten Largest Listed Companies in US and China's A-share Market (December 30, 2016)

2016年 Ranking	US	Market Cap. (\$ billion)	A-share Firms	Market Cap. (\$ billion)
1	Apple	618.0	ICBC	225.5
2	Google	546.1	PetroChina	203.2
3	Microsoft	483.7	China Construction Bank	194.4
4	Berkshire Hathaway	401.9	Agricultural Bank of China	145.4
5	Exxon Mobil	374.3	Bank of China	142.9
6	Amazon	356.2	Sinopec	93.5
7	Facebook	326.6	Ping An Insurance	93.5
8	Johnson & Johnson	313.7	China Life	92.6
9	JP Morgan	308.8	China Merchant Bank	63.7
10	GE	279.5	Maotai (Guizhou)	61.1

Average ROIC of the Chinese Listed Firms 1998—2015



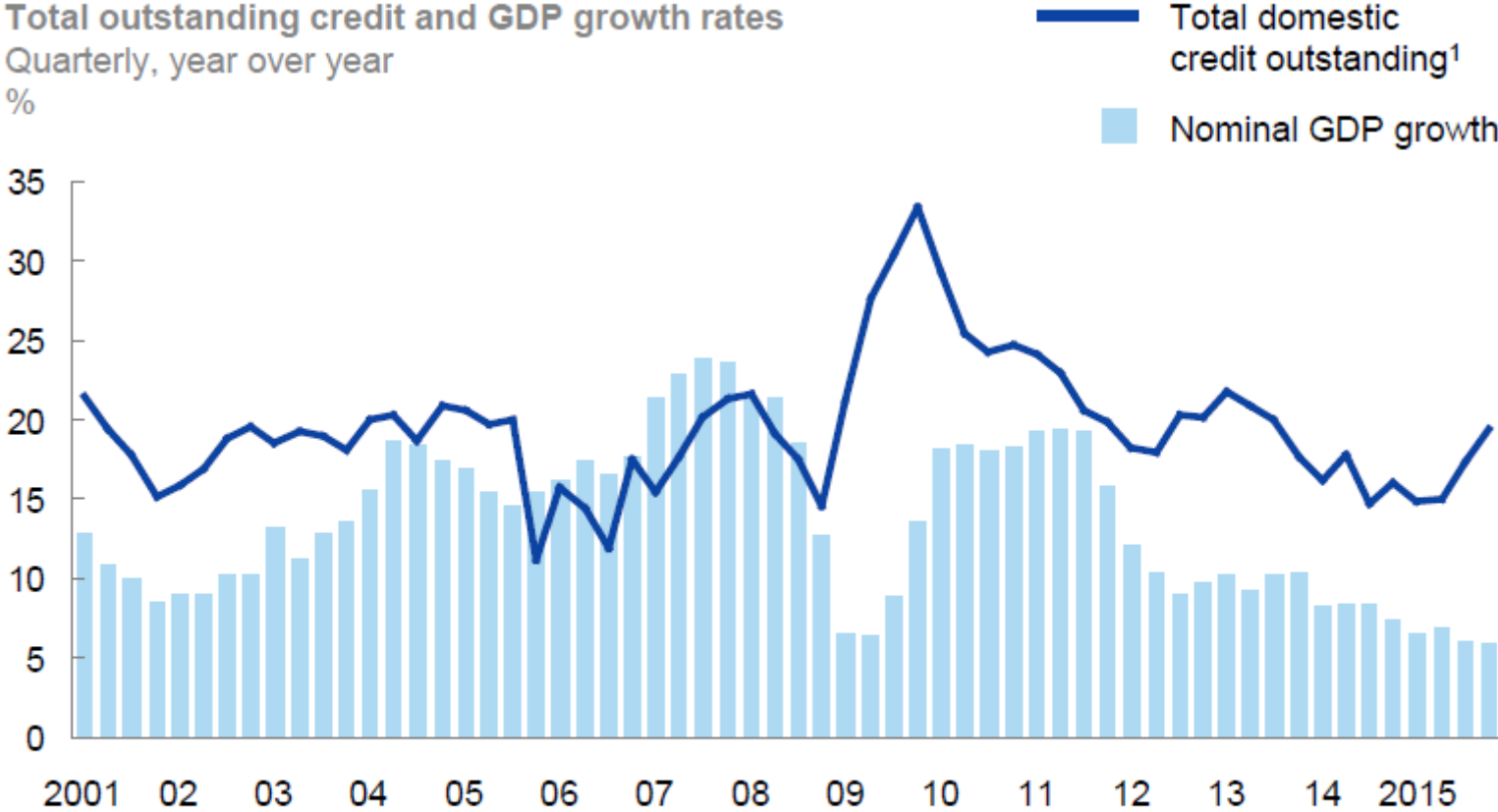
Source: Corporate China 2.0 – The Great Shakeup (Qiao Liu, 2016)..

Over Time, China Becomes Increasingly Reliant on Investment

Growth = ROIC X Investment Rate

China needs to strike a new balance between investment rate and return on invested capital (ROIC)

Investments Are Credit Fueled



1 Includes total social financing, non-loan bank claims on non-banking financial institutions and on corporations and households, and banks' net claims on government (a portion of the claims data is available only starting in 2005). This measurement includes all outstanding credit in the real economy but excludes interbank credit.

SOURCE: McKinsey Global Institute Debt & Deleveraging database; CEIC; Emerging Advisors Group; McKinsey Global Institute analysis.

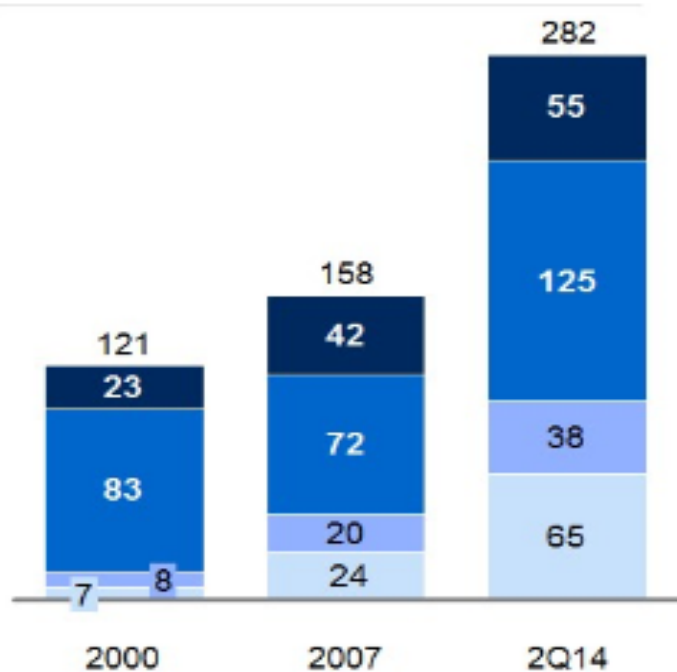
Credit Fueled Growth Caused High Leverage in Corporate Sector

China's debt reached 282 percent of GDP in 2014, higher than debt levels in some advanced economies

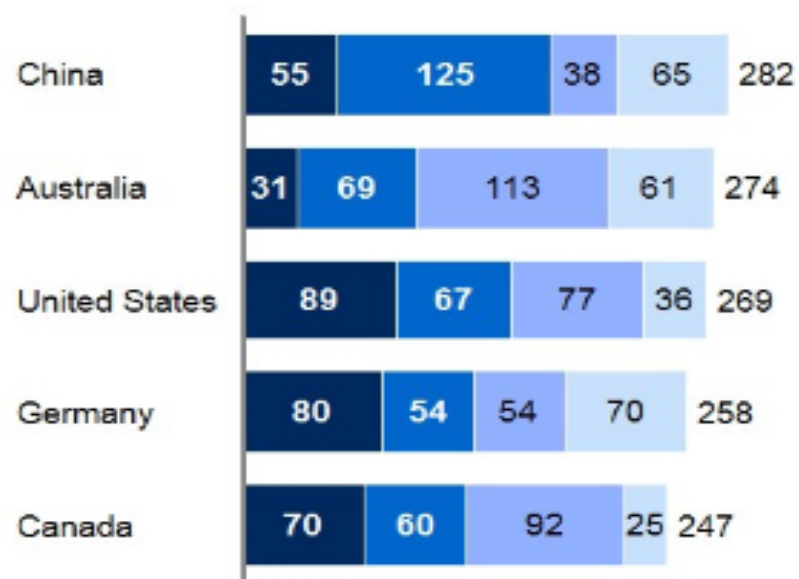
Debt-to-GDP ratio
%

■ Government ■ Households
■ Non-financial corporate ■ Financial institutions

China



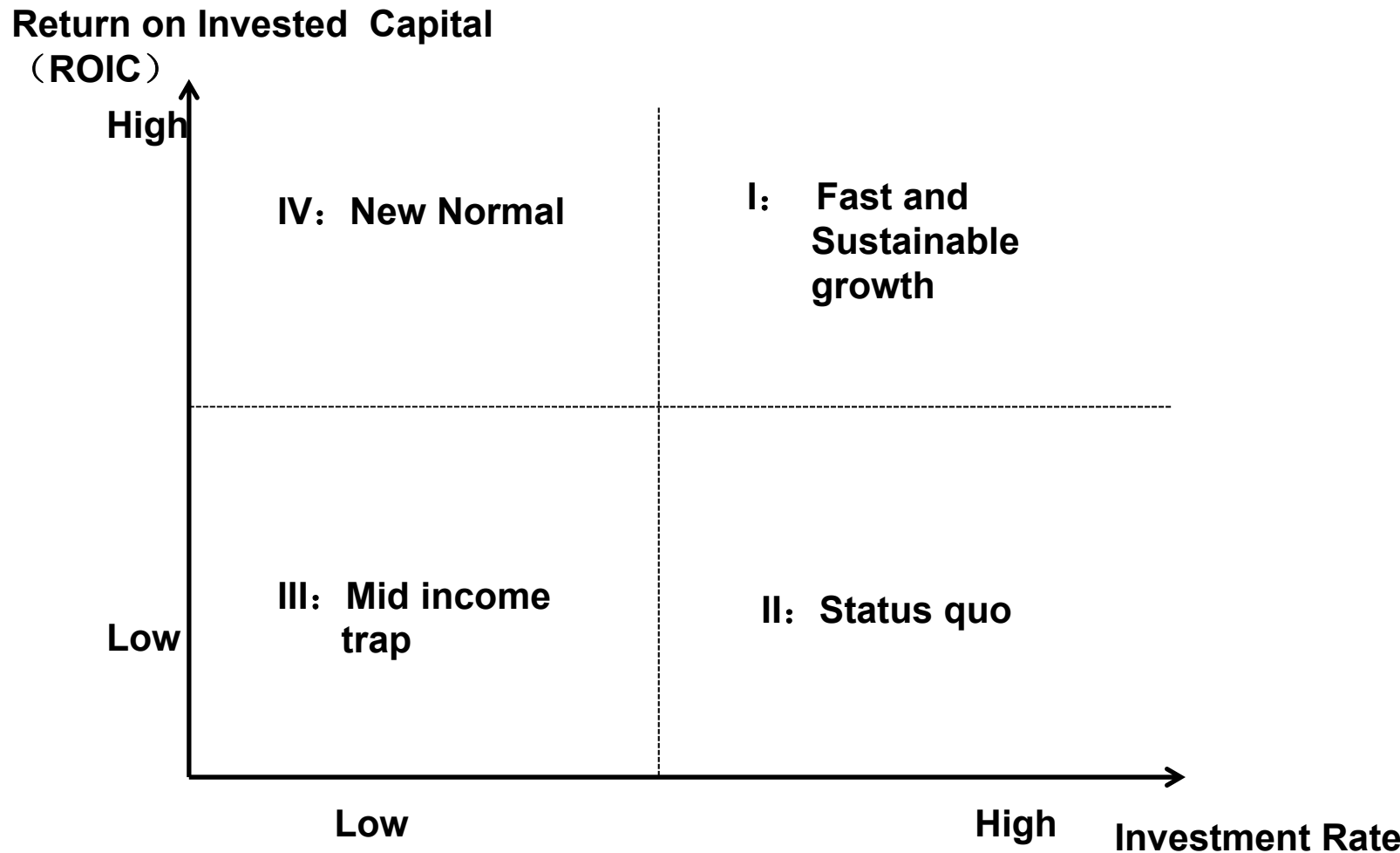
By country, 2Q14



NOTE: Numbers may not sum due to rounding.

SOURCE: MGI Country Debt database; McKinsey Global Institute analysis

The Chinese Economy --- Four Possible End Scenarios



The key is ROIC!

The micro-foundations of the Chinese economy needs to be fixed.

The key to China's future economic success is ROIC.

The supply side reform is all about capital efficiency!

The source of the Chinese GDP Per Capita Growth

Decomposing China's Growth: 1952–2007

<i>Average annual growth rates (%)</i>					
<i>Period</i>	<i>GDP per capita</i>	<i>Labor participation rate</i>	<i>Capital/output ratio</i>	<i>Average human capital</i>	<i>TFP</i>
1952–1978	2.97	0.11	3.45	1.55	-1.07
1978–2007	8.12	0.57	0.04	1.18	3.16

<i>Contributions to per capita GDP growth</i>					
<i>Period</i>	<i>GDP per capita</i>	<i>Labor participation rate</i>	<i>Capital/output ratio</i>	<i>Average human capital</i>	<i>TFP</i>
1952–1978	100	3.63	116.15	52.25	-72.03
1978–2007	100	7.05	0.51	14.55	77.89

Total Factor Productivity(TFP) accounts for close to 78% of the growth of GDP per Capita During China's reform era.

The annual growth rate of TFP in China

•1980-1989 : 3.9%

•1990-1999 : 4.7%

•2000-2009 : 4.4%

•2010-2016 : 2.3%

As of now, China's total factor productivity (TFP) is only 20% of the US level.

The sources of future growth are in private sector and emerging sectors that are associated with consumption, the upgrade of manufacturing, internet, and financial services.

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Think about the Future: Positive Developments

- By 2030, the nominal GDP in China will reach RMB 250 trillion; the real GDP is expected to be RMB 157 trillion (the 2016 figure is RMB 74 trillion).
- By 2030, the estimated value of financial assets in China will be RMB 900-1200 trillion. (Now ICBC has RMB 22 trillion of assets).
- By 2030, China will boast 400 million people born after 1990, and more than 200 million of them boast of college degree.
- By 2030, “made in China” will be replaced by “make for China” .
- By 2030, the largest industries in China might be healthcare, culture, education rather than just finance and real estate, etc.
- By 2030, there will be X world class Chinese firms and Y world class business leaders (Guanghua now boasts of more than 30,000 alums, and close to 7,000 EMBA alums).

The Next Big Thing - Healthcare

From 6% of GDP to 10% of GDP?

**Over 300 million people over 60 years old
by 2030.**

Market Size as of 2030: RMB 16 trillion.

Now: no single world-class player yet!

The Next Big Thing – Finance

New Generation of Finance

Market size: RMB 16 trillion (10% of GDP)

Challenges: how to improve the efficiency level of financial intermediation; how to enhance the access to finance; how to sort out a rich portfolio of financial instruments which can accommodate the increasing demand.

**The Next Big Thing – Culture, Sports, Leisure and Tourism
which appeal to post-90s generation**

**Movies: Box office from RMB 2.3 billion (2007)
to RMB 43 billion (2016) in 10 years.**

**Sports: as of 2025, a market size of RMB 5
trillion.**

Tourism: Post-90s generation

**Education: private schools, professional
educations, etc.**

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Takeaways

- **Corporate China will become increasingly important in Global M&As**
- **The tech sector, healthcare, consumption, and upgrading of manufacturing are key sectors to watch.**
- **For MNCs, understanding the post-90s generation in China is the key (as of 2030, there will be 400 million)**

Thank You