



'Jumping on the Asia Train': How Sustainable Is China's Rapid Growth?

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China's securities industry is just one of the sectors moving ahead at a dizzying pace as the country readies itself for full entry into the World Trade Organization this year, according to participants in the recent Wharton Global Business Forum's Asia Conference.

Not surprisingly, China dominated discussion at the conference, with many speakers noting the speed with which the country is advancing. While the U.S. has had approximately 200 years to refine its financial systems, one panelist said, China has had just 20 years to catch up. China's astonishing growth is even more remarkable in the face of its cultural heritage, which favors slow, deliberate progress over western style entrepreneurship.

This growth is not just confined to China. Y.J. Choi, permanent representative of the Republic of Korea to the United Nations and lunchtime keynote speaker, predicted that the 21st century will be the Asian century. A keen understanding of East Asia's distinct culture, said Choi, will be indispensable for those wishing to "jump on the Asia train."



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The Sophisticated Traveler

While much of the talk centered on Asia's exploding economic growth, conference panelists also asked whether such growth is sustainable. The answer is yes, "barring any major political crisis," said opening keynote speaker Ho Kwon Ping, executive chairman, Banyan Tree Holdings, a leading luxury hotel chain in Asia. His optimism stems from his experience in the travel and tourism industry, which often serves as a bellwether for economic development. During the expansion of developing countries, there is almost always a magic number for per capita income that is needed for tourism to thrive, Ho noted. "This [economic milestone] happened in Japan and Korea over the last 50 years, and now we are seeing it with China."

Indeed, China is the fastest growing supplier of tourists to Banyan Tree's exclusive resort in the Maldives, a group of islands in the Indian Ocean. And at one of Banyan's spas in Shanghai, the company charges rates much higher than anywhere else -- a move that the Chinese market supports. "There is a small but rapidly growing population of sophisticated travelers in China," said Ho. "We believe the country will be a very big player in world tourism." He doesn't discount the occasional bubble that may hit the market, but overall, he suggests, the fundamental signs of growth in Asia are strong.

"Outside Players Welcome"

During a panel discussion on the development of the securities industry, speakers noted that China in the past 20 years has invested significant resources in its securities infrastructure. According to Jin Xiaobin, assistant president, Haitong Securities (China), the capital markets have a huge potential for development, even if securities firms are facing growing pains. "We have only 14 years of history," said Jin, "and we are experiencing the problems the U.S. had [decades] ago." The three main businesses in the industry are brokerage (70%), institutional banking (15%), and proprietary trading and asset management (15%).

In December 2004, total net assets of China's 114 securities firms were 66.9 billion yuan (\$8.3 billion),

with 45.3 billion yuan (\$5.6 billion) in net capital. The growing pains alluded to by Jin are due in part to reorganization in the sector. Firms are now consolidating, with some 17 shut down since 2003. The sector is also undergoing a period of innovation, he added, with a new emphasis on professionalism (offering value-added client services) and internationalization (the development of overseas business and joint ventures).

The mutual fund market is also in an "innovation" phase, reported Ding Ying, deputy executive officer and chief investment officer, Citi Fund (China). In recent years, the country has instituted the Chinese Securities Investment Fund Law, which regulates fund managers and fund custodians. Additional laws were created by the State Council and the China Securities Regulatory Commission. Now open to foreign investors, China's mutual fund market boasts total assets of 400 billion yuan (\$49.6 billion), with banks serving as the main sales channel for funds.

China's stock market has seen huge changes since the establishment of the Shanghai Exchange and Shenzhen Exchange in 1990. Then, 10 companies were listed. By 2004, that number had risen to 1,377. Tradable capital stock value is \$140 billion, and total capital values are \$150 billion. "This is relatively small compared to the market in the U.S.," acknowledged Wu Zuyao, vice director of research, China Galaxy Securities, "but there is huge potential for growth." According to Wu, the volatility of the stock market is decreasing, with individual investors -- UBS is the largest foreign investor -- dominating the market.

According to Wu, one of the main problems affecting the stock market is non-tradable stock, a peculiarity of the Chinese market where it is common for as much as two-thirds of a firm's total capital to be non-tradable. "We cannot do M&A work in this market if most shares can't be traded," said Wu, adding that the government is working hard to convert non-traded to tradable stock. In addition, governance has improved markedly and internal risk control systems have been established. Wu's outlook on the stock market is extremely positive. "The ratio of capital markets to GDP is only 20%," he said. "We have sufficient funding potential, including pension funds, social security funds and insurance funds."

Early on, investors were reluctant to buy stocks, noted He Kuanhua, chief business officer, Investment Banking Department, G. F. Securities Co. Ltd., but that has changed as consumer confidence has risen. In the past, the government heavily regulated the size of IPOs and restricted the number of IPO firms in each region, he said. Recently the government has tried to reduce its impact on issuance, although qualified companies still need approval from the government to pursue an IPO. In 2005, while the government worked on reforming non-tradable stock, IPOs were halted, although activity is expected to resume soon, he added.

All of these reforms, along with China's full entry into the World Trade Organization this year, will lead to dramatic improvements in the country's securities sector, said Jin, adding that "all Chinese players welcome outside players" -- an allusion to what he sees as increased joint ventures in mutual funds with international partners.

Yin and Yang

The securities infrastructure is just one part of the development equation, stressed the Republic of Korea's Choi. In trying to understand Asia's position today, one must consider that "the population is the area's most important resource for economic growth." East Asia's 1.6 billion people, more than double the population of North America and Europe combined, are "a highly educated, motivated population, determined to change their lot," said Choi, noting that East Asia has a distinct culture and character that support economic growth.

Using the example of yin and yang, he contrasted the ways of the East with the ways of the West. In the East, when writing an address on an envelope, one writes the country first, then city, then family name, then first name. In the West it is the opposite. In addition, there are differences in how people count: In

the West, a person holds a fist and counts by putting out fingers. In the East, counting is done by first outstretching the fingers and bringing them in, one by one. "My observation," said Choi, "is that these characteristics are reflected in business practices. It's the difference between the moderation of the East versus the extremism of the West, long-term planning of the East versus short-term gains in the West, strategic planning in the East versus tactical gains in the West."

Continuing the comparisons, Choi suggested that the game of chess epitomizes the way the West developed: victory after victory, head-on collision after head-on collision. "The West developed by conquering wide open spaces and wide open seas," he said. "The East developed in a closed environment, with an un-navigable ocean to the east, the world's highest mountains to the north, and jungles to the south." Ironically, said Choi, the West turned an open world into a closed world.

According to Choi, the game of Go, popular in East Asia, might be a more appropriate metaphor for how to do business in the closed world of the 21st century. "The game of Go is sometimes very tedious," he said. "And sometimes you need to lose a local battle in order to win a larger battle." His conclusion? Don't fall into the debate over who is better. "We are different, like apples and oranges. Just accept the differences and learn from them." He did, however, point out that IBM's Deep Blue, a computer designed to play chess at the grandmaster level, managed to defeat a master chess player in 1995, while no artificial intelligence has come close to beating even an amateur Go player.

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