
Event Report

INVESTING IN CHINA: A NEW ERA HAS ARRIVED

MAY 10, 2007

On May 10, Columbia Business School and the Jerome A. Chazen Institute of International Business welcomed Frank Tang '94, a senior managing director at Temasek Holdings, to deliver the fourth lecture in the Sir Gordon Wu Distinguished Speaker Forum. A capacity crowd of students, faculty members, alumni and friends of Columbia Business School gathered at the Columbia Club in midtown Manhattan to hear Mr. Tang speak about the effects of recent market and economic reforms on foreign investment opportunities in China.

Temasek Holdings is among the largest overseas investors in China, having invested more than U.S.\$5.1 billion in mainland Chinese companies since 2004. Sectors in which it has been active include financial services, retail, consumer products, real estate, transportation and alternative energy.

The Sir Gordon Wu Distinguished Speaker Forum at Columbia Business School promotes the academic study and professional understanding of China's economy and business practices by bringing recognized business leaders to New York to share their perspectives.

While there is general consensus today regarding China's emergence as a global manufacturing power, Frank Tang '94 believes that recent macroeconomic developments, demographic shifts and financial market reforms in China will fuel much of the future growth over the next decade and transform the country into a true global economic power.

China embraced market reforms starting in the early 1980s, dismantling certain elements of its socialist, macroplanning apparatus. Subsequent GDP growth was volatile, largely because of this dismantling coupled with the lack of a strong central banking authority and effective regulatory mechanisms. Since 2000, however, improved central banking oversight has helped

stabilize GDP growth, now projected at 8 to 10 percent per year for the foreseeable future. Mr. Tang believes that steady growth will be critically important for current investors in China and for those seeking to enter the Chinese market.

Furthermore, Mr. Tang explained that the ownership structure of Chinese companies has changed in recent years, with significant implications for investors. Many of China's state-owned enterprises have been converted to privately owned enterprises, leading to more efficient deployment of capital, a stronger focus on growth and potentially larger returns for investors. In fact, from 1999 onward, privately owned enterprises have accounted for more than 50 percent of China's total industrial output.

China is also undergoing rapid urbanization, and the country's agricultural economy is quickly being supplanted by an industrialized and concentrated urban economy. Although China's 40 percent urbanization ratio lags behind those of developed nations, which have urbanization ratios of 70 percent to 80 percent, Mr. Tang stated that the rapid growth of urbanization in China will lead to higher living standards and quality of life for urban Chinese, resulting in higher levels of GDP. Mr. Tang noted that urbanization will directly impact investments in infrastructure, as growing urban populations will require improved healthcare, education and transportation.

China's labor supply, long considered unlimited, has begun to peak, evidenced by recent wage inflation in China. Speaking to the important implications of this new development, Mr. Tang noted that Chinese companies can no longer solely rely on low-cost manufacturing to remain competitive and fuel growth. Rising wages and prices will reduce the benefits of many cost-arbitrage opportunities. Mr. Tang explained that to fuel future growth, Chinese companies will need to increase investments in technology, develop and grow their own intellectual property and begin to build domestic markets and demand for their products and services. This will begin to shift focus away from squeezing value out of labor costs toward the quality of businesses and products.

Mr. Tang also spoke about China's "baby boomers" and what this generation means to China's burgeoning domestic market. Born after 1980 and numbering nearly 200 million, China's baby boomers are young, well-educated, optimistic about the future and willing to spend. Mr. Tang emphasized that given its aggregate spending power, this generation will define consumption in China for the next 20 years.

These baby boomers have been important in driving the proliferation of mobile communication and information exchange within the Chinese market. With nearly 500 million people in China owning a mobile phone, the Chinese today communicate with one another like never before. Furthermore, many Chinese use their mobile devices not only to communicate with one another but for entertainment purposes and for financial and e-commerce transactions, opening up numerous investment opportunities in the near term.

A watershed moment for China's capital markets occurred in 2005, as the Chinese government enacted share unification reforms, whereby previously illiquid state- and entrepreneur-owned equity became tradable. These reforms, along with China's large trade surplus and the increasing inflow of foreign currency into the country, have led to rising levels of liquidity. Given the amount of capital available for investment in China, Mr. Tang cautioned that investors must be prepared to bring additional value to deals, that is, more than ready access to capital.

Although optimistic regarding investment prospects in the Chinese market, Mr. Tang recognized that investors in China still face numerous issues and challenges. Deal completion in China can be a very lengthy process, and the myriad regulations governing this process are often confusing and out-of-date. Furthermore, the veracity of financial accounting information often remains unclear, requiring investors to perform extensive due diligence prior to closing a transaction. China's human resources and managerial capabilities are continuing to grow, but Mr. Tang stressed that investors will still need to bring outside management expertise to transactions as part of their value proposition.

Mr. Tang also touched upon rising economic nationalism within China, noting several reasons for this recent phenomenon and its implications for investors. With the recent influx of foreign capital into the country, many in China are concerned that critical assets such as large financial institutions, energy producers and domestic utilities, which represent a national security interest, will be compromised once sold to foreigners. Furthermore, there are fears that foreign investors will make windfall profits by acquiring state-owned assets very cheaply. There is also a desire to protect the interests of homegrown, domestic investors, given the increasing number of investment opportunities and the resulting surge in liquidity. Mr. Tang believes that in the near term these issues will persist; accordingly, investors must be prepared to address each of them. He stressed that prior to entering the Chinese market, investors must think about what kinds of value they will bring to transactions, deals and investments beyond just investment capital.

Additionally, foreign investors will often still need to find domestic partners when entering the Chinese market to comply with the country's complex laws and regulations related to business opportunities and investments. Mr. Tang urged foreign investors in China to remain patient while accepting some of the current realities of the Chinese market, such as the continued prominence of growth capital and minority interests as investment vehicles. He stressed that these realities exist in the broader context of China's continually evolving market, in which long-term growth prospects for investors remain strong.

Mr. Tang believes that the changing realities within China today present investors with significant opportunities going forward. In sharing some of his own experiences investing in China, Mr. Tang illustrated how in practice the changing realities of the Chinese market manifest themselves in transactions and investments. Throughout his speech, Mr. Tang repeatedly stressed that with a thorough understanding of the Chinese market and with an appreciation of the changing investment paradigm, investors can continue to share in China's successes today and in the future.