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"Our View"

KPMG China, Transactions & Restructuring

The future prospects of MNCs doing business in China

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A recent uptick in media reports of MNCs becoming increasingly concerned about the growth prospects of their businesses in the Chinese domestic market has prompted speculation regarding the economic dynamics of the Middle Kingdom.

While some high-profile players have exited completely, we at KPMG China believe that such decisions have generally been driven by individual company strategies or underperformance rather than macro trends, and that a number of options exist which could give MNCs reason to be optimistic of success in China.

Overall, we believe that the Chinese economy continues to offer foreign investors growth, scale and manageable risks.

We increasingly hear from clients that in certain markets a level playing field between MNCs and local POEs/SOEs remains elusive. Complaints vary from difficulties winning tenders to the expectation that MNCs must fully comply with tax and social welfare regulations that might be less rigorously adhered to by some local competitors. Furthermore, businesses in China are generally struggling with rising labour costs and scarcity of talent.

We believe that MNCs who have been in China for many years and who have already heavily invested in the industrial segments most exposed to these problems have learned to adapt to the China market – and while their market share may fall over time their Chinese operations should continue to grow with the economy.

While the Chinese economy is exposed to certain risks (e.g. local government and corporate debt) GDP growth in excess of 6% per annum could continue for at least another 10 years.

New foreign entrants to the Chinese economy are likely to invest in areas where they can differentiate from the local competition: in consumer products and high technology; in the ever-expanding service industry buoyed by the growing middle class; in healthcare to leverage from demographic challenges and government policy; and in water and food as resources become scarcer.

In our view, options for MNCs struggling to expand both into lower tier cities and to compete with local players offering ever-improving quality products at lower prices include the following:

- Protecting the Chinese DNA and entrepreneurial spirit of acquired companies by limiting additional costs: For example, full integration may not be needed, Chinese management could be retained and it may be possible to adapt (to some extent) the corporate governance, internal control and business practice requirements of the MNC for the Chinese subsidiary.
- Expanding into lower tier cities via a JV with a large Chinese player with strong distribution networks but who would welcome the added know-how, technology and brands of a global company: The recent Third Plenum of the Central Committee has given encouragement to such mixed ownership structures with SOEs. Examples of this approach include Pfizer's JV with Zhejiang Hisun[1] and Renault's announced JV with Dongfeng Automotive[2].
- Acquiring large-scale game-changing listed Chinese companies: While historically our clients have struggled with the high premiums and difficulties of acquiring listed companies, buying and consolidating small private companies is becoming increasingly challenging due to the fragmented nature of markets and lower quality of available assets. Examples of this approach include L'Oréal's acquisition of Magic facial masks[3] and Whirlpool's acquisition of Hefei Sanyo[4].

1. Pfizer and Hisun announce launch of Hisun-Pfizer Pharmaceuticals, (Sep. 12, 2012), *Business Wire*
2. Renault-Dongfeng JV Approved by China Regulator, (Dec. 5, 2013), *Automotive News Europe*
3. L'Oréal Acquires Chinese Beauty Brand Magic Holdings, (Jan. 16, 2014), *Businessweek*
4. Whirlpool buys 51 percent stake in China appliance maker, (Aug. 13, 2013), *Reuters*

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