RESTRUCTURING IN CHINA: STILL DIFFICULT

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"An interesting article from one of our partner organisations - The Asia Transformation and Turn-around Association – 'ATTA'. An essential read for those looking for opportunities originating in China."
Graham Rusling

INTERESTING TIMES

It's easy to be convinced that China should be the Utopia of the turnaround sector. Overcapacity, inefficient capital allocation, imitation of enterprises leading to gluts of products – a prime recent example the curious issue of shared bicycles. On my morning walk, I can count up to 600 new bikes available for a rental population estimated at no more than 150 people. Multiply this across Beijing and you see huge market inefficiencies.

Yet, for turnaround executives Chinese culture defines constraints and limitations.

CHINA'S CULTURE QUANDARY

A turnaround in China is an admission of failure, a loss of face and status. The person who calls in a turnaround manager, especially a foreign turnaround manager, is a loser who probably has had their last promotion.

According to President Xi Jinping, in his book, "The Governance of China", economic development is the key to China's socialist development and national pride. Party officials are promoted on the basis of economic growth and public problems are avoided. It's easier to fold a struggling operation into a larger entity under close Party supervision than to highlight the problem with a foreign interloper.

If there is a little squabble, or an unfortunate peccadillo, then the preference is for fame, and association with McKinsey, Deloittes, E&Y, or PwC - known entities filled with the American and British educated returning sons and daughters of the elite, who understand the importance of Premier Xi's message.

CAN FOREIGNERS HELP?

Yes, but carefully. One possibility remains solving problems in foreign owned enterprises in China sensitive to home office financial reporting. These tend to be transparent with sufficient resources for potential success. And western countries have a number of compliance issues that heighten concern for smooth and ethical operations.

(A CAUTIONARY TALE)

But not always. Foreign owned enterprises have surprising operational leeway but are the most exposed to intervention. One turnaround was a wholly foreign owned enterprise whose ownership preferred 23-year-old recent female graduates of remote provincial colleges as general managers, under the mentorship of the foreign chairman. Each lasted about a year in position, with the chairman insisting that visitors to China be picked up at the airport by female staff, taken to their hotels, with attention to the visitor's comfort. A credulous foreign board hired me with concerns of high staff turnover and a strange lack of interest in profitability and growth in a relatively vibrant sector, while the chairman seemed to have ample supply of capital for other ventures. Well, who doesn't like a fee-paying gig? But this time I let the deal lapse. This was a ticking time bomb for a foreign manager. You may ask, isn't this a salacious fiction, a war story embellished for bragging rights at the convention bar? Could such a thing really happen today?

The story is to make an important point: in China anything is possible – the most unusual circumstances - until one day it's no longer tolerated, for any number of ambiguous reasons. There is law in China. It can function obscurely and carefully, but when hubris meets its nemesis the retribution is swift and severe. Though once it might have been true, today being a foreign turnaround consultant in a wholly foreign owned enterprise is no protection.

ARE JOINT VENTURES EASIER TO TURNAROUND?

A mixed foreign/Chinese joint venture might be a better bet. These tend to be larger industrial or infrastructure sectors often only partly open to foreign investment – up to 49%. Of course, in China you can own 99% and still not control your company or own anything. Rule of law is superseded by rule of man. Everyone should understand that ownership percentage in a joint venture has little relevance to influence.

As a consequence, many Chinese and foreign executives feel that there are two options. Either be large enough to afford political support, or stay smaller and focused on a narrow sector of a large market. In the second option, turnarounds in joint ventures often are resolved by working with local authorities to fix management problems or improve operations. Joint ventures are among the easier turnarounds to accomplish, since everyone concerned has an incentive to ameliorate the problems before they become political liabilities.

CHINA'S GEO-POLITICAL OPPORTUNITIES

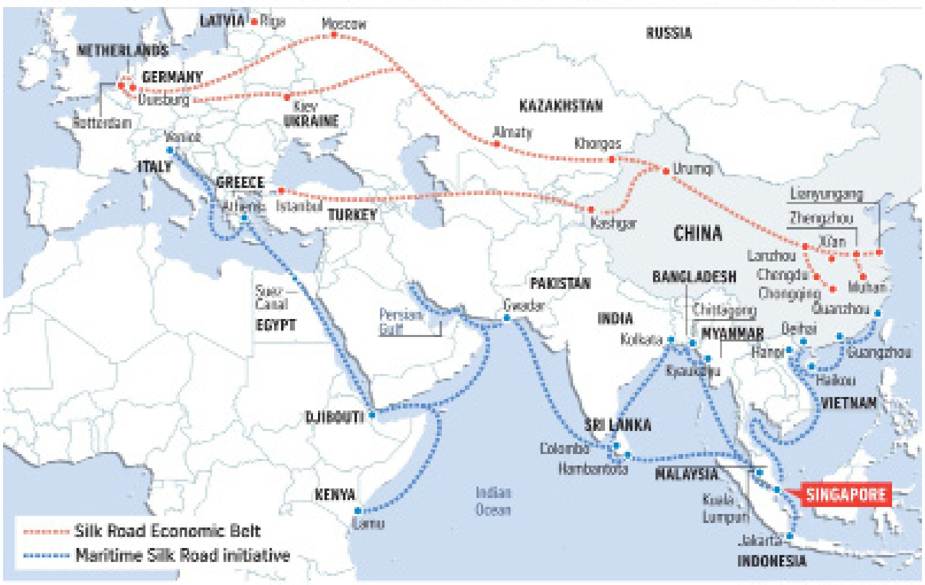
Russell Brown, of Lehman Brown International Accountants, an IFT and ATTA member, believes a third possibility it to offer services to Chinese multinationals outside of China. A quick look at a map will make obvious China's geopolitical strategy. The country is hemmed in along the west pacific littorals, which explains it interests in the South China Sea, and more recently the promulgation of a specific western geographic marketing expansion into Eurasia and Europe, called in English One Belt One Road "OBOR". The Belt is a set of alternative ports across the Indian Ocean to the Mediterranean, and the more familiar Silk Roads, two planned routes, to the south and north of the Caspian Sea and eventually into Europe.

Much of this investment will be through Chinese state owned enterprises and major banks. But foreign operating partners will be needed, and cooperative ventures will be a requirement of the host nations. There is limited management expertise in Central Asia and along war torn Middle Eastern routes. Outside management and turnaround consulting will be needed. These assignments will require a tolerance for limited 4-star accommodations, but Chinese companies provide security for their employees and partners, and Chinese managers are interested in completing projects without heroics. The turnaround marketing approaches to these opportunities should become clearer as the infrastructure projects get underway and run into problems, which they will, as anyone with experience in the Eurasian and Russian heartlands will testify. Keeping any eye on OBOR related web sites and reports will provide opportunities for contacts.

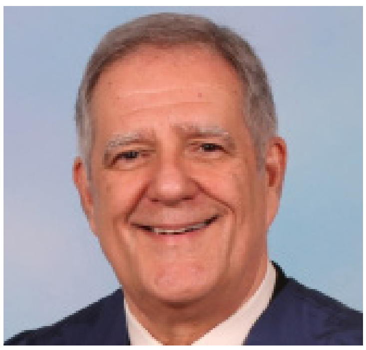
OVERPAYING, OVER BORROWED AND OVER HERE!

A final opportunity is the fallout from large scale purchases abroad by some of China's wealthiest conglomerates, with several recent acquisitions in the UK and Europe. Many of these are highly leveraged with wavering political support, and possibly subject to government review concerning issues of foreign exchange and capital flight. Several of these acquirers are being challenged for using loans from China's banks for overseas acquisitions, some closing quickly without deep due diligence, raising concerns about the efficacy of the potential returns. A withdrawal of banking support could lead to chaos in the operating units. Larger turnaround firms will be first in line to find opportunities, but Chinese investors and government operatives may prefer a quieter approach from people with experience in China sensitive to public relations.

China's One Belt, One Road



STRAITS TIMES GRAPHICS



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