Can China be a force for stability in all this economic turmoil?

Jason Inch

FOLLOWING the announcements of Lehman Brothers Chapter 11 filing and the buy-out of Merrill Lynch, China's stock markets dropped in tandem with world markets.

Tuesday's drop of 4.47 percent on the Shanghai composite index was yet another blood-bath in the markets, but at a time like this it is worth remembering that China's underlying economic fundamentals remain strong.

What causes the apparent contradiction of one of the world's best-performing economies having one of the worst-performing stock markets?

The theory of decoupling — the idea that China and other developing countries are mature enough to continue to develop on their own during an economic decline in the United States and elsewhere — is increasingly discredited.

We are living in an interconnected world and nobody, not even the world's fastest-growing major economy, can resist the forces that are sweeping our world. As John Donne famously said, no man is an island.

This financial crisis calls to all economies to act. China, with its strong economic performance in August and year-to-date, may appear to be an island of calm and prosperity, but it may later be found to have been in the eye of the storm.

According to recent data from economists at China's National Bureau of Statistics, virtually everything seems to be going well.

Starting with the drivers of the economy, consumption continued to show signs of strength, with retail sales maintaining a 23.2 percent pace of growth in August, only slightly lower than July's 23.3 percent.

The level of retail sales growth is far above the most recent inflation levels, meaning retail sales increase is not just about higher prices, there is real growth there.

In fact, CPI — the consumer price index, or basic inflation — decreased to 4.9 percent in August, continuing the downward trend, but it is still somewhat high, meaning China is not out of the inflationary woods yet.

Actually, many were regarding the fight against inflation to be one of China's core economic policies of 2008. In a surprise move, however, on Tuesday the People's Bank of China cut interest rates by about a quarter percent, down from 7.47 percent to 7.2 percent and, in perhaps the most surprising move of all, cut the reserve ratio by a full 1 percent after having just increased it by 1 percent in June.

There is something of a mixed message in this latest action. The message, that the economy is ready for a rate cut and wants to increase money supply, could be evidence that the PBOC overshot the mark and caused money supply to shrink too quickly, contributing to some of the summer's abysmal stock and real estate performance.

Growth in M2, the money supply, decreased to 16 percent in August, down from 17.4 percent in June.

It is important to point out that we are still talking about an increase of 16 percent, just that the rate of speed it was growing simply slowed down a little.

Time will tell

Is the PBOC acting wisely? Time will tell if they are cutting too soon, a knee-jerk reaction to the latest sub-prime casualties, trying to prop up the falling stock and property markets, or if they are presciently avoiding a much harder crash in the wake of Fannie/Freddie/Lehman fallout and other factors yet to come.

While some of this data could be construed as negative, China had a lot of other positive economic results in August.

For example, the trade surplus is up by 25.7 percent year-to-date, compared with January-August 2007 figures. Exports are down slightly, but still strong, FDI continues to be healthy.

So the question originally posed, why is there a contradiction — China's strong economy on the one hand, and its weak stock and property markets on the other?

Is this a sign that global markets cannot decouple and are doomed to falter together, or is it a sign that somebody needs to act more decisively?

Just as China became a stabilizing force in the Asian Financial Crisis of 1997, is there a way it could use its economic and financial strength to do so again?

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Don't choke on Coke and Huiyuan juice deal

John Gong

Illustration by Zhou Tao/Shanghai Daily

ON September 3, the stock of Huiyuan, a Hong-Kong-listed company specializing in juice production, more than doubled on the news Coca-Cola Co sought a US$2.4 billion acquisition for all of Huiyuan's outstanding shares.

The offer was three times Huiyuan stock's average trading price before the announcement. The Ministry of Commerce is studying the proposed takeover.

While Huiyuan's happy shareholders cannot wait, laughing all the way to the bank, concerns were raised among Huiyuan's competitors in the juice market. Some in the public, fueled by nationalistic sentiment, raised objections over the prospect of losing one more famous indigenous brand to a foreign company.

Coca-Cola said it has already obtained approval from three of Huiyuan's largest shareholders, Zhu Xinli, Huiyuan's founder and chairman of the board, Danone, a large French conglomerate in the food processing business, and a Hong-Kong based mutual fund company — they jointly account for over 60 percent of Huiyuan's outstanding shares.

The Ministry of Commerce said immediately after the Coca-Cola announcement that it would conduct a fair anti-monopoly review once it receives Coca Cola's merger application.

Both the Guidelines on Anti-monopoly Filings for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors passed in 2006, and the Anti-monopoly Law implemented this August stipulate the conditions triggering an anti-monopoly review. Coca-Cola is preparing paperwork for the filing.

Let us first clarify a few points before assessing the prospect of this acquisition and providing some public policy recommendations.

First, it should be noted that the conditions set forth in the two statues just mentioned are not the conditions under which a proposed acquisition by a foreign company may be approved or rejected. These state the conditions under which an application for anti-monopoly review and final approval is required.

For example, Article 51 of the Guideline says one of conditions for filing for review is that the domestic acquisition target has a market share of over 20 percent, and the combined market share of the joint company after the acquisition is over 25 percent.

Now these 20 percent and 25 percent numbers are not the magic market share thresholds to deter an acquisition or merger. These are merely numbers that are large enough to warrant an anti-monopoly review.

Second, the exact market share numbers of parties here seem to be in the eyes of beholder. So far I have seen three sets of numbers reported in the press.

The first set of numbers is from Euromonitor International, a Europe-based market research company. It reports that in the China juice market, Huiyuan holds 10.3 percent market share and Coca-Cola's Minute Maid unit holds a 9.7 percent share.

Looking at the whole soft drink market, Coca-Cola and Huiyuan's market share would be 12.4 percent and 4.4 percent respectively.

However, according to Beijing Orient Agribusiness Consultant, Ltd (BOABC), specializing in agri-business consulting to the food business, the three leading juice producers are Uni-President (Tongyi in Mandarin Chinese) with 18.69 percent market share, Coca-Cola's Minute Maid with 15.04 percent and Huiyuan with 13.95 percent.

> "High market share doesn't always translate into excessive market power."

Based on these market share numbers, the combined operation of the two companies in the juice market would be 29 percent, overtaking the number one spot by Uni-President.

Coca-Cola hired Methodology Canadean Ltd, a British investigation company for the drinks market, to produce a report showing the combined market share after acquisition would be lower than 20 percent. Finally, Huiyuan announced earlier in its own financial report that its share in the no-concentrate juice market is 42.6 percent.

The central issue

The statistics discrepancies may be attributed to product definition and marketing research methodology differences, or a combination of both. But the central issue in this controversy seems to be lost in the pursuit of the right or desired market share numbers.

The anti-monopoly concern stems from the combined company's potential market power to raise prices and seek extraordinary profits, as opposed to the market share statistics per se on paper.

High market share doesn't always translate into excessive market power. For example, in the cellular handset industry in China, Nokia occupies over 40 percent of the market, yet the industry remains highly competitive.

Therefore, the investigation during the Coca-Cola/Huiyuan review process, in my humble opinion, should be centered on the question of whether the combined company would have any market power to raise prices. And to discover that, one needs to go one level further to see each company's product portfolio.

Huiyuan's major product is 100 percent juice with no concentrate.

Although Huiyuan's overall market share in the juice market is between 10 percent and 14 percent, depending on which statistics one considers, its share in the 100 percent juice market is over 42 percent. This suggests that Huiyuan's market position in the concentrate juice market is weak.

Coca-Cola's Minute Maid on the other hand has its product line in China in the concentrate juice market. The proposed acquisition seems to suggest a combined operation more complementary in the nature of product lines, as opposed to a simple market share expansion.

The other public concern — the prospect of losing a Chinese indigenous brand to a foreign company — is groundless. In the United States, Coca-Cola has a track record of retaining the brands after successfully acquiring non-carbonated drink companies, including Minute Maid and Dasani.

In the 1980s, there were similar public concerns in the United States over Japanese money buying America, epitomized by the sale of the Empire State Building, the symbol of American capitalism, to a group of Japanese investors. But looking back, the idea of the American economy losing to the Japanese is found to be groundless.

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