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PERSPECTIVES

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THE DRAGON'S BEST FRIEND

Unleashing The Potential For Growth



Fifteen years on from the Asian crisis, the contrast between the fortunes of East and West is stark. Europe's economies continue to be plagued by high unemployment, with youth unemployment in some regions now exceeding 50%.

Meanwhile, previously stable countries have been forced to face the possibility of economic collapse, as the effects of the global financial crisis continue to be felt five years after its beginnings. The result: the lowest growth experienced in many years and continued uncertainty.

In contrast, the Asian region continues to grow powerfully.

China's economy has expanded by more than 300% over the last decade. Even Australia's economy has grown by some 30% over that time, reflecting the benefits of exposure to both China and India, and both economies have moved up the world rankings. Looking forward, Australia has the potential for sustained growth if it can continue to harness the opportunities that China offers. A key to unlocking the potential will be for both countries to understand clearly each other's cultures and each other's needs to figure out where the most attractive areas of mutual opportunity lie.



China is already the world's second largest economy and its growth will continue for decades to come, driven by ongoing industrialisation and urbanisation, and the steady increase in living standards demanded by the Chinese population. There will of course be challenges to this growth, given the various resource constraints that exist – although in many cases China already has well-established programmes in place to meet them. As just one example, it is interesting to note just how much China is investing in renewable energy, not simply to improve environmental outcomes, but also to reduce its energy costs over the medium to long term. In 2012, 96% of net new power generation capacity that came on stream was renewable.

Meanwhile, we have only just begun to see the impact of middle class Chinese demand for consumer goods, innovative technologies and luxury brands. Apple's success in tapping this demand over a very short space of time illustrates the potential of this segment. By early 2013, its revenues in Greater China (China, Hong Kong and Taiwan) reached \$6.83 billion, 67% up on the previous year. Impressive growth given that it only started selling iPhones in the Chinese market in November 2009. This demonstrates very clearly the opportunity for Australian businesses with goods or

services which can readily be exported. With a country of 23 million people, it is not surprising that it is easy to lose sight of China's demographics which means that a very small market share can translate into very substantial value. China's richest million people are now each worth over \$1.6 million and have significant disposable income. Reports suggest 63% of this group

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own iPads, an average of three cars, and take three international trips a year. And of increasing significance, is the much larger middle class beyond this million, whose already significant spending power continues to increase.

Australia is also a very important trading partner to China. As an example, Australia is currently by far the largest supplier of iron ore to China. In 2012, Australia delivered

some 352 million tonnes, or 47% of China's total imports of 743.6 million tonnes, well ahead of Brazil, South Africa and India, underlining the significance of Australia to China's ongoing development. The announcement last week that Australia and China would hold bilateral leadership meetings annually is particularly significant. Very few other countries have achieved this level of engagement, highlighting Australia's opportunity to continue to build a mutually beneficial relationship.

Twenty of Australia's leading companies and institutions accompanied Australia's Federal Government on its recent trade visit to China. Unsurprisingly, the composition of the delegation included leading companies representing a series of industries that are critical to Australia's long term growth. As we have highlighted before, financial services (and particularly the effects of China's aging population), education, agriculture, tourism and innovation all offer great opportunities for Australia. And these are not just domestic opportunities – there is growing interest from investors from China in particular to buy into these sectors in Australia, and there is potential for significant new export markets in a number of related areas.

Reflecting on the discussions in China last week amongst the business delegation, we see five key areas where many Australian

businesses can reach out and build connections with their Chinese counterparts or potential customers, and build trade and investment flows to mutual advantage.

- **Agriculture and primary production** remains essential to feed China's growing and increasingly wealthy population. Australia's position in the Southern Hemisphere growing season provides an important balance to domestic Chinese production and Australia's expertise in developing new crop varieties with higher water efficiency and resistance to disease is already highly attractive to Chinese agricultural businesses. Even more importantly, there is rapidly accelerating demand for premium produce. Australia represents a particularly attractive source of food for more affluent Chinese consumers, due to the strictly controlled environment in which our food is produced, and the highly reliable and tightly regulated supply chain through which our agricultural produce is processed. We also offer exceptional assurance regarding factors that impact the perceived quality of our food – as an example, all agricultural production (other than cotton and canola) is GM-free across the entire nation (7.7 million square kilometres in all)

- **Education**, whether at a secondary or tertiary level, is often the first connection with Australia. It is already one of Australia's largest exports, which reached \$14.8bn in 2011/12. This reflects the country's position as one of the top three destinations for international fee-paying students globally (after the US and UK). China is the top country in terms of student visa applications (around 50,000 in 2010/11), well ahead of other leading countries (India, South Korea, Brazil and Malaysia), and Chinese student enrolments were dominated by higher education courses, which generate more value than vocational education and training. So the education of Chinese students is one of

the single biggest export opportunities for Australia. And the longer term implications are profound. Individuals who study here – whether at school, in vocational courses or at university – are much more likely to continue to return on holiday, build trade relationships and invest in businesses in Australia, contributing both to our economic growth and the development of closer personal and business relationships between the countries

- **Technology and innovation** is well-recognised in China as critical to near and medium term economic development. Chinese society is enjoying the benefits of rapidly increasing access to technology and the desire for access to high technology and the benefits that it can bring permeates society. This is seen from the aspirations of the rapidly growing middle class and its demand for luxury technological products as well as from the industrial sector, which is transitioning from being a low cost producer of basic goods for the rest of the world to a low cost producer of technological products. The linkages between China and Australia have a very real role to play in helping China fulfil its technological aspirations, with Australia able to provide world-class input in a number of areas. A prime example of this relates to the manufacture of solar cells. The founder of Suntech, the world's largest solar cell manufacturer, was a graduate of the University of NSW's School of Photovoltaic and Renewable Energy Engineering. With the knowledge obtained in Australia, he founded Suntech and established its place as the dominant producer of solar cells worldwide. This is true notwithstanding its recent financial challenges, which relates to a substantial fall in global demand for solar cells. As a result, both Chinese companies and Chinese investors are focussing on the opportunities that Australia's "Silicon Harbour" presents, both in terms of the financial returns available as well as the

ability to leverage the technologies in their home market and more broadly around the world

- **Tourism** is critical to Australia's future. The country already generates above average receipts from this sector, ranking eighth globally in terms of share of international tourism revenues, and over the last decade the sector has been growing at around 4% a year in real terms, well ahead of the economy as a whole. Already the second greatest source of inbound visitor *numbers* (measured by visitor nights), tourists from China together generate more economic *value* than those from any other country. Indeed, at an individual level, economic value generated per person is higher than that generated by any other country in the top ten (such as USA, UK, Japan and Germany). And inbound tourism from China is the most rapidly growing amongst the top ten nations as well. In short, inbound visits from China are the single biggest opportunity for Australia's tourism industry over the next decade and beyond

- **The financial services sector** in China continues to grow rapidly and there is a strong focus on the effects of China's aging population on the demand for healthcare and aged care services, as well as for services related to investment and superannuation. The country is home to some of the world's largest banks, general insurers and life companies, and these companies will continue to grow rapidly as the economy continues to develop and domestic savings and investment rates increase. Meanwhile the rapidly aging population will also drive an accelerating need for a wide variety of health and retirement-related services. As a country, China benefits from exceptional financial strength, and the basic requirements of Chinese companies and individuals are generally well served by domestic institutions. There are many more specialist areas where the Chinese market



is at an early stage of development – investment management, superannuation and aged care are obvious examples – and we believe that these offer significant opportunity for Australian institutions to leverage their experience and expertise over the near to medium term.

The recent visit to China highlighted that, just as many companies around the world are seeking new sources of growth to drive increasing profitability over the medium to long term, there are many businesses in China that have created significant value over the last decade which they wish to protect. One way to do this is by diversifying risks, and in this context Australia's lower growth, but stable commercial environment represents a desirable destination for investment by Chinese businesses and individuals. Importantly, the high levels of transparency in regulatory decision-making in Australia are also attractive from a Chinese perspective. We have already seen a dramatic increase in inbound Chinese investment to Australia over the last five years, and this provides an attractive source of capital for many businesses. More broadly, these new investors and

shareholders can provide rapid connections to the very large market opportunities which China offers, highlighting the important opportunity for both acquirer and company to benefit significantly from such investment.

Although these opportunities are easy to describe, we are conscious that many organisations around the world have invested into China for decades, generating at best only modest returns. Over this period, China's business environment has evolved dramatically, so it's important to note that some of the lessons from ten or twenty years ago are simply no longer relevant in China today. As an example, a number of leading Chinese organisations are much more openly accessible, and have a much better understanding of the give and take of Western business relationships than even a decade ago. Meanwhile there is a significantly greater community of Western managers and professional advisors who have lived and worked in China and have a real understanding of how to build the relationships and *guanxi* required to operate effectively.

So what is the secret to unlocking value from Chinese trade? Ultimately, we believe that the most fundamental challenge is

to build better mutual understanding and better connectivity between both cities and people, and breaking down the barriers that come from unfamiliarity. One simple challenge is that Australia still has very few direct flights to cities such as Beijing, although this is changing rapidly as Chinese airlines are investing heavily in new capacity and expanding their networks, promoting business travel to China and leisure travel via air hubs in Beijing and Shanghai.

As a result, we believe that the opportunities we have identified above can be realised relatively rapidly, and with only modest capital investment. This may run contrary to the experience of the last 150 years, and is a direct result of the rapid transformation of the Chinese economy since the country entered the World Trade Organization on 11th December 2001. It is so easy for us to fall into the trap of selling people what we want to sell them, rather than understanding what they want to buy and tailoring our offering accordingly. Echoing the principles of The Year of the Snake, organisations can achieve substantial and profitable progress with a well thought through plan and clever, careful execution.

By Cassandra Kelly and Nigel Lake

About Pottinger

Our clients say that we offer a completely different proposition to traditional consulting and investment banking advisors, seamlessly integrating true strategic thinking, commercial insight, financial expertise and execution excellence. Our assignments typically relate to one or more of:

- Strategy and public policy
- Mergers and acquisitions
- Partnerships and joint ventures
- Restructuring and capital advice
- Risk, sustainability and related decision-making

Our approach to every assignment reflects a fundamental belief that strategy, business and execution perspectives must underpin any business initiative if it is to be commercially successful and stand the test of time.

Together our team has advised on over 200 M&A and financing transactions, as well as many significant strategic advisory assignments. Our first hand experience covers most of the world's larger economies, and we are accustomed to working on complex assignments across borders and cultures.

We are highly regarded for our investment in people, most recently being profiled by the Australian Workforce and Productivity Agency as a role model for effective skills development in financial services. In addition, Pottinger is the only organisation ever to have won the ABA's "Recommended Employer" award for six years in a row.



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Australia is the only major developed nation globally to have increased its world ranking in terms of overall GDP since 2000. Over the last twelve months, the country reached an all time high of twelfth, having overtaken Spain, Mexico and Korea in the last couple of years. By market value, NSW alone is home to two of the world's top 20 banks, two of the top ten general insurers, one of the top five retailers and one of the top five stock exchanges. Meanwhile, Sydney is home to the world's most patented innovator (responsible for over 10,000 patents), and Australia is responsible for amazing innovation in technology (contributing to the development of wifi), one of the world's most successful business to business internet companies (Atlassian), revolutions in health care (the cure for the stomach ulcer and the cervical cancer vaccine), smash hit smart phone apps (Flight Control), and world-leading advances in agri-science in areas such as crop productivity and resilience.

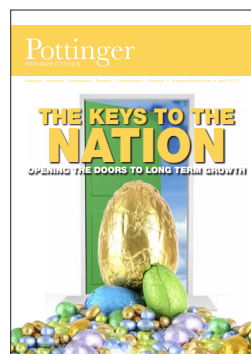
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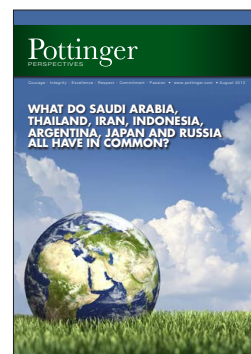
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