The Road to China: Fresh Insights into the World's Fastest-growing Economy

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Earlier this year, Harbir Singh, Wharton's vice-dean for Global Initiatives, launched a series of trips to foreign countries as a way for faculty to gain a deeper understanding of international economies and then use this knowledge in their teaching and research. Six professors recently visited the Chinese cities of Beijing, Shanghai and Shenzhen, and met with executives from Lenovo, Haier and Huawei, among other companies. Knowledge@Wharton asked three of the participants – Singh, management professor Saikat Chaudhuri and health care management professor Lawton R. Burns – to share insights from their trip. Below is an edited transcript of the conversation.

Knowledge@Wharton: Harbir, Saikat and Rob, thanks for joining us. Saikat, you mentioned in an earlier conversation that executives you me with are interested in the globalization of Chinese companies, partly through acquisitions, partly through increased outsourcing. Can you talk a little more about this?

Saikat Chaudhuri: Certainly. Chinese companies are, of course, aspiring to become global players. And we actually see a variety of approaches that they're taking. Haier for example, has taken more of an organic route, even though it did unsuccessfully attempt to buy Maytag. Huawei has also taken an organic route. They had attempted to buy US Robotics or take a stake [in that company], and that was unsuccessful. However, Lenovo is probably the prime example -- having bought IBM's PC business -- where [a company] did successfully use the acquisition strategy. And the main reason is that, beyond quick access to markets like the United States and Europe and so forth, they need high-end technologies and also established brands. Those are the elements that the Chinese firms have been missing. And so it fits very well to combine the strong and cost-efficient back end of Chinese firms with the branding, market access and technology that Western developed firms can offer them.

Knowledge@Wharton: Harbir, you and others have noted the role of the Chinese government in creating infrastructure for their economy and its benefit to businesses at large. Can you talk a little bit more about that?

Harbir Singh: I remember in 1997, I was standing on the Bund [in Shanghai] -- which was an area where all the various international communities used to be, pre-Communism -- and looking across the river at a lot of construction on the other side. People were saying there will be some office towers and businesses here. I was envisioning, maybe, something the size of downtown Philadelphia. When I came back ... [and went] to the Grand Hyatt in Pudong, this was a whole new city with large, modern skyscrapers. I was completely amazed at the huge contrast. I've been to China many times, but that's just one illustration.

If you look at Shanghai airport, look at Beijing airport, these are truly world class airports. You have the Maglev train coming into the city. The most populous nation in the world appears to be functioning at a very high gear in these big cities. What that does is create an opportunity for businessmen and executives to develop their products and services in a world class setting. I think that's the main benefit of infrastructure in terms of electricity, Internet communication and so on. I think that's been remarkably impressive in China over the years.

Knowledge@Wharton: How does this compare to the situation in India?

Singh: India is a dramatic contrast. I think if you look at India, we have had much less physical infrastructure development in the same period of time. In fact, many projects are underway, but they are moving very slowly. This is something that people in India will also say -- so this is, I think, an objective reality. What India has going for it is the development of soft infrastructure -- the human capital, the use of the English language which allows service professionals to work with companies around the world. So you have this remarkable contrast. What's interesting is it doesn't have to be that one of these major developing nations chooses the hard infrastructure and one chooses soft infrastructure. But for now, that's what the path has been.

Knowledge@Wharton: Rob, you were able to see first hand the efforts that China is making in the area of health care reform. What exactly are they doing, and are they running into the same obstacles that the U.S. is? That is, finding that you can't do everything at once and also insure high quality at low cost?

Lawton "Rob" Burns: Yes. First, just to follow up on Harbir's comments, China is also investing a lot in its health care infrastructure. In particular, they're rebuilding their hospital industry, which is primarily publicly owned facilities. They're also rebuilding their primary care system. Basically they didn't have much of a primary care system. They relied on lower level hospitals to provide primary care, and now they're trying to build these community health centers. So there's a massive investment in primary, secondary and tertiary care taking place in China.

What China is discovering is that it has its own version of the "iron triangle" of health care. It's the issue our country has dealt with for the last 70 to 80 years -- trying to balance three conflicting goals of improving quality, improving access and controlling the rate of increase and cost. They're now discovering the exact same thing. Their health care reform initiatives are designed to provide broader access to health insurance for the population. Yet at the same time, while they provide broader access to improve the level and quality of care, that expands the cost of care. They are trying to figure out ways to control the cost as they increase access to health insurance.

Knowledge@Wharton: Does their government structure make it easier to get these things done than, say, in the U.S.?

Burns: Their government structure is very similar to ours. It's an incredibly fragmented government bureaucracy with different ministries overseeing different parts of the health care system, with different insurance plans for different segments of the population. And like us, they're going to try to craft a universal system by basically cobbling together all these different components.

Knowledge@Wharton: By being provided with access to companies and high level executives, Saikat -- you mentioned Haier, Lenovo and Huawei -- you were able to get insights into things like concerns over social unrest, the pollution problem and efforts to build a knowledge-based economy. What's the current thinking about how to deal with these issues?

Chaudhuri: Any developing country, and for that matter any developed country, will have challenges because there are inherent trade-offs that must be balanced. That is a very natural outcome of managing conflicting demands as you grow. On the point about building a knowledge-based economy, I think that's what struck me the most: It's very interesting because here the contrast with India also becomes apparent. China has strong infrastructure and has been able to build a very strong manufacturing-based economy, whereas India has veered towards the knowledge-based economy. Now, of course, both countries are trying to do the other [approach]. In China's case, they're investing a lot of money in trying to set up firms and the appropriate ecosystem to foster innovation. That means venture capital, entrepreneurship and processes which will help to further innovation, because that's something I think China sometimes suffers from, as far as its image is concerned.

It's not easy, because building infrastructure is a matter of capital. Building an innovative ecosystem requires several elements to come together [as well as] the exchange of ideas among the right individuals.

But I'm confident that given the way China has managed its economic growth so far, this will be a step that they will successfully manage.

Knowledge@Wharton: What about the pollution problem? I'm wondering, Rob, if you could talk about that since it is a health care issue at the same time.

Burns: Yes, it's a huge public health issue for the Chinese. They have a number of public health challenges. One is pollution, both in the air and in the water. Then you have public health habits. There's an enormously high smoking rate in China, with very few smoking cessation programs taking place.... What compounds the problem for China is that the public health dollars are disproportionately spent in the urban areas, whereas most of the population lives in the rural areas. So they have a problem with trying to allocate resources to where the problems are.

Singh: One thing I noticed; we were in a very high hotel, I think in Beijing, on the top floor looking out. And we were told that it was one of the clearer days. But I thought it was actually very hard to see any structures around. This is true, as Saikat was saying, for the developing world. It's the classic problem of how do you grow rapidly and keep these greenhouse gases under control? It seems China is working very hard on it because its own population is putting pressure on the government. But at the same time, clearly there is a lot of work to be done there.

Knowledge@Wharton: Did the issue of social unrest come up in anything that you did or saw over there?

Singh: We had the party secretary of Beijing whom we met allude to that. But it was more in the spirit of one of the factors that he saw in the remote areas. So that was one place where it was specifically raised.

Burns: I think he also mentioned just how important it was to try to contain any social unrest and the importance of stability in keeping this economic engine going forward.

Chaudhuri: In one sense, you could just say it's about managing diversity. China's a big country with a huge population and they have many different types of people with varied interests. It's about meeting the aspirations of those people and managing the differences, as much as it is promoting some uniformity in a standard of living.

Knowledge@Wharton: During your trip, you all indicated that Chinese officials made it very clear the U.S. is to blame for the financial crisis. They talked about providing a different model. What is that model and how successful do you think it can be?

Chaudhuri: I suppose that one way to look at the alternative model is perhaps not as unbridled capitalism, but with selective intervention and some controls. This is, of course, the debate that's been going on around the world in countries which thought that they had perfected the model, such as the United States, but also the European countries. So it's a wider debate. I would see it as not yet being established what is working, because we have some confounding factors here. So you could attribute the success in managing the crisis to a particular system in the emerging markets. But you could also attribute it to the inherently higher growth rates that they have been experiencing due to the rise that they've had over the last several years and the tremendous domestic demand and other factors driving it. I do think it's good food for thought and should fuel the debate so that we can come up with appropriate structures globally to avoid such crises in the future. It's not yet evident to me what exactly the model might be, though, and perhaps where the balance may lie.

Singh: Also, one of the things referred do was the impact of derivatives on the U.S. economy and the decline of many of the financial valuations and portfolios of banks and other institutions. I think because [other economies] have less exposure to derivatives and other exotic instruments, there was a sense that [not having them] ... was helpful. I hear similar comments in India where people say that the central reserve bank actually had put certain limits on derivatives, so many of these mortgage-backed securities and all those exotic instruments were not allowed to be traded in India. Now does that mean that there's a better policy? Well, that's a whole different question. But maybe it speaks to some degree of conservatism which, in this case, was helpful.

Knowledge@Wharton: President Obama recently returned from a visit to China where he encountered efforts to restrict public access to him, and also came in for some blunt criticism over the weak U.S. dollar and low interest rates. In addition, the Chinese accused the U.S. of protectionist trade policies because of their actions against some Chinese products like steel pipes and coated paper. Do you have a response to this lecture that Obama got? And do you think it signals a worsening of relations between the two countries?

Singh: There's a high degree of dependence between both economies. That's absolutely clear. One of the questions that is divisive among many is the yuan and where it is pegged in the international markets. Given that China is the manufacturing hub of the world, one of the interesting questions is, if you revalue the yuan, what happens to the costs of those products in the economies where they're being exported? This is one of the more complex issues underlying the debate, and it's not clear what the right answer is. But the dependence is so great that this is going to be an ongoing debate.

So on one hand, perhaps, [there are] exhortations to revalue the Yuan; on the other hand, [there are] arguments that we are protecting our products. They're both interlinked.

Burns: You know, just to add to it in the health care arena, the interesting development there is that the Chinese are undertaking health care reform at the same time we're undertaking health care reform. I don't think it's any longer the case that we have lessons to offer other countries. Other countries are now saying, 'We have lessons to offer you.'

Knowledge@Wharton: Okay, good point. Saikat, you noted that a whole generation of Chinese has seen progress now for about the last 30 years, and that a lot of overseas Chinese are, in fact, going back to China, not just senior people, but junior people, too. Do you think that will continue? And what are they going back to?

Chaudhuri: We talk about the so-called reverse brain drain -- nowadays it's known as brain gain -- both in the context of China and in India. I think in China's case it started earlier and the scale is also a bit higher. As you noted, what was particularly impressive is that it's not only the senior people who go into senior roles, especially at multinational corporations based in China who are now taking this opportunity, but it's also the junior people. We see this increasingly here at Wharton as well. That signals to me very, very clearly that the opportunities are there to actually build a career. Earlier I was talking about building the right ecosystem for a knowledge-based economy. The infrastructure, the people, are of course a critical element. So beyond building the hard infrastructure, to get the right mentality, mindset, it's very, very critical for China to get back some of that talent which has gained experience abroad. Undoubtedly, they've become very, very attractive as a destination. So I think it's a very, very important driver.

If I may also note, the entrepreneurs that we spoke to were, to a large extent, also of that type. They can, of course, appropriately take business models from both sides, blend them and find what is unique, both for domestic purposes but also to build new global players. So what's happening on that front is a very, very important driver of China's future aspirations to become an entrepreneurship and knowledge-based economy.

Singh: One thing that I noted with respect to people going back to China and to India is that the rates seem to be increasing every year; this suggests the perception of opportunity that our recent graduates see in those economies. That's the first point, that opportunity is rising in some kind of very visceral way, because people are voting with their feet. But the second is that we met seasoned entrepreneurs who had moved 10 years ago, 15 years ago, and they saw confirmation of their projections early on. I think the idea of the ecosystem is very interesting, because they were in, some sense, the creators of the ecosystem which now these young recent graduates are getting into. Related to that, we had the Wharton Alumni Forum not too long ago in China. There were over 700 alumni, many of whom were coming from other countries.

Knowledge@Wharton: What were some of the more impressive business practices or products that you saw in the firms you visited?

Burns: I don't know about the most impressive practices. I think the most impressive thing I'm seeing is the huge set of demand drivers that are going to accelerate the Chinese health care economy. The projections are stunning that within maybe 30 years China will be the largest pharmaceutical market in the world, eclipsing the United States. That's stunning to everybody who studied the pharmaceutical industry. And the same thing may happen with medical devices, too.

Singh: What I found fascinating about China were two things. One was scale and the rapid rate of growth. There's no question that it may not be a linear path, but it's going to be a major large market in almost every industry. But the other part that I found interesting is when we went to Lenovo and the head of product development for Lenovo was talking about the role of the company's North Carolina facility, the role of its Japan facility and the Beijing facility, and how they all work together, around the clock as it were, but with a lot of face to face interaction. So they're trying to grapple with the issue of how to work across borders.

I was sitting in the conference room saying, "This conference room could easily be in Silicon Valley or in Raleigh, North Carolina. But it happens to be in Beijing." And he was saying the same thing. He often doesn't know which part of the world he is in. So Lenovo has, on the product development side, created a global organization.

Chaudhuri: To build on that a bit further, I think new forms of organization are being experimented with and being designed and promoted by these firms. Harbir mentioned Lenovo. They have interaction to allow for 24 hour development cycles, yet at the same time [allow] expertise in certain pockets to be developed and to be globally applied. I think that applies to the emerging markets.

I can't help but be reminded of when the Korean and Japanese economies really took off and those firms rose to prominence. They also brought interesting new management practices, such as in the area of supply chain management. I believe that firms like Lenovo or Haier or Huawei will contribute at that level as well, [along with] Brazilian and Indian and other emerging market firms.

Knowledge@Wharton: Great. Thank you for joining us.