

# EnpRisk - Lecture Notes Week 11

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## 1 Risks and Opportunities: How to work with China

### 1.1 The Post-COVID World

Let us begin with a short comparison between the US and China after COVID-19:

**The US:**

- New budget and monetary experiment to stimulate final demand
- Launch massive investment programs at a time when there is little industrial spare capacity
- Encourage a property and construction boom, even as the sector suffers shortages of workers and raw materials

**China:**

- Curb government spending and are constraining money supply growth
- Rein in government spending
- Slow construction activity

This has led to an accelerating breakdown of the world into two key zones:

- The empire of the sea, or the "Western bloc" - dominated by the US
- The empire of the land, or the "Eastern bloc" - dominated by the duopoly of China and Russia

This leads to the following implications:

- Energy is one of the key factors for many decisions including geopolitics, monetary policy, trading zones, etc.
- Each zone prices energy and other trades independently
- Globalization and global optimization is over
- Independent trading zones centering on different currencies will be established
- The clash of empires will intensify
- The global asset network structure previously dominated by the US and the US Dollar will change

In general, it would be wise to understand a bit about the superpower in the other bloc of empires:

- As an investor, you may want to know how to diversify your investment globally
- As an entrepreneur, you may want to know the largest market in the world and how to make money from it
- As a global citizen, you may want to know how the world is becoming more polarized with the rise of China
- As a potential partner or competitor, you might want to know your team member or enemy better

## 1.2 Chinese Economic and Relationship with the World

China has the fastest growth of a major economy in human history: 9.5% annualized growth from 1978 to 2017, far beyond the world economy's 2.9% in the same period. In more detail:

- GDP rose from 367.8 billion Yuan in 1978 to 99.1 trillion Yuan in 2019
- China's GDP in purchasing power parity (PPP) terms overtook the USA's in 2013, and now accounts for nearly 19% of the global economy
- Per-capita GDP rose from 285 Yuan in 1978 to 70982 Yuan in 2019, lifting China from the notch of world's low-income to middle-income countries

The consequence of this is that *China has been one of the major driving forces in the world.*



Let us take a closer look at the imports and exports between Switzerland and China.

### Swiss exports to China (\$21.7B):

- Gold 37.4%
- Packaged Medical Goods 9.81%
- Blood, antisera, vaccines, toxins and cultures 9.53%
- Base Metal Watches 6.79%

### Swiss imports from China (\$13.1B):

- Computers 10.2%
- Broadcasting Equipment 10%
- Office Machine Parts 3.56%
- Jewellery 2.55%
- Nitrogen Heterocyclic Compounds 2.33%

### Why China needs Switzerland:

- An entry point to the European market
- A signal to Europe and the west advanced economies
- An entry point to the global stage via international organizations
- A neutral and friendly country
- A balance with Europe and the US

#### Why Switzerland needs China:

- A huge competitive market
- Engagement in an emerging power in the global stage
- A balance with Europe and the US
- A client that Switzerland has been selling its neutrality service to

### 1.3 China as a Planet with different Value System

China's culture can be named as **Confucianism**. The main foundations of Confucianism emphasize duty, sincerity, loyalty, honor, filial piety, respect for age and seniority. As individuals maintain harmonious relations among themselves, society itself becomes stable.

Chinese business culture is largely influenced by Confucianism:

- The Confucian concept of Guanxi means that a relationship network is crucial and based on the values of solidarity, loyalty, modesty and courtesy.
- Hierarchy in China, both in business and privacy, is purely vertical and highly respected.
- Chinese people will be careful to save face in order to protect individual reputations, influence and dignity.

**Collectivism vs. individualism** is referred to as the degree which individuals in a certain country prefer acting as individuals rather than as members of groups. This dimension focuses on the relationship between the individual and the larger social groups.

It encourages people to pull up their socks and get out of poverty. On the other hand, China as a collectivistic society encourages more group work and puts more emphasis on strong relationships between individuals hence the basis of guanxi. To them, the needs of a group are way more important than individual needs.

*Characteristics of individualistic cultures:*

- Fosters contractual relationships that revolve around the basics of exchange.
- Concentrates more on self and the very dear or near ones.
- More emphasis on personal pleasure, over duties, fun, enjoyment and social norms.
- Value independence and self-sufficiency with self-interest placement.
- They hold unique beliefs and decisions are made based on individual needs.

*Characteristics of collectivistic cultures:*

- Behavior must subscribe to the social norms established.
- More giving up of personal interest.
- Before making any major decisions, the implications to the wider collective must be considered.

- Be a part of few influential in-groups and inclining towards conformity.
- Much emphasis on hierarchy and harmony within the group.

After the stabilization in China's economy, there was a new economic shock. The economy looked to be improving before the lockdowns hit. The march lockdowns reversed China's economic momentum.

Property policy kept easing as lockdowns stopped sales. Property sales had improved but were headed back down. Housing market sentiment bottomed out in late 2021.

Fiscal spending will help stabilize growth. China's public spending will recover strongly in 2022 and infrastructure spending should have a decent rebound in 2022.

## 1.4 Two Innovation Styles

We consider innovation styles of Swiss Start-ups and Spin-offs in comparison to other startups:

	Swiss Start-ups	Other Start-ups
Innovation model	Show Me	Believe Me
Entrepreneur culture	Conservative, prudent	Aggressive
Impact	Relatively low	Higher
Industries	High-tech mainly	Comprehensive
Risk preference	Low	High
Average return	High	Low
Enterprise life	Long	Short
5-year survival ratio	50% (ETH 93%)	<10%

China's spending on research and development in science and technology, surged ten-fold since 2000, while the U.S. spending grew a modest 39% in the same time period. Innovation refers to the ability to produce new economic value through the creation or improvement of products or business services. China has advanced far beyond the mere copying of Western products or technologies and now excels at **incremental innovation** (a modification or enhancement to an existing product or service that improves its market position and increases its economic value). It still lags the US, Europe and Japan in **transformational** (something that fundamentally alters a market or an industry), science-based innovation, but with sustained policy focus and investment by its government, transformational innovation can also be expected to advance.

Advances are clear at the national level, in fields such as supercomputing, quantum communications, space, and robotics. In the private sector, advances can best be seen in mobile commerce, where China currently leads the world.

**When bottom-up meets top-down: Switzerland's vs. China's strategies:**

**Switzerland:**

- **Strategy Level:** The most innovative country in the world, ranked No. 1 for 11 consecutive years on the Global Innovative Index.
- **Asset Level:** *High-quality assets:* 99% of tech-driven enterprises are SMEs/start-ups. The 5-year survival ratio of ETH spin-offs is as high as 93%. *Limited European markets:* many choose to enter the US, while few choose China or Asia.
- **Capital Level:** *High demand for VC capital:* many cutting edge and high-tech start-ups face funding gaps. *Conservative Capital:* due to the cultural influence, the capital development is limited by its risk preference.

**China:**

- **Strategy Level:** national strategy of Mass Entrepreneurship and Innovation, which has been a new driving force for national developments.

- **Asset Level:** *Wide market:* Cutting edge technology in Switzerland could be better transferred and commercially applied in China. *High demand for high-quality assets:* China lacks the world's top quality innovative technology and enterprises.
- **Capital Level:** *Adequate Capital:* after years of capital bubbles, capital tends to pursue high-quality projects. *Sufficient risk tolerance and strong operational capacity:* the capital has strong capacity in technology transfer, packaging and operation.

## 1.5 Risks and Opportunities

### Risks:

- COVID-19 policies: cost of traveling, local operation of factories and supply-chains, etc.
- Geopolitics: US-China relations, sanctions, wars, etc.
- International reputation risk: mostly negative headlines about China, US policymakers have created a climate of moral shame for doing business with China
- Local competitors: rise of local companies and the government stress of pursuing self-sufficiencies
- Local regulatory environment: against foreign companies, data protection, platform companies, etc.

### Opportunities:

- Well-trained labor source and local support system
- Positive expectations on economic growth
- Expanding middle-class population and the unique consumption market
- Special opportunities in certain industries