CHINA AND NEW ZEALAND

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When people are determined, they can overcome fate;
when the will is unified, it can mobilise energy.
Enlightened people do not let nature put them in a set mould.

Huanchu Daoren, 1600

Passivity is not an option

Of nations that are important to New Zealand, China, the once closed, backward communist country of communes and bicycles, has changed more than any other in the past 20 years. China is becoming one of the key arbiters of New Zealand's common wealth and regional security. Yet, to many New Zealanders, China is as little understood — or as widely misunderstood — as it was during its reclusive communist era.

Regardless of the differences between the two cultures, the response of most New Zealanders to the Chinese people is one of respect and empathy, and New Zealanders (although they are seldom differentiated from other foreigners) are generally liked and accepted in China. There is a strong, but still narrow, body of expertise in New Zealand about China, and some 1,000 New Zealanders are currently based in China, with perhaps another 500 or so Chinese who have recently taken New Zealand nationality.

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New Zealand has a high profile among the senior Chinese leadership, and there is a generally positive view of its people as being straightforward and fair in their business dealings. New Zealand may even go as far as to say that due to its relative non-alignment and its preparedness to take diplomatic initiatives, such as backing the Chinese on international trade issues, it is somewhat favoured among China's developed trading partners. This favour is also due to the 30 or so years of New Zealand policy initiatives and diplomatic engagements that, regardless of which political party was in power in Wellington, maintained a high degree of continuity and consistency. New Zealand's trade policy and ongoing diplomacy is, however, well ahead of the activities of the nation's companies in China. It is true that strategy is often ahead of tactical commercial realities in business, but if New Zealand companies do not redouble their efforts in converting this legacy of government initiatives into commercial reality, they will have lost a rare opportunity.

Passivity is not an option; New Zealand needs to become proactive at all levels of its engagement with China. In order to approach China effectively, New Zealand companies must also become unified in key sectors such as forest products, wine, meat, education, technology and specialised manufacturing. Businesses need to look beyond traditional products to the sectors that offer high-value, cross-border transactions. Film production and boutique investment banking are examples of such sectors, and both have begun to find real traction in China.

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Most New Zealand firms are small and would benefit from working collectively in their sectors. This issue of size is too often used derogatorily when referring to New Zealand's commercial culture. Yet, although many New Zealand firms lack both human capital and financial resources, the very fact that they are small means that they have the potential for flexibility and innovation in ways that large companies of any culture find difficult to achieve. It is the more flexible and innovative companies that thrive in the Chinese economy.

In the present economic climate, New Zealand companies must not be distracted by the fact that commodity sales to China continue to reach unprecedented highs. The recent investments by Chinese companies in Fisher & Paykel and PGG Wrightson also risk creating the false impression of a new trend in Chinese investment into New Zealand. The respective Chinese investors in these two iconic New Zealand companies took advantage of the fact that both firms were under considerable stress as a result of the global economic crisis. While it is a credit to both New Zealand firms that they managed to secure their new Chinese shareholders, if they had initiated such deals themselves in the years before the recession, they would have probably done so on better terms and at much higher valuations. Their fault was perhaps their slowness in recognising the importance of China as both a source of capital for their parent companies in New Zealand and as a market for their businesses.

Fischer & Paykel and PGG Wrightson still have historic opportunities to turn their passive positions into active ones in the Chinese domestic market. They are among New Zealand's more experienced international companies and the probability of their succeeding is high. Neither transaction was a purely financial play on the part of the Chinese. New Zealand technology and knowhow are too often undervalued by New Zealand's own investment community.

Attracting Chinese investment

China's slew of industrial and sovereign investment funds and state-owned companies and many of its larger private companies have strong cash reserves and are looking for opportunities around the world. New Zealand companies need not wait for Chinese investors to seek them out; they should instead be assessing the relevant sectors in China and undertaking due diligence on the best potential partners to invest in their New Zealand-based businesses.

> *'We were approached by a Chinese investment group last year. Although too small to take on the complexity of China in search of investment, given the barriers of language and different commercial practices, we took a chance and started negotiations with them. We tried to project the view that they needed us more than we needed them. It wasn't true, but it helped us project a measure of strength. We hired a small but experienced investment bank in China and have just closed a deal with our new Chinese partner. This probably saved our business. It will create more jobs in New Zealand and will also help us become a significant player in the Chinese market.'*
>
> Small South Island industrial technology company

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New Zealand businesses have, largely by necessity, developed a short-term trading mentality that often prevents them from establishing strategies, or encourages them to establish ones that are little more than sales plans to move more products. There is also the propensity to export the competition that exists between New Zealand companies at home to international markets, when in fact a degree of unity is crucial in order to succeed. New Zealand's real competitors are other foreign countries in markets such as China, not each other.

This is nowhere more evident than in the New Zealand wine industry. Wine exports worldwide now earn more for New Zealand than wool exports. However, with reduced global demand for wine in the wake of the financial crisis and increased supply, the nation is in danger of establishing a market for its wine in China at the lower price levels from which there will be no escape. New Zealand as a wine country itself is virtually unknown to the Chinese, and the market share of its wines in China is currently very small. When considering imported wines, the Chinese currently only really recognise French (particularly Bordeaux) and Australian red wines. The Chinese consume their own mostly poor quality, cheap wines at ceremonial occasions such as weddings, where they are drunk more for their auspicious red colour and as a gesture than for the quality or flavour.

This first generation of Chinese middle-class consumers may nevertheless be persuaded of the benefits of many things. This once lactose intolerant nation was persuaded to drink milk in sizeable quantities in under a decade. China is and will remain the only wine market with significant growth in the world in the coming five years. Chinese consumers drank 700 million litres of wine in 2009, 10% of which was imported. National consumption of all wine has been growing at roughly 10% per year for the last five years and will continue at this level, or at least at the rate of GDP growth (which was over 8% in 2009).

Given that 70% of New Zealand's exported wine is Sauvignon Blanc, it would make sense to build a China strategy around this varietal. New Zealand vintners should focus this strategy on the Shanghai and Beijing markets, as consumption of premium food and beverage products still remain confined to these two concentrated centres of middle-class consumers. Any New Zealand vintners, except the few largest ones, that attempt to take on the Chinese wine market alone will fail. Unity is the only way forward.

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Another example of this need to be proactive is in the seafood industry. Australian lobster producers are now met by small Chinese traders at the quayside when they return with their catch. These piecemeal sales are beginning to undermine the Australian fishing industry's ability to deliver fresh and live product to the Chinese consumer and to govern food safety, quality and customer perception. The Australian lobster industry has a great deal to lose in this situation, as Australian lobster is among the highest priced seafood in China. It is a sad irony that a significant portion of these lobsters are actually from New Zealand and are sold indirectly to China and identified by consumers as Australian product. 'Brand New Zealand' has yet to be established in China in many industries; now is the time to do so.

Forging a new partnership

It takes time, patience and a great deal of cash to assess industrial and service sectors in China and establish companies in Chinese cities. With banks and financial institutions in New Zealand as reluctant to lend to small- and medium-sized business today as at nearly any time since the Great Depression, a more strategic approach to lending and risk needs to be developed. This could be in the form of a China-New Zealand private equity fund that could be seeded by the New Zealand government but also raised substantially internationally and managed according to international standards. Chinese managers of funds would be among the likely international investors. The fund could invest in everything from China-based dairy farms and specialised manufacturing businesses owned and managed by New Zealand entities to New Zealand-based companies selling goods and services to China. New Zealand and Chinese governments could also work together to develop the performance of New Zealand state-owned assets for the benefit of both economies. Such an initiative could, where appropriate, focus on maximising returns for New Zealanders through partnership rather than one-time sales of state assets for cash windfalls. This effort could also complement Wellington's ambition to create an international fund management zone in New Zealand. Many of the solutions to New Zealand's economic issues lie beyond its borders. In this interconnected age, geographic isolation, while being a physical reality, need not be a state of mind.

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China will continue to sustain high growth in 2010 and 2011, with GDP growth continuing to exceed 8%. The internal engines of the economy are strong, although there is the possibility of inflation in some sectors. The booming property markets do not constitute a single, all-encompassing bubble in China, although there are some eruptions of inflation in some of the wealthier coastal cities. The infrastructure projects in which the Chinese government has invested have, in some cases, a decade to be competed and will continue to create strong demand and employment. Demand for building materials, and therefore New Zealand timber, will continue. Whole milk powder sales to China have reached record highs; so poor is the domestic supply of raw milk, and so strong is demand, that volumes are unlikely to abate in the next three to five years.

There will be some curtailing of bank credit, but largely to stem speculation in China's narrow and often unstable capital markets. Bank reserves will be increased again this year, and there is the possibility of a small rise in interest rates. While the Chinese government is unlikely to resort to a radical revaluation of the renminbi, we can expect incremental increases in its value over the next 12 months of approximately 5%; the government prefers that further revaluation of the renminbi be similarly incremental over the next two to three years.

The Chinese government will struggle with issues such as high unemployment levels among university graduates, the increasing inability of lower-middle-class people in major cities to buy property and the enduring problems related to the opaque nature of the political and legal systems. It will nevertheless effect, as it has over the past three decades of reform, significant, albeit incremental, changes to the Chinese economy and society according to real priorities. New Zealand can have confidence that China will remain economically stable and therefore a prudent commercial risk in the near future.