'If we do not look where we are going we might end up where we are heading'\textsuperscript{1}

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\textsuperscript{1} Old Chinese Proverb
EXECUTIVE SUMMARY

One fifth of all the people on the planet live in China on one fifteenth of its surface. It is the only modern nation that can trace its own continuous history back more than 3,500 years and today, by some measurements, it is the world’s second largest economy. China is the world’s greatest manuscript and its story is about to change radically. Unquestionably the impact of this change will influence all of the global community and the magnitude of that impact is a question that anyone interested in the ‘long view’ would be intrigued to answer.

Discerning the future is not an end in of itself rather it should be part of a decision making process. Accordingly this study attempts to go beyond describing China’s possible futures to specifically how the consequences of these possibilities could be used to answer the key question “What should be the 15-year strategy in China for one of the world’s leading management consultancy firms?”

The future is chaotic, not determinate. In any system with multiple variables, in which the results of one complex interaction become input for the next, the future state of the system is unpredictable in its very essence. China is such a complex adaptive system with billions of variables. One cannot know its future. However one can analyse its present, searching for the deep drivers that are most likely to shape its future and out of those deep driving forces one can shape scenarios, ways of thinking about China’s possible futures. This was achieved using the methodology of P. Schwartz in ‘Art and Science of the Long View’:

1. Determine key decision;
2. List key forces in local environment and identify stakeholders;
3. List driving forces (macro-factors) that drive these local forces;
4. List & rank uncertainties;
5. Define/ select axes;
6. Flesh out scenarios (use 2 & 3);
7. Implications (return to 1);
8. Selection of leading indicators.

Nine macro drivers were identified that would shape China’s future:

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Cross impact analysis indicated the fundamental drivers for change in China’s future and the axis that would define the scenarios to be created. These were identified as Political Response to Change and China’s Degree of Globalisation. The axes chosen resulted in four broad scenarios. However, the gaps left by these four scenarios resulted in an important fifth that needed to be included to provide the most complete view of China’s alternative futures. Therefore five scenarios are defined in the study, broadly described as:

- A Military Future
- Asian Union
- Island China
- Market China
- Disintegration

Each of the five scenarios brings to life radically different futures for China. The exercise provides interesting learning points for the management consultancy whose current China Strategy is based on one fundamental supposition – China’s is the world’s biggest untapped market. The created scenarios demonstrate the pitfalls of this simplistic analysis. It provokes consideration of strategies and contingencies for environments that would be difficult to imagine with conventional strategic planning approaches. Today’s strategy must be based on a tactic that offers flexibility in an uncertain future.
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1 INTRODUCTION

One fifth of all the people on the planet live in China on one fifteenth of its surface. It is the only modern nation that can trace its own continuous history back more than 3,500 years and approximately 50% of that time China has been ruled by a single Emperor, the remaining time it has been divided into two, three or more warring regions. Today it is estimated to be the world’s second largest economy (by 1998 GDP measured at purchasing-power parity). China is the world’s greatest manuscript and its story is about to change radically; analysts believe that China will change as much in the next five years as in the past extraordinary 20 years. Unquestionably the impact of this change will affect all of us and the magnitude of that impact is a question that anyone interested in the ‘long view’ would be intrigued to answer. That is not to say it will be easy...

The future is chaotic, not determinate. In any system with multiple variables, in which the results of one complex interaction become input for the next, the future state of the system is unpredictable in its very essence. China is such a complex adaptive system with billions of variables. One cannot know its future. However one can analyse its present, searching for the deep drivers that are most likely to shape its future and out of those deep driving forces one can shape scenarios, ways of thinking about China's possible futures.

Discerning the future is not an end in of itself rather it should be part of a decision making process. Accordingly this study attempts to go beyond describing China’s possible futures to specifically how the consequences of these possibilities could be used to formulate a strategy for an International Management Consultancy interested in servicing China.

2 METHODOLOGY

To arrive at feasible and consistent scenarios requires a rigorous and comprehensive methodology. The methodology adopted was that first proposed by Peter Schwartz. The framework outlines eight steps:

- Determine key decision;
- List key focus/forces in local environment and identify stakeholders;
- List driving forces (macro-factors) that drive these local forces;
- List & rank uncertainties;
- Define/select axes;
- Flesh out scenarios (use 2 & 3);
- Implications (return to 1);
- Selection of leading indicators.

Based on this framework, the following process was agreed for data gathering, implementing and reporting:

- Team Workshop I to agree key decision and key factors;
- Gather data around local environment and macro-factors;
- Team Workshop II to list the macro drivers & rank the uncertainties;
- Team Workshop III to select the axes; including cross impact analysis;
- Produce internally consistent scenarios;
- Team Workshop IV to discuss the scenarios and consider the implications; select leading indicators that serve as early warning signs;
- Finalize report.

3 KEY QUESTION

The last two decades that have seen China emerge as a major manufacturing power, have been based on catch-up growth, gains that came from disbanding the agricultural communes and from allowing capital and particularly labour to be poured into low-end manufacturing and processing. However the consequence of this focus and the country’s socialist legacy is that China’s service sector is only half the size expected for a country at this stage of development. Consequently management consultancy providers see enormous opportunities in China but the magnitude of future change and the uncertainty...
associated with it makes strategy formulation difficult. This study will use scenario tools as a framework to develop strategy recommendations by asking the key question:

“What should be the 15-year China strategy for one of the world’s leading management consultancy firms?”

Our research shows that most management consultancies already have a presence in China. Accordingly, our management consultancy already has a presence in Shanghai and/or Beijing.

4 **KEY LOCAL FORCES IN CHINESE MANAGEMENT CONSULTANCY INDUSTRY**

During workshop I the group listed key stakeholders and developed and analysed major forces and issues in the Chinese management consultancy industry. Consolidation allowed three broad categories to emerge: Clients, Product and Environment. Subsequently, the individual elements were clustered into these broader categories and the inter-relationships identified. The influence of macro-drivers in China's change process on these elements, considered in the second workshop, determined the uncertainties that will shape this industry's prospects in China’s futures.

5 **MACRO-DRIVING FORCES**

China’s future will be shaped by macro driving forces whose influence or potential influence is evident in the present. Identification and understanding of these macro-drivers is fundamental to the methodology of scenario planning. Following extensive research (Sources: 12 General References) nine broad macro-drivers were identified, considered below.

The quality of China’s land is declining rapidly because of soil erosion, over-population, over-farming, pollution, over-development, and the growing salinity of delta farmlands. By some estimates, China has consumed 25 percent of her total forest just in the last thirty years, and one-seventh of the county is now desert. The Gobi, the great desert on China’s north flank, is spreading at the rate of 950 square miles a year. Of the 1066 lakes in Hubei Province in 1949 only 326 exist today. It is estimated that air pollution in China caused 915,000 premature deaths in 1993, one third of them children. China’s present growth model is unsustainable and will come under increasing external and internal pressure; how this will be managed is uncertain.

Despite expenditures of around one billion dollars per year by the Chinese government, as of 1994 approximately 25 percent of China’s population – 350 million people – were still living in poverty, including 60 million still living at the near-starvation level of 60 cents per day or less. The national average GDP per head (excluding Hong Kong and Macau) was $735 at 1998...
prices, which makes China somewhat poorer than Indonesia. That average, though, conceals great regional inequalities. The poorest province, Guizhou, has a GDP per head of $280, on a par with Bangladesh or Yemen. Sichuan, with a figure of $525, is level with Pakistan. Meanwhile, Shanghai’s residents, at $3,400, are as high as Turkey or South Africa. Hong Kong, at $22,990, has a higher per-head income than Britain, its former master. The dozing commuter on the Star Ferry is likely to be 90 times wealthier than the vegetable-seller in Guizhou.

Equally serious is the wealth gap between city and countryside. In cities, 90% of households have washing machines and colour televisions. On farms, the most widely owned consumer durable, found in 70% of all households, is the sewing machine.

These discrepancies are fuelling social unrest and high levels of urban migration and may well be the catalyst for China’s next social revolution.

Other factors that are of concern:

- Growing population (UN projections do not result in zero population growth until 2030)
- The failure of state owned firms (SOE’s) in which banks have heavily invested have led to a loss of life savings and unemployment amongst the poorest members of society.
- Demographics point towards period of growing number of elderly.
- One child policy caused backlog of social dissatisfaction.
- China is home to 25% of the world’s children and has created serious problems in the education system by directing its stretched resources to a few prestigious universities.
- Growing pressure for improved human rights.

Just as America’s growth in the 19th century took off with the building of the railways and of a national financial system, so China hopes to unify its hitherto fragmented, disjointed economy. Until recently, it took less time to ship a container from Shanghai to Seattle than from Shanghai to the inland city of Chongqing, 1,000 or so miles up the Yangzi river. Just a dozen years ago, China had no highway system linking its provinces; now it has over 12,000km (7,500 miles) of such highways. The number of passenger flights has trebled in the past decade. There were 36m new subscribers for fixed-line telephones in 2000 alone, and 42m new mobile subscribers: fixed-line penetration, at 17% of households, grew 30-fold during the 1990s. Internet use, though still tiny, is more than doubling every year. China is integrating fast, and information technology is helping. However, progress is in its infancy and the problems are still immense. The inadequate infrastructure permeate all elements of the business environment:

- Poor transport and distribution structures
- Lack of legal infrastructure, especially for ownership
- Lack of culture and protection of brands and IP
- Lack of information infrastructure with respect to economic performance indicators
- Under-developed accountancy systems and profit tracking
- Lack of social security coverage, particularly for pensions
- Lack of infrastructure for e-commerce
- High mobile penetration and fast growing internet use, although low income inhibits widespread diffusion of internet

Whether China can invest sufficiently and rapidly enough to solve these problems is uncertain.
Conflicts like this will continue to shape China’s behaviour as it seeks to manage its internal and external stakeholders and there is great ambiguity as to how these forces will be reconciled.

Economics

China’s economy has been gradually opening up since Deng Xiaoping introduced market reforms 20 years ago. In that time the economy has grown more than fivefold, incomes have quadrupled, and 270m Chinese have been lifted out of absolute poverty. However, much of China’s growth up to now has been merely of a catch-up kind, as entrepreneurial spirits were unleashed after agricultural communes were disbanded and restrictions on travel and informal enterprise were lifted. The government did not have to do much except stand back. However, for all the growth in the country’s exports as China became a manufacturing colossus, only in 1993 did China’s share of world trade reach its pre-1939 peak. China’s manufacturing is getting more sophisticated and employing more capital. Potentially even as its economy moves up the manufacturing chain (e.g., to semiconductors and to information-technology hardware, of which it is the world’s third-biggest producer), China will not lose its advantages in cheap, labour-intensive areas such as toys, textiles and shoes. Without China’s cost structures—that is, its economies of scale and its low standard of living—other exporters in the region, from Indonesia to South Korea, will have trouble staying in business: China can just about out-export them all!

The coming two decades offer the possibility of an even more extraordinary pace of economic change. These could be the decades when China truly joins the world, and when the crushing legacy of a socialist economy is swept away. China certainly has the potential, over this period, to become the second-largest economy in the world. The geopolitical effects would be immense. If China sticks to its WTO commitments and, in effect, moves to a market-based economy by 2005, it will grow at 7% a year till 2005, then at 9% during 2006-15, as it reaps the benefits of restructuring, before slowing a bit thereafter. If so, by 2020, China’s economy would have grown to $10 trillion in 2000 dollars, making it the size of America’s economy today. This progress will scarcely be affected by external global recession. Even if China’s net exports declined by a quarter in 2001 (after growth of the same in 2000), a mere half-percentage point would be knocked off the country’s growth. This reinforces the point that China’s is a continental economy, driven by domestic demand.

Nevertheless with China now on the cusp of joining the World Trade Organization, it still has far to go. The country’s banks are still coping with bad loans; the financial service sector and capital markets must be overhauled; its overstuffed, inefficient SOE’s urgently need restructuring; and the private sector, promising in theory, is still squeezed. As China’s leaders deliberate over how far and how fast to reform, foreign investors, ever ambivalent, are watching with mixed trepidation and interest. The potential achievements of the next twenty years could easily eclipse or neutralize the accomplishments of the past.

In 2002 Jiang Zemin is expected to step down as China’s party leader and relinquish the state presidency the following year. This will be the first step in a transition of power to the next generation; the ‘Class of 77’ who were the first to graduate from university after Mao’s death. This is a generation who remember the chaos caused by radical politicians and who have far greater experience of the world beyond China. However their task will be no easier than their forebears.

In the last decade the Chinese government has sought to open up China and introduce market reforms while maintaining control and has finding it increasingly difficult to do so. There is already evidence of the restiveness that this change is precipitating:

- farmers rioting over arbitrary taxes
- workers taking to the streets to protest at unpaid wages and factory closures
• separatist sentiment in China’s Islamic borderlands

Unfortunately the hardest work is yet to come with the Chinese economy desperately needing more radical devolutionary political reform if it is to achieve its full potential. Moreover as this economic miracle progresses the newly formed middle-classes will demand more personal freedom and sense of choice (as they have done in countless other nations).

Within some parts of the Communist Party itself there has been recognition that, without further political reform, party control would become dangerously brittle. Yet attempts to debate all this, except in sterile formulas, has resulted in the periodic expulsion of the best brains from party think tanks, and the banning of books and films. Similarly, behind the attempts to crush the ‘Falun Gong’ spiritual movement, filling China’s jails in the process, was a determination to let no organization occupy space uncontrolled by the party. It is unclear if this next generation has the vision and the stomach to expand and accelerate this huge economic experiment and manage the uncertainty and inevitable loss of power that it will bring.

The Peoples Liberation Army (PLA) forms the single largest economic organisation in China with over three million men under arms. It also owns the world’s third largest nuclear arsenal. Far from redirecting fiscal resources away from defence spending in the move to a market economy the Chinese government have increased investment in the PLA. Between 1988 and 1994 investment in the PLA has increased by 50% in real terms to $7 billion and in March 2001 China announced an increase of 18% in defence spending, the biggest for 20 years. Clearly the PLA will continue to exert a large influence on China in the future and how the PLA will handle its evolving role as its old ally the communist party wanes and new forces grow is unknown but it is sure to affect any unfolding Chinese future.

China is in cultural freefall. Mao succeeded in destroying the old China, but he failed to create a new one. Money, sects and symbols are filling the vacuum he left. The rapid popularity of mass cults such as the quasi-Buddhist ‘Falun Gong’ and the yoga based ‘Qi Gong’ reflects the phenomena of a people seeking a spiritual identity. As China evolves so too will the populations beliefs and values but what these will be and how deeply they will be held is undefined.

In advanced economies, companies do business within a rules-based system. This means that business is generally conducted in a publicly verifiable manner (i.e., using contracts), under laws that are widely known and consistently enforced. Although it may not be apparent to those operating in a rule-based system that has grown up over decades or even centuries, such a system carries large fixed costs. That is, the establishment of the legislation and the judiciary, the drafting and interpretation of laws, and the implementation of contracts all involve high sunk costs. On the other hand, the incremental cost of enforcing an additional contract is small.

China does not work in a rules-based economy, it is still an economy based on relationships ‘guanxi’. Business transactions are made on the strength not of contracts but of personal agreements. Transactions are purely private. They are neither verifiable nor enforceable in the public sphere. How, then, do you avoid being cheated in such a system? You thoroughly check a person’s background, his status and his assets. If he cheats, you know how to seize his assets, blackmail him or, if you have to, kidnap him.

A rule-based system needs a high and costly level of public order. A relations-based system needs only minimal public order. All you need to know is that you are unlikely to be mugged on the way to the bank, and that the bank manager is unlikely to run away with your money. On the other hand, the marginal costs of finding, screening and monitoring a potential partner are extremely high. For instance, the relationships have to be managed personally: you cannot afford to delegate the task. Given this high marginal cost of cultivating new relationships, it makes sense to do business first with close family, then with the extended family, then neighbours from your home town, then former classmates, and only then, reluctantly, with strangers. This is how market reforms spread in China during the 1980s and 1990s.
Instead of incurring the high fixed costs involved in setting up a rule-based system, the country took the cheaper route of relations-based development. That led to an explosion of markets, and to a rapid division of labour.

As markets expand and the economy becomes more complex, the average cost of relations-based governance rises whereas the cost of rules-based governance falls. Further, in the absence of a rules-based economy, those splintered local markets cannot merge into regional, national or even international ones. Moreover, they create immense economic distortions through corruption and the misallocation of resources. By trying to push through tough economic and legal reforms, the Chinese government is attempting to switch from relations-based to rule-based governance. It is trying to break the cozy links between banks and their state customers. It is cracking down on the many smuggling rackets that are simply a form of relations-based trading. It is trying to disengage itself from its over-close relations with business. And it is attempting to produce laws for the market economy, not the socialist one. The success and product of this effort is uncertain.

6 Defining the Uncertainty and the Axes of the Scenarios

The future is formed from the dynamic interaction of the local forces and the macro-drivers that have been identified. What prevents us from knowing this future is the uncertainty that exists in these elements. At Workshop II the team listed and ranked the certainties and uncertainties associated with the interaction of China’s macro-drivers on the three local elements of Clients, Product, and Environment that defined the future consultancy industry. The results are shown in Fig. II.

There were some surprises including the conclusion that China’s future no longer includes the uncertainty of whether China’s central government has committed itself to creating a market economy at home, tied to the world at large. What is uncertain is how successful and how quickly it will achieve these reforms and how great will be the political appetite for potential magnitude of this change. In total 11 uncertainties and 6 certainties were identified as critical in answering the key question.

In order to evaluate the uncertainties and develop a basis for the choice of axis that would define the scenarios a cross impact analysis\(^{vi}\) was completed. In order to allow a democratic evaluation, all team members completed an independent analysis and the final result was based on a mean of the totalled results. A statistical analysis of the results was completed to identify where significant differences in responses occurred. Where the standard deviation of the response was greater than one unit the final result was debated to confirm that all participants’ assumptions were the same. Where differences existed re-evaluation was completed. The final Cross Impact analysis and statistical analysis is shown as Fig. III.

The cross impact analysis indicated that the team was unanimous in their decision of the fundamental drivers for change in China’s future. These were identified as Globalisation and the Political Response to Change of which only the latter is an uncertainty. However following debate and review of the local and macro drivers it was decided that the axis of Political Response to Change and China’s Degree of Globalisation would best reflect the envelope of possibilities to answer the key question. Given this conclusion the scenarios of China’s Futures were created.
7 SCENARIOS

The axes chosen resulted in four broad scenarios. However, discussion of the gaps left by these four scenarios resulted in a fifth being agreed, the collapse of the Status Quo, in order to provide the most complete view of China’s alternative futures. To ensure consistency, the scenarios are named after Status Quo song titles.

Looking back to 2008 it all seems so obvious. How anybody could have believed that China would be able to adapt to a Western model of capitalism and democracy seems incredulous now. But, then in the years running up to the 2008 Massacre, China appeared to be well on its way to a capitalist revolution.

With Jiang Zemin in power and the reforms he introduced, China quickly became a magnet for foreign investment. International relations with the West had never been better. China joined the WTO. The landscape of the major cities changed as powerful global brands sought to take advantage of the liberalisation and many people from the rural and industrial provinces flocked to the big cities in search of a better life.

Everyone knew that the transition wouldn’t be easy. But since the former members of the Warsaw Pact and Soviet Union had made the change, it became accepted wisdom that the forces of capitalism in China were unstoppable. After all capitalism was consistent with human nature! Why would people want to return to the old regime?

The answer probably lies somewhere in the country’s culture and traditions. China was and is heavily influenced by its mystical and complex past. Here was a nation who had consistently closed itself down to external influence over the course of its 5000-year history. From the Tang Dynasty (618 – 907 AD), the Ming Dynasty (1368 AD) and the Ching Dynasty (up to 1911 AD) the country had oscillated between a degree of openness and complete closure. History rarely repeats itself, but human motives often drive similar behaviour. What happened to China in 2008 was probably a culturally based response to the conditions that were unfolding. We should have seen it coming.

In the first 6 years of the century, the Chinese authorities continued its programme of reform. They reduced investment in the military, increased investment in infrastructure, began programmes to improve education standards and continued to encourage foreign investment. Their plan was to gradually and slowly move to a market economy by controlling the transition and avoiding the crises suffered by other former communist countries. However, they were quickly to discover that the forces of capitalism were beyond their control.

The changes required by WTO membership began to cause hardship. There appeared to be a small number of people doing very well out of the reforms, but the vast majority were seeing a decline in their living standards. By 2010, the impact of the global recession had hit investment in China. Unemployment began to increase, many international investors were withdrawing from the country as they struggled to find opportunities that generated reasonable returns.

Disillusioned by the failed promise of reform, the Chinese people began to become dissatisfied by the actions of the government. Conservative traditionalists became more vocal. 2006 saw the first People’s Congress. This was held in Fuzhou and chaired by Zhi Wang and is now regarded as the start of the process that led to the bloody massacre in Beijing that led to the rise to power of Wang and the downfall of Zemin and his government.

Of course Wang could not have achieved his “corruption cleansing” without the support of the military. Their role and influence had been in decline since the late 1990s as the Zemin government reduced...
military spending. Overall, the military leadership had acceded to the reforms although many were reluctant and some had dissented. When Wang launched his campaign to return the country to its traditional values he received a great deal of support from enough senior military figures who wielded significant power with the forces to make his challenge threatening and credible.

At first, the national government had ignored Wang. But as the economy began to stall and the regional governments started to offer their support to him, the centre became increasingly concerned. By 2008, Wang could not be ignored: in the spring of that year, there were riots in Beijing. Forces loyal to the government intercepted demonstrations organised by Wang. The sheer scale of the number of protestors was overwhelming for the troops who responded with force, killing 125. The scale of the damage caused by angry protestors was enormous. For many people, the torching of the McDonalds restaurant in the centre of Beijing was symbolic of the attitude of the people of China. Their short engagement with capitalism was over. Supported by a large element of the military, Wang stormed the government building and placed Zemin under arrest, declaring himself the saviour of the country. Shortly thereafter, he formed a new government that consisted of many senior military officials.

One of Wang's early actions was to order China's withdrawal from the WTO. This generated a huge amount of global criticism and strained the country's international relations. At the time, many Western governments were concerned about the stability of the new government and their political motives. In particular, did a return to a more traditional form of government mean that the Chinese authorities would restate their claim on Taiwan? Increasing political tension between Beijing and Washington over Taiwan resulted in the US government trebling the size of their fleet patrolling the waters of the South China Sea. However, China's increasing isolation from global trade compelled Wang's government to act out of a sense of pragmatism. Recognising the value of Taiwan as a gateway to world trade, the Beijing government offered the Taiwanese authorities a number of significant concessions that succeeded in forging a federation between China and the 'rogue state'.

By opening up the State Owned Enterprises (SOEs) to Taiwan and Hong Kong's managerial skills and business experience, the key SOEs were modernised and gradually revitalised. The government overhauled the country's tax system and gradually got to grip with the economy. A national welfare system was then introduced to include basic medical, unemployment and social security funded largely through the taxes generated by the SOEs.

Overall, the country remains closed and largely isolated but is now relatively stable and making progress. GDP per capita is approximately $1,600 (about double the 2000 figure), although people are content and appear to have accepted their lot in life. The military remain powerful and although international relations have improved they are still distant. The economy is still largely industrial, lagging a long way behind the information-based economies of the West.

From the beginning of 21st century it seemed inevitable that China would open itself up to the world. With the benefit of hindsight, one could argue that the seeds were sown as early as 2008. Following riots in Beijing in 2008, Xiaoguang Yu, was quick to act. A reformer, Yu quickly seized power from Jiang Zemin and appointed like-minded Party Members into office.

In was no secret that Yu admired the achievement of the European Union. As early as 2004, Yu had laid down the structure for an Asian Union (under Chinese leadership), using Asian systems, and based on Asian values, in his book “Taking China Global”.

In Party-ranks, it was no secret that Zemin and Yu clashed on many occasions, but this was never shared with the public. During Party gatherings, Yu had publicly launched ideas about an Asian Economic Union, one Asian Currency, one Asian military. What many Party Members did not know was that Yu had a set of ideas to deal with member states that “went astray”. Yu had carefully watched how the United Kingdom had been “body swerving” at the turn of the century; how they were part of the EU, but did not want the Euro, did not want to align tax regime. As everyone had expected, the UK proved it was unable to survive outside Europe. Yu was determined that he was not going to allow delays in the rollout of his Asian Union by “short-sighted member states” and would use military intimidation to speed up the process.
The most feared scenario was the Chinese invasion of Taiwan. However, Yu was an intelligent man and knew that he needed some time and space to lure a few countries into the Union before giving it a high profile. Yu maintained this long-term view, even though he was very keen to launch the Union as soon as possible. Yu’s first two targets were Mongolia and North Korea. Both countries were once faced with two powerful neighbours, Russia and China, which gave them relative stability. With Russia’s power decimated, both North Korea and Mongolia had become dependent on China and they had no other choice but joining the Asian Union in the autumn of 2009. The opposition had been “controlled” by the military.

In an attempt to make the Union look like a brotherhood of states, Yu arranged for Ulan Bator to become the capital of the Asian Union and for Pyongyang to become the seat of the Asian Parliament. The Asian Bank would be based in Hong Kong, but everyone knew that the real power centre was Beijing. Quickly after the announcement of the Asian Union, the three former countries “agreed” to a joint military and to a common currency. With the military firmly in place, Yu ensured that Mongolia and North Korea were fully under control of Beijing. The world could not act as Mongolia and North Korea “volunteered” to join the Union.

Kyrgyzstan, Tajikistan, Vietnam, Laos, Cambodia, Myanmar, Bhutan, and Nepal “joined” the Union in 2013. They were all convinced by Yu military pressure and after a while almost started to believe that together they could make a difference. In 2014, they were incorporated in the monetary and military Union. For Beijing, it was important for Bhutan and Nepal to join, as this gave the government a reason for transporting troops and military equipment through Tibet into these countries. On their way through Tibet, Yu casually “solved” the problems that Tibet had with aligning with Beijing.

Yu now held a large part of Asia in the grip of his Asian Union and even though historians today would present a picture as outlined above, in those days, the Union was perceived as an Asian attempt to increase its economic power. The Asian Union was also an economic union. Yu made sure to play the monetary card rather than the military card. The military union was strongly downplayed by all members. Instead they would focus on their “excellent internal relationships and one currency.”

Yu knew in 2015 that he was now facing the two largest challenges of his leadership: how to incorporate India and Thailand and how to get this vast economy to prosper whilst maintaining a political grip on it. Yu realised that he could hardly intimidate the vast Indian military and also that he could not easily control the monarch of Thailand. The death of Yu came as quite a shock to everyone in 2016.

Yu’s successor, Han Son, while supportive of the Asian Union, was also a western trained economist. Although he did not always approve of Yu’s expansion drifts, he was now left with a large Asian Union and he had to make it work before it crumbled. While maintaining a tight political grip on the country, Son loosened his military grip on the Union and with the money that was freed up from military assets, started to implement a market economy across the Asian Union. Under these conditions, Son was able to annex Thailand and India to the Union.

Although the people of China and the Asian Union today are still politically oppressed and human rights is still an issue, people can travel and trade freely within the Union and foreigners do not have much trouble visiting the Union. The three trading powers in the world: America, Europe, and the Asian Union are friendly towards each other, although banana wars still exist between Europe and the USA and textile wars still exist between the USA and the Asian Union.

The country never dispelled rumours about the Indian government’s involvement in Yu’s death.

As the first rays of sunlight brushed through the half drawn blinds in Jiang Zemin’s vacation house, he reflected on how things had changed so quickly. The election of President Meihong Xu in 2008 was indicative of how much had occurred in such a short space of time – China’s first female premier, forming its first democratic government of a truly capitalist age. The status quo had been upended. Now people were responsible for themselves and their benchmark was other people’s wealth.
Xu, nicknamed the Daughter of China, had overseen the widespread implementation of WTO laws and guidelines. In most of the major cities, internationally accepted accountancy guidelines were in the process of being implemented. Approximately 30% of economic activity was accounted for by firms which were either foreign owned, joint ventures with foreign parties or had foreign investors listed on the balance sheet. Over half of this investment was new. Solid relations with the US and Europe had increased the level of foreign aid. This came in the form of national grants to meet globally agreed environmental targets or at a regional level for infrastructure development. This was a major source of funds for the inland regions in particular.

Investment in broad economic infrastructure, such as transport and telecommunications were slow to take off. Property and contractual law development was piecemeal, often being driven by multi-national enterprises and international trade, but it was occurring. The priority had been the re-capitalisation of the banking sector and development of accountancy systems for the (ever-growing) private sector made up of the town and village enterprises.

There had been a host of privatisation of state owned enterprises – among the most prominent were two of the Chinese banks. President Xu, was now considering introducing a parallel currency. Debate was underway as to whether the US Dollar or the Euro should be adopted for this purpose.

There was a considerable amount of mergers and acquisitions activity, both as MNs sought to acquire cheap assets in China and as Chinese companies sought to reach a critical size to be able to fend off international competition. There was also growth in venture capital/private equity markets. In the US and Europe there had been considerable success in raising capital for China and SE Asia growth funds. Investors were seeking to tap into the Chinese entrepreneurial spirit, ever increasing inflow of management expertise, opportunities for business development in major cities and cheap factor markets. There was also a flow of Russian and American scientists to Shanghai and Beijing where the demand for IT and biotech expertise was raging.

There was a considerable amount of migration towards urban centres as these growth opportunities emerged. Many people with highly variable educational backgrounds, skills and ages were making these trips.

On the positive side, relations with Taiwan were rapidly improving and their was even talk of possible integration. Strategic alliances with Europe and the US occurred through corporations, rather than at the governmental level, but it was through these alliances that market orientation and business learning was occurring amongst the Chinese people. There were a few stars from the privatisation process and consolidation in the TVE sector, which were able to compete on a global level and were exporting over half of their products. The emergence of a legal and accounting infrastructure was accelerating international trade. The coastal regions were booming and Hong Kong and Shanghai were the fastest growing financial centres in the world. However, there were many negatives.

Many of the state owned enterprises were going to the wall, including some banks, which was having a knock-on effect. In coastal regions, property prices were rising very rapidly – there were pockets of the wealthier regions were suffering from high inflation. The strain on social security of unemployment and old age was causing the public sector deficit to widen and with it interest rates were rising, increasing the risk of indebted company defaults on payments. Despite interest rate rises, the local currency was rapidly losing value, putting pressure on manufacturing companies reliant on imported raw materials to use up their dollar reserves. The average credit rating of corporate bonds was falling also. In the agricultural sector and rural areas there was economic chaos.

All of this was leading to a state of political flux. There was democracy, but there was a serious threat that the elected government would not be allowed to determine when the next election would be - further revolution appeared to be possible. China was struggling to meet agreed environmental targets and foreign investors were thinking twice about whether it was right to put further money into China. Foreign aid was forthcoming but funds for investment in infrastructure were not occurring fast enough. President Xu had many challenges ahead.
To understand the China we live in today, it is best to begin with a brief history lesson. In 2001, there was much optimism about the future of our country. We were attracting the attention and investment of much of the Western World. We were poised to become members of the World Trade Organisation, to join the world order and to throw off the poverty and difficulties of the previous centuries. So what happened? Well there was certainly change.

Unrest with the centrally controlled economy came to a head in 2003, when one of the three central banks collapsed: the pressure of bad loans to state owned enterprises unable to repay them finally brought the system to its knees. In the same year Jiang Zemin retired and was replaced by Hu Jintao, a weak leader with no distinct power base. Opposition gathered momentum, led by the Class of 77 in Beijing. In 2015 after a loss of confidence in the status quo, Wan Chen, leader of the Chinese Democratic Party (CDP) assumed power with the full support of the Chinese people and the PLA.

The regions of China are now strong, semi-autonomous districts with elected representatives, sitting in regional assemblies. Coastal provinces such as Hong Kong and Shanghai are particularly powerful. These people of the regions elect representatives to the People's Parliament, which sits in the capital, Beijing. Many of the parliamentarians and regional leaders are former generals in the People's Liberation Army. The PLA, now renamed the Chinese Protection Force (CPF), although still a major presence in the country and a prestigious career for young Chinese, is a military, not political force. China maintains strong investment in its military capability, primarily for defensive reasons, to increase worldwide influence and to act as a deterrent against potentially offensive actions from Taiwan, Japan or the US.

Each region has developed a distinctive language, culture and style. Chinese central government recently launched a ‘One China’ campaign in order to give the different regions a sense of nationalism. Wan Chen and his successors still travel the country extolling the virtues of the One Free China, their party’s slogan. This theme, and a culture of self-reliance is echoed in the country’s education system. Children as young as four swear allegiance to the Chinese flag. Despite these efforts, there is growing tension between the regional parliaments and the central government, as the Chinese people get used to democracy and the power it gives them. While the CDP faced no real opposition in its early years, now there is a significant threat from bodies such as the Hong Kong Free Trade Association, campaigning for freedom from the rules of Beijing. There is always an underlying tension that China may call on the PLA to use force to impose its will – something the older generation fear.

The policy of the CDP is that China should not need any other country’s aid whether economic or political in order to succeed. China therefore sits strong and alone in the Asian world; some of the CDP’s opponents fear it is too isolated. China is not a member of the G9 nations and withdrew from the WTO in 2010. Even more dangerously, its Asian counterparts, seeing China’s isolation and military strength, have joined together in an Asian alliance. Many of China’s twelve neighbouring countries view China as a federal state and wonder how long the centre can retain control.

There are high tariffs on imports from abroad. The Government encourages inward investment through favourable tax breaks for businesses. It also provides favourable business conditions for start-ups and for those employing people from their own provinces. The Government still supports the ailing state owned enterprises. China’s economy grows slowly; overall growth rates and the returns on investment are lower than in the West. Some industries lag behind global efficiency standards, as China has no way of gaining the learning. The growth in its economy is accounted for by continued (but reduced) FDI (primarily from Chinese abroad) and migration into the cities from the regions. Each region has developed its own relative competitive advantage, such as insurance, internet and wireless. These businesses trade with neighbouring regions. There is limited international trade in items in which China is not self-sufficient. There is a large black market in the coastal cities for Western music and fashion items such as Levis jeans.

Many young Chinese have seized the opportunity to build businesses in China. There are many examples of successful entrepreneurs. However, there are also a great number of displaced, elderly individuals, who used to work for PLA or for a state-owned enterprise, who find the new order difficult to understand. These people depend on relatives and the brimming mental hospitals for support.
China continues to exploit the environment. Deforestation continues apace. China has set up its own Environmental Council that sets environmental targets for businesses and communities in China. This Council comes under repeated attack in international media and pressure groups such as Greenpeace for its lack of international accountability.

The state has moved out of people’s lives, allowing freedom of expression amongst the affluent upper classes in the major cities. The national theatres, cinemas and arts centres display 90% Chinese material, pervasively taught in schools, and there are several ubiquitous Chinese consumer brands – drinks, fast food and fashion. Each region has its own high circulation newspaper. Foreign newspapers are available, but are priced out of most people’s reach.

There is increased unrest among the sophisticated young of the region’s capital cities. There are often demonstrations and pressure on the regional assemblies to take a greater role in global affairs: both environmental and commercial. There is a growing trend of migration out of the regions into the cities as the rural population faces increased poverty and even starvation levels.

Doing business within China is a relatively smooth process. There are nationally accepted definitions of business practices, including laws that protect and encourage the investors and entrepreneur. Intellectual property rights are recognised and protected. However much of these laws, including accounting practices and litigation are not recognised outside China. Large global brands such as McDonald’s have invested heavily in recruiting local knowledge to enable them to do business. China’s stock market encourages Chinese rather than international investment.

China has invested in roads along the coastal region which make a percentage of the country accessible, both for tourism and logistics and distribution. However, there is still great diversity between the coastal, inland and rural populations.

Wan Chen, the much-praised Class of 77 leader of Chinese democracy reflected on how much things had gone to pot in China. First there was the ousting of his government by a military coup, then there was a response from the people’s front of China, who in turn were dis-empowered by the Chinese People’s Front. It was unclear who held power and, as a result, international relations were not being taken forward at all. New managers were not coming into China – incumbent foreign managers had to adapt to a new economic chaos of bartering, unwritten rules and allegiance switching.

The people of China were worried; mental illness was on the rise - the chaos of life in China had taken its toll. Business leaders had seen large numbers of their working class staff rise up and leave in protest against the neo-capitalist regime.

Social stabilisation was not going to occur in the short-to-medium term. Lifelong savings had been lost and the government were in no position to recapitalise the pensions and social security systems having reached an insurmountable level of public debt. An ageing population, hyper unemployment and excessive urban immigration were causing a significant drag on the Chinese economy at a time when it desperately needed to invest into its primary economic and legal infrastructure. Whilst there were pockets of growth, inflation was escalating.

In the west, this was being reported as the 2nd Asian crisis, but with a sinister twist. China’s build up of its military capability was a source of concern. Within China, the PLA was seeking to detract attention from economic difficulties and to unite the country in a “socio-economic war” with the US. It was setting its sights on an invasion of Taiwan on the one hand and, on the other, was engaged in discussions with rogue states (ex Soviet Union) with a view to possibly invading Siberia for its oil reserves.

Within China however, there were many factions building up. The likelihood of internal split was increasing all the time. There were talks of Hong Kong seeking independence again and there was unrest in the inland regions and western provinces. South Korea was engaged in talks with the US and Japan. Immigration was also increasing, especially amongst the young business elite.
Whilst the Chinese economy was still growing, there were clearly fundamental problems which needed to be addressed. The IMF was poised to jump in and help and, with its introduction, would come a much needed boost to foreign aid to China - but the IMF would not be able to enter the fray until a stable government was in power.

### 8 Implications for Management Consultancy Strategy

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Strategic Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reforms stop or are reversed</td>
<td>The opportunities for a global consulting business in this world are likely to be limited. The strict control exercised by the government will aim to grow and develop the country on its own terms. Much of the mystical, complex and unknowable features of Chinese culture will dominate commercial activity.</td>
</tr>
<tr>
<td>Modest wealth creation through Hong Kong and Taiwan.</td>
<td>Potential clients could be the government, SOEs and national conglomerates competing in the global marketplace through Taiwan and Hong Kong.</td>
</tr>
<tr>
<td>Country is internally focused. Aim is to be largely self-sufficient.</td>
<td>The consultancies that win are likely to be those with a strong presence in Taiwan and Hong Kong who have a deep understanding of the Chinese system. However, this is largely a hostile environment in which to do business.</td>
</tr>
<tr>
<td>Centrally planned &amp; managed, old economy</td>
<td>Strategic options include:</td>
</tr>
<tr>
<td>Banking system controlled by government. Access to capital limited.</td>
<td>• Consider limited entry to Taiwan and Hong Kong.</td>
</tr>
<tr>
<td>Standard of education remains relatively low.</td>
<td>• Exit. The volatility and risks do not outweigh the potential gains.</td>
</tr>
<tr>
<td>Conditions are hostile to foreign investors</td>
<td>• Form alliance with government/global SOE’s.</td>
</tr>
<tr>
<td>SOE’s are old and lack sophistication.</td>
<td>Management consultancy must expand as the Asian Alliance expands. It must consider not only Chinese cities but also potential markets in North Korea, Vietnam and Nepal.</td>
</tr>
<tr>
<td>Hong Kong and Taiwan act as gateways to global markets.</td>
<td>The company must also consider its relationships with other stakeholders in the marketplace, particularly the military.</td>
</tr>
<tr>
<td>Industries progress slowly.</td>
<td>There are opportunities for creating an Asian capability and providing consultancy services to companies looking to expand across borders.</td>
</tr>
</tbody>
</table>

**In the army now**

- There's something about you baby I like

China is a sophisticated player in the global economy.
- Access to capital
- Rule based economy
- Emergence of financial centres in Ulan Bator and Pyongyang

However, there the strength of the military may undermines the free market economy and status quo depends on small group of individuals.

Likely to have poor international relations.
### Living on an island

<table>
<thead>
<tr>
<th>Little international market</th>
<th>A consultancy doing business in this scenario should weigh up investing strategically in the coastal regions with exiting the market altogether. Under no circumstances should it invest in inner China.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Culture of favouring Chinese industries</td>
<td>There will be opportunities to advise privatised industries and growing entrepreneurial businesses within China.</td>
</tr>
<tr>
<td>• Strong Chinese market and disparity between the coastal regions and the rest of China.</td>
<td>Legal and accounting infrastructure make staying less risky than in 2001.</td>
</tr>
<tr>
<td>• A sense of isolation from global business practices</td>
<td>Consultancies that stay must have a strong Chinese accent: Chinese employees, brand name and working practices. This could be achieved through expansion via acquisition of an existing Chinese company or via a joint venture.</td>
</tr>
<tr>
<td>• May be difficult to get money out or to invest Western money in.</td>
<td></td>
</tr>
</tbody>
</table>

However, democracy and nationalism, coupled with the sheer size of the country mean there is a real danger of regions seeking independence, and Beijing enforcing control through the army. These factors and China’s 15 neighbours mean there is also a danger of hostilities between neighbouring countries.

### Rocking all over the world

<table>
<thead>
<tr>
<th>China is a global player</th>
<th>Globalisation and democracy combine to give the consultancy the best opportunity for long term expansion.</th>
</tr>
</thead>
<tbody>
<tr>
<td>• High foreign investment, liquid markets and active venture capitalists</td>
<td>International companies and Chinese companies are likely to be active and requiring advice in mergers &amp; acquisition, diversification, IPO and other corporate restructuring.</td>
</tr>
<tr>
<td>• Good international relations</td>
<td>The company should recruit, expand and invest, moving inland from the coastal regions.</td>
</tr>
<tr>
<td>• Improved infrastructure</td>
<td></td>
</tr>
<tr>
<td>• High growth rates and returns on investment</td>
<td></td>
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<tr>
<td>• Booming urban centres</td>
<td></td>
</tr>
<tr>
<td>• Gap between rich and poor</td>
<td></td>
</tr>
</tbody>
</table>

However, there is always a threat of future instability.

### Collapse of the status quo

9 CONCLUSIONS

Each of the five scenarios brings to life radically different futures for China. This partly analytical, partly creative process takes a long-term view to make real some of the ways in which the forces driving China may inter-react to create different worlds. The exercise provides interesting learning points for the management consultancy whose current China Strategy is based on one fundamental supposition – China’s is the world’s biggest untapped market. The created scenarios demonstrate the pitfalls of this simplistic analysis. It provokes consideration of strategies and contingencies for environments that would be difficult to imagine with conventional strategic planning approaches. Today’s strategy must be based on a tactic that offers flexibility in an uncertain future.

There are common themes running through the scenarios that can be included into today’s strategic plan to provide opportunity in the future with minimal downside risk. The strategic lessons from this exercise of the management consultancy are:

- In each scenario, there is a threat of instability, either from the military within China, opponents within China, international relations or local disputes. The consultancy must always have a credible exit strategy and this may deter companies from ever expanding too far into China within this time horizon.
- The reaction of central Government is critical: companies working in China should keep close relations with Government including efforts to work with SOE’s.
- Success in many of China’s futures will depend on a high level of indigenous knowledge and expertise. The consultancy in China must exploit and tap into this resource by developing strong links with the local community through business and social alliances.
- Consultancies should take a broad view of business opportunities in China. It may be profitable to be in China even if the market does not globalise, capitalising on regional development or Asian alliances.
- The majority of the scenarios consider the coastal regions, particularly Hong Kong, to be key. Consultancies should maintain a foothold in these regions.
- Some factors, which feature highly on the media radar regarding China, do not affect its future over this time horizon, including its human rights record and its environmental behaviour.

By understanding the key drivers that will precipitate change the strategy can include monitoring of key indicators that will provide evidence of how the future is unfolding:

- Relationship between central and local government.
- Relationship between central government and PLA.
- China’s compliance with global initiatives: WTO, Kyoto.
- Increase in opposition from democratic parties – which China feels unable to squash.
- Evolution of China’s relationship based business systems.
10 FIGURE II – LISTING OF CERTAINTIES AND UNCERTAINTIES OF CHINA’S FUTURES

**Environment**

**Certainty**
- Investment in military
- Change will not be easy
- Change in Political leadership
- Diminishing Political Control
- International relations continue
- Environmental awareness
- WTO
- Globalisation

**Uncertainty**
- Law-based economy
- Government debt
- Individualism
- PLA/Centralised/Regionalised/Federalism
- Taiwan, Japan, US, India, Russia
- China’s Sustainability
- “Commons problem”
- Human rights
- Financial capitalisation/liberalisation

**Product**

**Certainty**
- There will be a market for services

**Uncertainty?**
- Education levels/resources -> skills
- What Currency
- Location of delivery
- Domestic market vs. global market
- Business model/marketing
- What Language

**Clients**

**Certainty**
- Shift to Market Economy (need for financial logistics)
- Globalisation

**Uncertainty?**
- Speed of market economy
- Success of market economy
- Speed of investment in infrastructure
- Who/what clients (big or small) (private or public)
- Rate of foreign investment
- Demand side -> market economy?
- Relationship (long vs. short term)
FIG. III: CROSS IMPACT ANALYSIS AND STATISTICAL ANALYSIS
12 General References


13 Notes

i The Economist pg. 25, March 16th 2000.
v The Economist pg. 21, March 23rd 2000.
vi Methodology of Erik R. Larsen, City University Business School from ASLV Lecture 6.