

## *Soaring dragon, busy tigers*



Source: *The Economist*, 27<sup>th</sup> April, 2002, pp 63 - 64

Asian companies and the China challenge

### **HONG KONG**

**The rapid industrial rise of China is the third shock in quick succession to companies in neighbouring economies. How are they adjusting to it?**

1. Its name, Giordano, sounds Italian. Its business model, too, rings western – as a fashion retailer, similar to Gap, Giordano trades largely on its brand name and makes money by maximising “asset turnover” (sales divided by assets) and other management ratios beloved of Harvard Business School. Even its ownership seems Anglo-Saxon; Giordano’s shares are publicly held and no single owner has control. All of which makes Giordano a rarity, for it is Asian.
2. A typical description of a traditional company from Hong Kong, Giordano’s home, or from the other “tiger” economies in East Asia, would be the exact opposite. There would be no concept of branding. The business model would be based not on pushing more sales through fixed assets, but on asset-trading – buying a property or other commodity and selling it for profit at the first opportunity, with no attempt to build a lasting franchise. A founding family would control the firm and run it one transaction at a time.
3. If that business model is now in decline, and gradually being replaced by the one that Giordano espouses, it is thanks to three powerful economic shocks. The first – severe, but nonetheless short – was the financial crisis of 1997. The second – also severe, but now also looking ephemeral – was last year’s collapse in the

region’s western export markets. It is the third shock, the rapid industrialisation of mainland China, that is now proving the biggest, and most lasting, catalyst for change.

4. East Asia’s tigers industrialised in the 1970s, 1980s and early 1990s, when China was just starting to re-enter the world economy after its long Maoist isolation. In those years, tycoons in the tigers could count on two things in their favour. The first was an advantage in labour costs over rich countries, which allowed tiger firms to out-compete their western rivals in manufacturing anything from shoes to ships. The second was predictably rising prices, which made the tycoons’ asset-trading a sure bet. Companies such as Sun Hung Kai, Hong Kong’s largest property developer, and OUB, one of Singapore’s top banks, rose to riches simply by riding inflation.

### **The China comparison**

5. China’s gradual re-entry into the global economy during the 1990s, and its recent acceptance as a member of the World Trade Organisation, mark the end of this phase. The relevant cost comparison in labour-intensive industries is no longer between the tigers and the West, but between China and everybody else – and China, with average manufacturing wages of 60 cents per hour, usually wins hands

down. Moreover, China, with over-capacity in nearly every export sector, is now spreading deflation to the rest of Asia. "The Asian crisis was a one-time shock," says Andy Xie, an economist at Morgan Stanley in Hong Kong. "But China means that the whole region can never return to inflation and mere asset-trading."

**6.** China therefore spells doom for many once-illustrious companies in the tiger economies. Giants such as Formosa Plastics, once a Taiwanese petrochemicals blue chip, or Henderson Land, one of the biggest Hong Kong property developers, have already become mere shadows of the empires they used to be. But others are more nimble. Corporate re-engineering, a fairly new term in East Asia, has begun.

**7.** It comes in three main forms, of which two are easy and opportunistic and one is difficult and far-reaching. The first two are about companies decoupling from their home economies. On the cost side, this means moving factories to mainland China. Already, for instance, over half of the information-technology products of Taiwanese companies are made on the mainland. Acer, Taiwan's best-known computer brand, looks increasingly like a mainland company with a head office in Taipei. The same shift is also happening on the revenue side. South Korea's Samsung Electronics, for instance, is hoping to triple its sales in China to \$7 billion in three years.

**8.** It is the third form of restructuring, however, that is transforming the soul of companies; changing their position in what consultants call the "value chain". Here, China is the catalyst, but the change affects how tiger companies are situated not in China, but in third-country markets or at home.

**9.** Traditionally, tiger companies have been good at "back-end" functions such as trading, production and logistics, reckons Mark Daniell of Bain, a consultancy, and bad at "front-end" stuff such as marketing, design, innovation and packaging. "Now China is the ultimate back-end machine," says Mr Daniell. This forces the tiger companies to build a front end.

**10.** Mostly, this means concentrating on intangibles. Take, for instance, semi-

conductors, a business in which South Korea, Taiwan and Singapore are strong, but into which China is now aggressively moving. What does, say, Taiwan Semiconductor Manufacturing Company, the world's largest non-branded chip maker, sell that China's mushrooming foundries cannot offer? Morris Chang, TSMC's chairman, says that it is "trust", not only in quality but also in the security of a customer's intellectual property.

**11.** The most successful tiger companies often restructure in all three ways. Consider Giordano again. These days, it sources some 90% of its garments from mainland China. The mainland, where Giordano already has 500 outlets, is also the biggest sales contributor. More fundamentally, however, in recent years Giordano has changed its corporate culture to concentrate on such soft skills as inventory management, store layout, service and style.

**12.** The key intangible that China is forcing Asian companies to cultivate, says Peter Lau, Giordano's chief executive, is "differentiation". A shirt, for instance, is a commodity; and Mr Lau thinks that there is no money in competing with mainland China in selling commodities. But take a shirt and turn it into an image (a promise of hipness, say), aim it at a specific customer segment (such as young Filipinos in Hong Kong), and display it to them in the right setting and with enthusiastic service, and you will both have differentiation and a winning business model.

**13.** There is, in other words, nothing mysterious about the effect that China is having on corporate strategy in the rest of East Asia. Companies in the tiger economies are undergoing the same sort of evolution as those in America and Europe once did. Indeed, they probably would have started thinking about differentiation anyway, even if China remained closed to the outside world, says Usha Haley, an expert on Asian business from the University of Tennessee. It is just that now the change is no longer one of ambition to be pursued at leisure, but one of survival, to be started at once.

Source: *The Economist* 27<sup>th</sup> April, 2002.

## **‘Soaring dragon, busy tigers’**

- i. This article is from *The Economist*, a weekly magazine that reports on political and economic developments around the world. Its style of writing is sophisticated, though it does not assume a detailed prior knowledge of economics in its readership. Its headlines are sometimes puns (i.e. “a play on words”). **This headline is referring to a recent film by a Taiwanese-born director. Do you know which film?**
- ii. The article is about the economies of several East Asian countries. Which country do you think ‘dragon’ refers to? Which countries do you think ‘tigers’ refer to?
- iii. If the ‘dragon’ is soaring, how well do you think its economy is doing? What effect is this having on the tigers’ economies?

### **VOCABULARY:**

**assets:** anything owned by a company.

**Fixed assets:** Those assets which are purchased for continued use in manufacture (e.g. land, machinery, etc.).

**Intangible assets:** those assets which, though not visible, add to the earning power of the business, e.g. goodwill, patents, copyrights, etc. (*intangible* [adj.] = sthg. which can’t be touched)

Make sure you know the meaning of the following nouns:

<i>franchise</i>	<i>turnover</i>
<i>firm</i>	<i>revenue</i>
<i>commodity</i>	<i>inflation</i>
<i>tycoon</i>	<i>deflation</i>

### **Questions on text:**

1. What are the key features of Asian versus Western businesses? Write points under each heading, using **NO MORE** than 5 words. (½ mark for each point)

<b>Asian businesses</b>	<b>Western businesses</b>
♦	♦
♦	♦
♦	♦
♦	♦



2. The Giordano company is used as an example in the first three paragraphs. What is it being used as an example of?

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3. Three powerful economic shocks have caused the changes described in the first three paragraphs of the article. List these shocks below in NO MORE THAN 5 words.

**1997:** \_\_\_\_\_

**2001:** \_\_\_\_\_

**Recently:** \_\_\_\_\_

4. The tiger economies' advantages over other economies in the past few decades have been:

i. \_\_\_\_\_

ii. \_\_\_\_\_

5. What change has recently occurred which affects the first advantage (mentioned in Q.4)?

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6. What change has recently occurred which affects the second advantage (mentioned in Q.4)?

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7. Formosa Plastics and Henderson Land (paragraph 6) are examples of what phenomenon? (Answer in your own words.)

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8. What does '*It*' refer to in paragraph 7? \_\_\_\_\_

\_\_\_\_\_

9. What recent changes to costs and revenue have occurred (paragraph 7). Use NO MORE than 5 words in each of your answers:

a) Cost \_\_\_\_\_

b) Revenue: \_\_\_\_\_

10. Summary of paragraphs 8 – 10. *Fill in the gaps with NO MORE than 3 words:*

Economic developments in China are causing a repositioning of the tiger economies in what is known as \_\_\_\_\_. As operational activities such as \_\_\_\_\_ and \_\_\_\_\_ increasingly take place in China, companies with headquarters in places such as Hong Kong and Taiwan, have become increasingly focused on aspects of business such as \_\_\_\_\_ and \_\_\_\_\_. This, in turn, has an effect on these companies' positions in \_\_\_\_\_ or at home. As many of the tiger economies face tough competition from China, they are emphasizing 'intangibles', such as \_\_\_\_\_.

11. What point is being made about China's economic environment, when (in paragraph 10) TSMC's chairman refers to what his company can offer in terms of intellectual property?

\_\_\_\_\_

\_\_\_\_\_

12. '*Sources*' in paragraph 11 is closest in meaning to: (circle correct answer)

- a. produces
- b. origins
- c. finds

13. Explain in your own words the concept of 'differentiation' which is being embraced by companies in the 'tiger' economies:

\_\_\_\_\_

\_\_\_\_\_



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