
For MNCs, Big Decisions About China Are on Ice



By Hellmut Schütte , INSEAD

Western multinationals have put important moves on hold amid political and economic uncertainty.

When China abruptly ended most Covid-19 restrictions in December 2022, hopes were high that the world's second-largest economy would quickly return to its pre-pandemic dynamism. Those hopes were dimmed last week, when then-Premier Li Keqiang announced a 2023 growth target of 5 percent, the lowest since 1991.

It was the latest sign of how much has changed over the last three years. Political winds shifted, Covid-19 struck and Chinese economic growth nosedived. Many in the global business community who had enthusiastically advocated engagement in and with China have lost their voice and are in retreat. In the West today, arguing in favour of China carries reputational risks.

Unsurprisingly, China's latest growth target was greeted with a wave of downbeat Western media coverage that somehow ignores the fact that very few countries – and certainly no large economy – could expect growth on a

similar scale this year. According to a recent [report](#) by McKinsey Global Institute, if [China's economy](#) were to grow by 5 percent between 2021 and 2030, it would expand by the equivalent of the combined GDP of Japan, India and Indonesia in 2021. A lower growth scenario of 2 percent would still add more than the equivalent of India's GDP in 2021.

Perhaps such [forecasts of exceptional growth](#) explain the optimism of expatriate and Chinese top executives working for multinationals in China in recent surveys, despite the deluge of negative, if not hostile, reporting on China in the West and hesitation at their own headquarters.

Positive business sentiment about China, after all, has been the norm rather than the exception for decades. Western multinationals have poured capital and technology into the country since its economic liberalisation in the 1980s and in the initial years of its ascension to the World Trade Organization in 2001. Many have achieved billions of dollars in sales, and surveys of the European and American chambers of commerce in China suggest that profits at their members' China operations have, in many cases, exceeded results at home or in other markets.

Foreign companies had first-mover advantage in bringing products and services into a country in which little demand had existed and where local competitors had limited technologies and management know-how. There were plenty of operational problems to be solved, but older multinationals such as Unilever and Shell drew on their experiences in similar markets around the world. Growth across the board remained high for years even after Chinese companies eventually gained market share or opened new businesses [in the digital realm](#) across many industries.

Not quite business as usual

Despite souring ties between China and the United States in recent years, which have triggered fervent discourse about decoupling and deglobalisation, China's exports and imports of goods have continued to grow significantly and reached an all-time high last year. Neither the bickering nor the high import duties Washington has imposed on Chinese goods have slowed bilateral trade.

Meanwhile, investment flows into China remained robust. Funds from European companies [spiked by 92.2 percent](#) last year, according to data just published by the Chinese Ministry of Commerce. Four German

multinationals – Volkswagen, Mercedes-Benz, BMW and BASF – all first movers with substantial assets in China, continue to dominate European investment flows into the country.

In short, deglobalisation and decoupling do not appear to be an inevitability in the next few years – at least if the business imperative prevails. Yet, the hardening of Western attitudes towards China, a relatively new and unexpected phenomenon, has had a major impact on the leadership at multinationals. Few headquarters are prepared to consider further expansion in China at their next investment committee meeting. Confidence must be restored first. Business loves predictability.

China-plus-one strategy

Multinational corporations are now trying to apply a "China-plus-one" strategy, which calls for developing activities in at least one other country to reduce their dependency on China. Apple and its Taiwanese partner Foxconn, for example, are building up operations in India and Vietnam, though the shift concerns only a very small part of the tech giant's extensive activities in China. Siemens, which derives 13 percent of its sales from China, is likewise looking towards South-east Asia.

Relocating substantial operations is extremely difficult due to smaller local markets, a shortage of skilled workers and weaker ecosystems of suppliers and service providers. In low-skilled and low value-added industries such as shoe and garment manufacturing, relocation from China to lower-cost countries such as Bangladesh has been taking place over many years. This may accelerate as multinationals seek to reduce their reliance on China.

The perennial pursuit of supply chain optimisation now entails diversifying away from China. Whereas costs and logistics used to determine decisions, reliability and trade rules now dominate. Procurement centres have had to acquire legal and political expertise to navigate the changing geopolitical landscape.

Exiting China is not yet publicly discussed. Due to the economic and technological importance of the country and the growing presence of Chinese companies outside their home territory, any such move will have significant implications for a multinational corporation's global market position. The fraught recent departure of Western multinationals from Russia, a much smaller economy than China, points to major strategic and

operational challenges should multinationals also leave China.

In sum, for most Western multinationals, the big decisions on China are on ice. It will take more than a sudden end to zero-Covid lockdowns for that ice to melt.

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