

Case

Grand Social Challenges and Opportunities to Business in China

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Abstract

Since the introduction of economic reform policies in China, private and foreign business has spread throughout the country. Today, the impact can be seen at every level of Chinese society, from reductions in poverty to the sheer scale of the Chinese economy. With the economic developments have come a set of challenges and opportunities unique to conducting business in this market. By breaking down the business environment into the relevant categories of demographics, urbanization, corporate governance and social responsibility, and the natural environment, this case aims to analyze and understand the existing challenges and opportunities, and how they influence those looking to do business in China.

Keywords: Social challenges, corporate governance, environment, China, economic reforms

In 1978, Deng Xiaoping launched the beginning of the Chinese Economic Reforms. What would follow over the next 40 years would be arguably one of the greatest transformations in world history, as China would shift to becoming an economic powerhouse that features the world's second-largest economy. Today's China is nearly unrecognizable compared to the years before Deng assumed power, as the gross domestic product (GDP) per capita has multiplied over 50 times from roughly 183 USD in 1979 to over 10,500 USD in 2020¹.

Arguably, the biggest key to the rapid growth in Chinese development has been the introduction and promotion of both foreign direct investment (FDI) and privatization of business. According to the United Nations Conference on Trade and Development, FDI is "an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy (foreign affiliate)"². This is particularly important in the context of Chinese development because it represents possibly the single biggest change in the policies of the Communist Chinese Party (CCP), moving away from collectivization and state-owned businesses towards a system of privatization and FDI. The results of the new "Open Door Policy" of 1978 were readily apparent, as FDI jumped from an estimated 80,000 USD in 1979 to 57 million USD the next year, reaching a high of 290 billion USD in 2013¹. Alongside the growth in FDI was a noticeable growth within the private sector. Compared to years of collectivism, privatization of business was a resounding success and driver of growth, with the proportion of private sector accounting for above 70% of China's GDP by 2005³.

Even as the current President of the CCP, Xi Jinping, reaffirms the party's commitment to Marxism, global firms taking advantage of free-market concepts have been, and will likely continue to be, the key to China's status

as “the world’s factory” and the subsequent economic success that has brought for the country^{4,5}. With both a workforce and a potential customer base of over 1.4 billion people, it is not a surprise as to why any company would want to conduct business in China. Luckily, due to the development of the Chinese economy post-reforms, it should be easier to take advantage of the Chinese market than ever before, and there are seemingly endless opportunities available. In reality, however, there are also social challenges to understand and appropriately deal with when conducting business in China.

Environmental pollution in China resulted from the country’s rapid urbanization and industrialization, as evidenced by factors such as the country’s continual increase of CO₂ emissions and status as the largest emitter in the world for 14-plus years⁶. Additionally, the country is starting to experience the beginning of a potentially devastating demographic crisis, as the younger population (below the age of 65) is declining, and the elderly population (65 and over) is currently at its largest percentage of the total population in modern Chinese history⁷. While the full impact of the rapidly aging population has yet to be experienced, it does bring forward a set of potential issues for business, such as the availability of a young, quality workforce, a requirement for any business. These issues create challenges and opportunities for doing business in China. Analyzing them can help understand the pros and cons of entering this dynamic market.

Demographics

In the year 2020, China had a population accounting for more than 1.4 billion inhabitants⁸. The population growth rate as of 2020 was 0.26%, and the median age was 38.4 years, with females on average being 39.4 years old and males 37.5 years⁹. The country’s GDP per capita increased from 1,053 USD (in current USD) in 2001 when China decided to join the World Trade Organization to 10,500 USD in 2020 (in current USD)¹⁰.

To combat population growth and to further minimize overpopulation in the 1970s, China integrated the one-child policy, which was introduced in 1979 by Deng Xiaoping shortly before the Chinese population hit 1 billion in 1982^{11,12}. The birthrate in China had peaked in 1965 with 6.39 births per woman. Since 1995, the birthrate has plateaued at around 1.6 births per woman¹³. By 2050, it is predicted that around 32.5% of the population will be above 60 years old^{14,15}. This will be a heavy burden on the economy and the retirement scheme. This imbalance is also visible in the population pyramid of China in 2021, as seen in Figure 1.

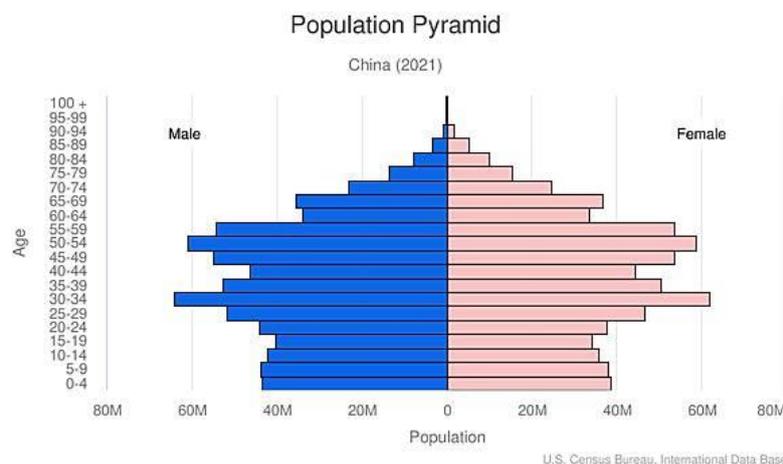


Figure 1. Population Pyramid China¹⁶

Life expectancy in China has increased to 77 years in 2019 from 50 years in 1965¹⁷. Therefore, in 2016, China implemented a regulation that would allow a couple to have two children¹⁸. However, the loosening of regulations did not increase the childbirth rate in China¹³. Hence, in 2021 the Chinese government announced that Chinese couples are allowed to conceive three children¹⁹. However, the pressure on the younger Chinese to be able to provide for their family and parents who are aging is huge²⁰. Moreover, living expenses, available childcare opportunities, and economic factors oftentimes play a crucial role in the process of decision-making²⁰. Therefore, the Chinese are not deciding to have more children as of 2021.

Additionally, the one-child policy has shifted the gender balance²¹. Whilst the gender balance before the one-child policy was equitable, proven by the estimated sex ratio in 2020 for 55-64-year-olds with 1.02 males/female²². The impact of the one-child policy and the gender balance is especially visible for 15-24-year-olds with 1.17 males/female²². The one-child policy had already been relaxed in the 1980s in more rural areas if the firstborn was a girl²³. It was considered favorable for a family to have a male descendant to be the family heir, but biological nature increases the imbalance further²⁴. Furthermore, outside of the city, farmers were in need, and labor capital was invaluable²⁵. Changing gender roles in cities have resulted in more females focusing on career and living independently, or not wanting to have children^{26,27}. Additionally, with China's gender ratio there are comparably fewer females to reproduce²⁸.

Moreover, the actual age of retirement in China is 50 for women and 60 for men²⁹. Women, who work in the public sector, can postpone their retirement to the age of 55²⁹. The retirement ages have not been updated since their introduction in the 1950s when life expectancy was much lower³⁰. Nevertheless, the aging population ratio was higher in rural areas with 10% in 2010 compared to 7.8% in urban areas, which suggests that the population migration in China has been focusing on the workforce and has not included the elderly equally³¹. The retirement age will be increased progressively and steadily to accommodate for this demographic change^{32,33}.

China faces issues of overpopulation, an aging population, and repercussions from the one-child policy, including the growing gender imbalance in the workforce. These demographic changes provide challenges for businesses. Female dominant jobs need to increase their focus on attracting male contestants to counteract the gender imbalance in society and expand the pool of potential employees. Moreover, some men may be unhappy due to personal challenges, specifically with being single if they desire to have a family. Therefore, providing attractive benefits at work will support their mental health and their productiveness and desire to be at work. Additionally, the aging population will need to be integrated into the workforce. With an increasing retirement age, company structures need to make sure to provide opportunities to keep the elderly included in the workforce without reducing the company's productivity. As the Chinese government incentivizes family planning for two or even three children, women will need to take time off for childbirth. Thus, companies need to provide flexible structures to accommodate family planning. If the birth rate should increase again in the future, the Chinese economy will have to accommodate for a decrease in a workforce that has experience but is still rather young.

Nonetheless, the above challenges also provide opportunities for businesses. Even though the population is aging, China still has a huge workforce compared to other economies. Even though the GDP and therefore the wage of workers has increased, the workforce is still comparably low-cost. To increase the attractiveness for a workforce, a company can consider offering free or subsidized childcare opportunities. This would alleviate the stress of employees and at the same time be an incredible benefit where childcare is expensive and options scarce. Whilst the increasing retirement age can be considered a challenge, it can also provide an opportunity. Firstly, this increases the workforce that could be employed, and secondly, they have gained experience throughout their career. Moreover, a company could provide additional income to pensioners to capitalize on this age group. With an increasing life expectancy, companies need to cater to the needs of ageing people. Employing the target group will help in the innovation process for products and services. The overpopulation of China can also provide opportunities for innovations in housing, food, or commodities and perhaps establish new industries and market niches.

Education

The school system is managed centrally by the Ministry of Education³⁴. Before writing the national entrance exam, students have six years of elementary school and six years of secondary school³⁵. Additionally, children attend day care for three years before starting elementary school³⁵.

In 2005, elementary school was completed by 95% and secondary school by more than half of the students³⁴. 21% of students continued to complete higher education at the university³⁴. Hence, the literacy rate is very high with 96.8% of the total population, though slightly higher for males than females²². Education provides an opportunity to move up in social class, which explains why families focus on investing in their children's education³⁶.

Tsinghua University and Peking University rank among the top 50 according to the Times Higher Education World University Ranking of 2020-2021³⁷. Overall, China has a highly educated workforce that currently is still

comparably low-cost. Moreover, the focus on education and the increase of quality have supported the development of the Chinese economy. Nonetheless, the education provided in China will further increase the price of labor and will decrease China's comparative advantage that fueled its economic success. Hence, China needs to provide more capital-intensive jobs and move away from a labor-intensive workforce.

Urbanization

Although only the third biggest country in the world in terms of landmass, China ranks first in the total world population ranking. The density of the population in China is 153 per km², and around 63% of the population live in urban areas^{38,39}. China set up an urbanization plan for the country during 2014-2020 to expand and create cities. The urbanization strategy in China aimed to create a better living situation for the population and have positive environmental and social effects. The final goal was to expand the urbanization percentage of China from around 50% in 2014 to 60% in 2020. For migrants from rural areas to cities, there were fewer social benefits earlier. This gap in treatment was removed by the Chinese government, which led to an increase in migration to cities, resulting in an urbanization rate above 60% in 2020³⁹.

For businesses in China, the past and the new urbanization strategies bring social challenges, but also opportunities that needed to be taken into consideration. Increased urbanization leads to increase of environmental harm through construction and transport for example. While the air pollution in cities rises and natural resources shrink, it is important for a responsible business with to consider, if there are more environment-friendly strategies to urbanization³⁸. In the rapid rise in urbanization, many cities grew without a good planning of infrastructure expansion to satisfy the basic needs of inhabitants⁴⁰. For businesses, it is difficult to have offices in a city in which employees cannot comfortably commute due to issues of infrastructure. Another challenge could be the health of employees. Cities cause stress to their inhabitants because of traffic, work, and the lack of natural spaces. Businesses need to take action when for the well-being of their employees. Lastly, urbanization also increases poverty, and some people can end up being homeless due to exorbitantly high rents and challenges in finding suitable jobs, as the competition for workplaces is high⁴¹. For businesses, high rents and the lack of land and space can also be a challenge because expansions might be expensive or not possible.

Even though there are some challenges to consider, urbanization is also an opportunity for businesses investing in China. The large population bears a potential that is not realized fully yet. Urbanization has also brought economic and social benefits⁴². The rise of education is one of the aspects that benefit companies in China. China and its cities are therefore becoming a place where businesses want to locate part of their production or administration through high-quality labour that is relatively cheap in comparison to other countries with that level of education⁴⁰. Improved living conditions also need to be mentioned. Next to better educational facilities, there is also better access to modern housing, healthcare, or more recreational activities for inhabitants. People from urban areas have access to the internet in China, which makes it easier for them to take opportunities. Although there are increasing mental health problems of employees in urban areas through high stress levels, higher living standards will also lead to happiness if the work-life balance is managed well⁴³. Urbanization also means driving the market demand and increasing the capita consumption per inhabitant⁴³. Local businesses have therefore more opportunities in increasing the sales of consumptions goods. In addition, with the increase of per capita consumption, the GDP of China also rose through urbanization and is now at 14.7 trillion USD³⁸. Moreover, the diversification of the economy will lead to increased innovation potential and a broader supply of goods. Additionally, urbanization will enable businesses in the cities to only hire the best employees suitable for one job, as the more educated people are more likely to move to cities for better opportunities⁴⁴. Finally, the economies of scale favours urbanization in China. Through better infrastructure and higher demand, companies will continue to benefit from economies of scale and therefore stay competitive within their business segment⁴⁵.

Although there are some grand social challenges that China needs to face because of its past strategies to urbanize the country, urbanization is a good step for China to increase the living standards of inhabitants. For the past years, China put quantity over quality, which caused some damage to the environment. China has the opportunity to change its past mistakes and continue to grow its cities and infrastructure sustainably, which Beijing is keen to do. For companies, the business environment in Chinese cities is good now. The business environment will become even better when work-life balance and environmental issues will be improved.

Corporate Governance and Social Responsibility

Corporate governance is about people, purpose, process, and performance. People come first. They are the board of directors, stakeholders, and consumers. Each individual contributes to the development of the purpose, and the purpose is realized through the process. Processes change over time to adapt to the purpose as systems and environments change. Performance is a key determining factor for each company. Continuing to ask questions of how things can be more effective and efficient will be crucial to the growth and achievement of the purpose.^{46,47,48}

When good corporate governance is in place, it allows ethical decisions to be made for the benefit of everyone involved. A socially responsible company can empower the image and build its brand in that social responsibility programs boost employee morale and lead to high productivity.^{46,47} Investing in your company's tools, training and technology shows a commitment and ethical responsibility clear to the people. Being able to generate positivity for an organization publicly through mainstream media and social media allows positive recognition. Consumer appeal can increase when customers feel that the efforts of a company are charitable. The direct link to purchase and donation allows the consumer to feel as if they are contributing to the greater good, creating a connection and brand loyalty to the company. Finally, employee retention is a direct tie to the company's core values when applying for a job. Such values allow employees to feel like their purpose is greater⁴⁹.

Social challenges in today's world of business are surrounded by consumers' concerns of not only the product and service provided. Consumers are interested in the policies and ethical standards that companies practice. As the social and environmental issues become more prominent, consumers are willing to take their money elsewhere if companies do not have a well-developed or even absent standpoint. China sets standards when it comes to consumer social responsibility practices. The opportunities for China are endless as they are a fast-growing and well-developed economy. China's reputation is seen as underpaid labour and very cheap product quality. This reputation is coming to a halt when Chinese companies are trying to remain competitive in the global market. For them to do so they must socially embrace not only the environment but also the alignment of their practices and viewpoints with their consumers, who are more cautious and concerned today about environmental and social issues. For China, implementing corporate social responsibility can lead to a more sustainable competitive advantage.^{50, 51, 53, 54}

China has taken steps to improve its corporate social responsibility. Obstacles such as public influence, green energy superpower, and government policies need to be addressed to move forward with an international standard of corporate governance. Challenges will arise, as standards will change over time. The ability for Chinese companies to influence their consumers and build a loyal relationship with them will depend on their continual efforts in improving their corporate social responsibility policies⁴⁸.

Environment

More than forty years ago, China began to open up its economy. As millions of Chinese now belong to the middle class, their awareness of the environment has grown. As a result, they now demand good air, clean water, and more sustainability⁵⁵. The years of economic boom and globalization have resulted in strong growth for China, but also immense environmental problems. Recently, the government has declared war on smog, water pollution, and social injustices. The new path towards more sustainability in China also opens up opportunities for foreign companies⁵⁶.

Chinese foreign trade frequently surpasses experts' forecasts with its growth rates. China's contributions to the global economy are undeniable, but the environment is also paying a price because of the economic boom⁵⁷. The situation concerning water and soil is not good. China suffers from an unequal distribution of water as 80% of the resources is located in the south but every second Chinese lives in the north^{58,59}. In addition, according to estimates, 85% of central urban waterways is polluted⁵⁹. Furthermore, the condition of soil and grounds is equally drastic. According to the Food and Agriculture Organization of the United Nation (FAO), one-fifth of agricultural land is contaminated. Other sources estimate that 12 million tons of contaminated grain must be destroyed each year. Experts from the website China Dialogue put the losses for agriculture at 20 billion yuan, which is equivalent to more than three billion US Dollars.^{58,59}

The government is aware that it must offer its citizens improved environmental conditions, as increasing wealth is transforming the preferences and consumer behavior of the Chinese. They long for a healthier life and want to spare their children better conditions⁶⁰. To achieve this, China has embraced environmental protection and sustainability, and it is tackling its ecological challenges with determination⁶¹. Examples are proving that China is

indeed looking for new solutions to old problems. In 2017, for instance, the Chinese government gave an order to close factories and power plants for several months in the Hebei province, an industrial region with a population of 90 million. By May 2018, according to the directive, nearly 4,000 of the more than 7,000 local companies were to halt production⁶². In addition, the Chinese government committed to obligatory climate protection objectives, strived to reduce its CO₂ emissions by 65 percent by the year 2030, and approved the Paris Climate Agreement^{63,64}.

During a speech to the United Nations, President Xi Jinping, China's head of state, issued a target of reaching peak CO₂ emissions before 2030. In other words, this means that emissions are to be reduced from 2030 onwards. Indeed, China aims to be a climate-neutral Republic from 2060 forward. The environment was already an issue in the 2016 five-year plan. However, now official objectives have been set. This means that the 14th Five-Year Plan in 2021 and the one after that will need to lay a decisive foundation for these goals, especially when it comes to the consumption of coal^{63,65}. The current Five-Year Plan states that green production and lifestyles are to be promoted on a broad basis. At the same time, however, oil and gas production is being supported with new pipelines⁶⁵.

Conclusion

As with any developing country, China has created and worked towards obtaining status as a developed nation, along with economic and social benefits that are brought to the population. The unforeseen success in economic development has undoubtedly improved the lives of millions of Chinese citizens in incalculable ways. However, as with any major development, there have been also disadvantages.

While industrialization has created the opportunity for businesses to reach new heights in China, the ensuing urbanization plans have also led to many poor citizens due to factors beyond their control, such as rising rent prices or lack of access to higher education. Furthermore, the speed at which cities have grown throughout China has led to questionable infrastructure developments, something that is not conducive to business or public health. While these issues must be accounted for, the fact that they exist offers a series of opportunities as well. Increased urbanization, when properly managed, will certainly lead to increased access to education and healthcare, increased wages, and most importantly for businesses, to more consumption and purchasing power from the people. A company offering education or healthcare opportunities for its employees would certainly gain an advantage against competition and simultaneously increase the social opportunities for the people of China.

Another major hurdle for those looking to operate in China is the legacy of corporate governance and corporate social responsibility in the country. For both domestic Chinese and foreign companies to stay competitive in the global market, they must embrace proper corporate governance. As international public perception is beginning to push back against companies participating in ethical "grey areas," change will be necessary for companies looking to retain their consumer's goodwill. This will spur positive growth for the business environment in China, one in which companies will operate more in line with the traditional business ethics found in most developed nations.

Finally, a key challenge facing China today is the protection of the environment from the side effects of business. As waterways are choked by pollution and the air quality in much of China ranks among the worst in the world, the country is facing a crossroads. Continuing to follow the path of the last 40 years will likely see irreparable damage to the nation's environments. The other option is to embrace environmentalism and sustainability, which is more popular than ever before both in and outside of China. CCP has publicly embraced the fight against environmental destruction, with President Xi Jinping reaffirming its commitment to protecting the environment. In reality, however, this has hardly slowed the emissions produced by the "world's factory." While it is a promising sign to see the government pledging action, it will also take a commitment from companies operating within the country to operate at a sustainable level. By doing so, they can operate cleanly and contribute to the ecological health of the planet. As China invests in the production and implementation of green energy, the opportunity to contribute to the ever-important field of "green technology" arises, which is an opportunity not just for proper environmentalism but also for companies looking to take advantage of a growing field and reap the profits.

Combined, these fields represent just a few of the many aspects that are influencing business in China. While it may often be the easiest to focus on the challenges, the opportunities in the country present incredible potential that is waiting to be unlocked. The balancing act between overcoming these challenges and embracing the opportunities is what is likely to define the Chinese business environment in the near future.

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