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China needs entrepreneurs more than they need the Communist party

By Henny Sender Author alerts

Private sector one of most encouraging signs in China today

It was only in 2002 that the Chinese Communist party got around to deciding that it would no longer discriminate against private entrepreneurs and would instead embrace them, given their contribution to the country's economic development.

Twelve years later, Jack Ma, the diminutive founder of Alibaba, the Chinese internet and ecommerce giant, has engineered the biggest stock offer ever, raising $25bn in the process. The listing led the China Daily to quote Chinese business school professors proclaiming "the end of US dominance in the world technology sector".

That may or not be the case, but the rise of the private sector, as chronicled in scholar Nick Lardy's latest book, *From Mao to the Markets*, is one of the most encouraging signs in China today – especially the internet firms.

Entrepreneurs such as Mr Ma are transforming the economic landscape of China, generating jobs and making the country a far fairer place in the process.

The rise of impressive private entrepreneurs will change the investment landscape as well, giving investors an alternative between bureaucratic state-owned enterprises whose interest is often not aligned with profit-seeking shareholders and a host of get-rich-quick founders who should never have been allowed to list in the first place.

That is especially the case at this moment, given both macro and micro uncertainties. It is not clear, moreover, what to hope for: whether the bigger danger for China's economy today lies in fast growth or slow growth, given the need to rebalance away from the old investment-led model to a more domestic consumption-driven template.

Recent data have been very confusing. The growth in credit was unexpectedly weak in July, but recovered in August. Exports were strong, according to the latest numbers, but imports were weak, particularly for industrial metals such as steel, leading to an almost $50bn trade surplus. Producer price deflation continues. Retail sales are strong but housing data remain far from robust.

Capital inflows for the first quarter of 2014 totalled some $127bn but dropped to only $10bn in the second quarter and reversed. Outflows amounted to a combined $21bn in June and July, according to data from Bank of America Merrill Lynch.

Meanwhile, the anti-corruption drive continues to have a suppressant effect on everything from the price of a luxury hotel room to shark fin soup.

Still, a strong economy has never been particularly portentous for stock market or private equity investors. Today, there are several keys to how to get China right, whatever the strength of GDP figures. These include piggybacking on a combination of select government policies such as a clean environment and clean energy, and macro trends such as the rise of the middle class in China (rather than the sliver of the most wealthy section of the population – especially today).

In the new China, it also seems increasingly wise to look to the private sector rather than to state-owned enterprises.

That is because in most cases, despite all their traditional privileges, the profitability of the state-owned entities, whether industrial or financial, is only going down as they are increasingly and unexpectedly marginalised by different kinds of rivals, as enterprises from China Mobile to the state-owned banks can testify, in the face of companies like Tencent and Alibaba.

In the recent past, many investors backed princelings directly or looked to put money to work with funds in which princelings were involved. That is a tempting but risky strategy. A princeling-related fund will get wonderful deals that may not be available to anyone else, such as Boyu Capital's Sunrise duty free shopping deal. But at the same time, a private equity fund associated with the family of Wen Jiabao has become much less active with a new regime in power.

It is much better and safer to invest with entrepreneurs than with princelings. That is partly because today's princeling may well be tomorrow's scapegoat. It is also because the Communist Party needs entrepreneurs and has begun to treasure them. To some extent, they need the party too and many entrepreneurs in China today are members of the Communist party.

But these days the party needs the entrepreneurs more than they need the party. At the moment, that is one of the most hopeful things about China.

henny.sender@ft.com

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