China for China: How MNCs Are Rewriting Their Playbooks

Updated 23 March 2026

[00:00:00] Steve Odland: Welcome to C-Suite Perspectives, a signature series by the conference board. I'm Steve Lin from the conference board and the host of this podcast series, and in today's conversation we're gonna discuss the latest situation in China, and specifically [00:00:15] what companies who are trying to do business there are facing today.

Joining me is David Hoffman, the senior advisor and the China Center leader for the conference board. David, welcome.

[00:00:27] David Hoffman: It's great to be here, Steve. [00:00:30]

[00:00:30] Steve Odland: So David, you've been in and around China for decades and you lead our China center in Beijing. And uh, just for our listeners, if anyone wants to hear more about the China Center and membership and that and all of that stuff, just contact.[00:00:45]

David directly via email. Um, but we've been, David, you've been, uh, developing insights, uh, about China and how businesses can do, particularly Western businesses, can do business in China. Talk to us [00:01:00] about the state of play in China today versus where it's been in the past.

[00:01:05] David Hoffman: Yeah, thank you Steve. Um, you know, in fact I just returned from China last night.

I've been there the last three weeks in both [00:01:15] Beijing and Shanghai, and, um. You know, for, for the listeners, um, it, it may help to recount our, the China Center setup in 2006, that's when a group of 10 of our trustees got together [00:01:30] and decided that China was big, important, mysterious, risky, innovative. Um, inscrutable, risky, all these things, and that the chi, that the conference board should have a presence there on the [00:01:45] ground to study the economy, to study the business environment and inform them with the facts they need to needed to succeed.

So we've always had an orientation of helping. Foreign companies, our members, uh, understand the business [00:02:00] environment there. And today, the business environment is, um, is complex. You know, on one hand you've got a slowing growth trajectory. China's going through a structural shift in, in, its in its growth model.[00:02:15]

Relying on very heavy investment and now trying to transition more to a, you know, a knowledge based, services based and consumption based economic model. And, and that's not easy. Uh, you've got [00:02:30] the rise of competition. Uh, Chinese competition, which have really improved their capabilities along design and quality dimensions.

Um, and we can talk more about Chinese competition and, and what it means [00:02:45] because, um, we think it means big things both in China and globally. Uh, you've also got a policy agenda that's sort of trending in an un marketized way. And what I mean by that is. There's more of a [00:03:00] heavy hand on planning and industrial plans than there is on market forces.

And you know, our Western businesses, American businesses, our members are very market driven. So when they have to kind of contend with [00:03:15] state. Influences, it can make things difficult. And of course, you've got the geopolitical issues. Those are sort of the downward pressures on the upside. You've got a su, you know, a supply base in China that [00:03:30] is just, um, astonishingly broad and diverse and capable.

Um, highly innovative where innovations cycles from sort of rapid prototyping to mock-ups [00:03:45] and finished products are, are just unbelievably fast and competitive. Uh, you've also got, even though the, the, the. Policy environment is, as I mentioned, unfavorable in a way. And so far as it's not [00:04:00] really oriented towards reform and marketization, it is very stable.

And I, I say that, uh, you know, with a grin, because I would argue that probably China and [00:04:15] Singapore are maybe the two. Countries in the world where all the policy environments are stable. And you've said many times before, Steve, that what businesses really like is a stable environment. Even if, if the [00:04:30] environment is less favorable than they, like, stability is something they can manage.

Um, so you've got a big market, a slowing market, an innovative market. An increasingly competitive market and, um, you know, [00:04:45] external issues to deal with as well. But I would argue that China remains just as essential as ever. Even, even more so, um, not just as a big market that our members, uh, you know, need to support their [00:05:00] scale and global competitiveness, but increasingly as an innovative base.

[00:05:05] Steve Odland: Yeah. And you know, when you think about doing business in

China, there's China for China, and then there's doing business in China really as part of a supply chain [00:05:15] to supply businesses outside of China. You just talked about primarily, um, the situation for businesses doing business in China. Just just talk a little bit about the opposite, you know, what, what the, what's the supply chain [00:05:30] environment like in order to, in order to supply businesses outside of China.

[00:05:35] David Hoffman: Well, the supply chain is incredibly competitive and, and. You really need to appreciate the sort of [00:05:45] end-to-end ecosystem components of the supply chain across almost every category, Steve, and all supported by very modern, very large scale infrastructure. So [00:06:00] China's competitiveness as a manufacturing base is not diminishing.

Secondly, they are not abandoning the lower end segments of the value chain of the production chain, [00:06:15] even as they move overseas. And this is unusual because Western companies, when we began to, um, produce in China, we often engaged with suppliers on a subcontract. [00:06:30] Basis. China is not doing that. They're actually replicating their supply chains overseas.

So you've got kind of end-to-end control and, and that poses a real challenge [00:06:45] from a geopolitical and geopolitical competition standpoint. But from a. From a producer standpoint, if you are actually producing in China, the products are globally competitive. And [00:07:00] you can see this in China's export numbers, which have been Unfathomably strong.

Um. During COVID and since COVID and in fact, so strong that China accrued a 1.2 trillion US [00:07:15] dollar, um, export, um, surplus or trade surplus last year. And if anything. China's export competitiveness. So if you say, say our members go there and, and, and buy stuff or procure stuff, [00:07:30] it's very, very competitive.

But it's becoming a big problem in terms of balance of trade arrangements around the world and the US. Government has, has raised barriers to, to Chinese exports. Europe has, [00:07:45] has imposed some and is considering more, and we expect trade defense measures to rise around the world because they just can't handle these imbalances.

So back to your question, it's a great market to procure and produce and export [00:08:00] from, but. It's so great at it that it's running these trade surplus, trade surpluses that are unsustainable and, you know, something's gotta give. Uh, we don't know when, but, uh, soon, I would reckon.

[00:08:13] Steve Odland: Now, you know, there's, there [00:08:15] are geopolitical tensions and we're gonna talk about that in a minute.

But how is it, you know, you've been, there, you is just spent three weeks there, but you go, you're, you're there every month. How is it for Westerners in China today? I mean, for, you know, initially, you know what it was [00:08:30] it 50, 60 years ago it was closed. Then it kind of opened and it was a little tense and gradually it warmed, and then it was kind of like very friendly.

It was like anywhere else in the world, but it seems to have chilled again. So, are Westerners welcome in China to do business [00:08:45] or is it, is it uncomfortable?

[00:08:48] David Hoffman: No, absolutely. Uh, not. It's actually very comfortable. Very friendly. Very welcoming. Welcoming. Probably a lot, a [00:09:00] lot more efficient than the last time you, you've been there, Steve.

You know, things have gotten really smooth and easy, whether it's, you know, booking a car, getting in from the air. Everything is, is smooth and easy. Um, but the people are [00:09:15] very friendly and, um. You know, I think, um, the, you know, the environment is, is very enjoyable. Air quality has improved. Um, you know, all sorts of things are, are, are net positive.

One thing I [00:09:30] would say though is that since COVID, um, when a lot of expatriates left China due to various, um. Issues like, like they did around the world. [00:09:45] Um, there's a lot fewer westerners there now. It feels a lot like it did to me when I first went there as a, a young expert in a joint venture graduate school in 1985 and, um.

There are fewer, [00:10:00] and I would say China is kind of de westernizing. It used to be you could find lots of, uh, western restaurants and, and, and, and western pubs and things like that. There are, there are still, there are still some there, but there are [00:10:15] fewer. And, um, the de westernization is on, on the one hand, sort of offset by a, by a, by a real revival.

Or, or, or burgeoning. Chinese cultural [00:10:30] sector. So there's a lot to do and it's very interesting and, um, but it's changing, you know, it's changing and it, it could be that we see a, a, a influx of expats once again, and we see kind of the, you know, the [00:10:45] western culture things re-emerging in China. I don't think it has anything to do with anti westernism, it's just that there are fewer westerners there, so, you know.

Restaurateurs and hospitality venues aren't [00:11:00] catering as much to, you know, the Western taste as they once did. But top line, very friendly, uh, very accessible and, um, extremely interesting.

[00:11:12] Steve Odland: And of course you've got the geopolitical, uh, [00:11:15] overlay to all of this, which, which does create some tension between the west and.

China doing business there. Um, even though what you've said is that the environment is friendly, the, you know, the, there are the tensions between, there are [00:11:30] trade tensions, as you said, between China and the West, but, um, but there are also tensions, uh, around, you know, military dominance who's gonna control the South China Sea.

And the situation in Taiwan, just talk [00:11:45] about that overlay. We're, you know, we're not political at the conference board, so we don't get into that element of it. But, uh, just in the context of doing business there, how do all of these tensions play?

[00:11:56] David Hoffman: Yeah, so. The tensions [00:12:00] raise a lot of risks and uncertainty at kind of a global level, and we've been doing a lot of work with members to help them understand and contextualize and plan for these risks.

We have a [00:12:15] couple different models that we've developed a, a, a gray swan planning tool to add nuance to, um. Planning, uh, scenario planning exercise and what we call a bottoms up or, um, impacts based approach [00:12:30] to geopolitical risk management. So there are ways to manage these risks, but I wouldn't say our members think about these day to day at a business level.

They're really focused on developing [00:12:45] the chi, their China business, and in this kind of. Bipolar or polarizing or multipolar world that we now live in fraught with geopolitical risk, which looks [00:13:00] like, I mean, my assumption would be that this is going to be the state of the world for some time to come. The playbook is really that, that companies should over overinvest in resilience.

Localize operations to the [00:13:15] deepest level possible in each country or region they play in so as to insulate themselves from external geopolitical risks. And that's what we refer to when we say China for China and our members. So any company, [00:13:30] any large western company, European American or Asian company that's committed to China and the China market.

Because it's important to them for, for various reasons, has has now moved down a China for China track that [00:13:45] sees them becoming more and more localized. China is becoming a more and more divergent market. It's, it stack is almost entirely different from what we use in America and Europe. And, and companies are [00:14:00] needing to address that, that that changing environment.

And I think the best way to think of it is, you know what, what, what companies have done in Japan, I think you, you've worked in, in Japan before, you know how different the business environment is. And [00:14:15] you know, any American company that has a large presence in Japan, their Japan operation will look very different.

Than their, their home country operation. And that's how China is becoming. So geopolitical risks are real. [00:14:30] Um, companies are doing the best they can to plan for downsides, um, if they happen. And in the meantime, they're trying to ring fence and build resilience around their China businesses by [00:14:45] making them less connected to.

You know, global influence is either supply chains or there are other things so that the businesses are are protected.

[00:14:56] Steve Odland: We're talking about the business environment today for [00:15:00] Westerners in China. We're gonna take a short break and be right back.

Welcome back to C-Suite Perspectives. I'm your host, Steve Lin from the conference board.

And I'm joined today by David Hoffman, who is the senior advisor and the leader of the [00:15:15] conference boards China Center in Beijing. So David, we, um, we were talking about geopolitics and trade largely, you know, before the break, you know, let's talk about what's happening in China. You, you mentioned in your introductory comments, but.[00:15:30]

Growth, Chinese growth, GDP, consumption, all of that is slowing you, you've said that and

[00:15:37] David Hoffman: Right.

[00:15:38] Steve Odland: You know, we've talked for several years about the real estate market and how that has impacted it. That's not intuitive to people. How does [00:15:45] that, how does this, the slowing nature of, uh, of, of how does the lowering growth in GDP and, and the real estate environment impact doing business in China?

[00:15:57] David Hoffman: Well, you know, real estate, [00:16:00] um, still has farther to go down in China. It peaked in 2021. Prices are down about 40% off their peak, and I reckon it can still go down further [00:16:15] that has. Consumer pocketbooks hard in China because, um, in China, households put very significant down payments down on their, on their properties, much more so than, than [00:16:30] we do here in, in the us And that that means that that's good for the banks, but it does mean that Chinese households bear.

The capital risk for the Chinese real estate sector, and, um, that's a problem. So, [00:16:45] um, a declining market, the decline of real estate as a, as an investment asset that was appreciating strongly, all of this drags on consumption, but more importantly, Steve, it drags on investment [00:17:00] so. China has been an investment, uh, driven economy for some 45 years.

It's the long, has had the longest running investment led growth cycle in contemporary history. The closest equivalent here [00:17:15] was South Korea, I believe, at 28 years, and usually after a long period of time. Um. Of, of an and of investment cycle, the returns on investment become too low, [00:17:30] um, or, or the investment becomes so inefficient that, um, it, it's costing more to invest in it.

Then, then you're getting back as to the aggregate economy, that there's a, an adjustment and you begin to see investment. [00:17:45] Drop and real estate investment upstream by developers in new projects has really fallen off a cliff, and that has put a huge hole in Chinese aggregate investment. They're trying to fill it with [00:18:00] manufacturing and infrastructure, but the hole is too big, and that is what is bringing growth down.

So that's kind of how the, the two relate. But on the consumption side. China has, um, [00:18:15] tremendous potential to, to further develop its consumer markets. Um, they need to undertake structural reforms in order to do this. The net net is that Chinese households in aggregate. [00:18:30] Don't have enough money to spend. So it's not impoverished.

We're not talking about a, a poor society, but the average Chinese household has very little discretionary, uh, income to spend on. [00:18:45] Consumer products. Uh, it does have a large cohort of wealthy, uh, uh, families and wealthy individuals, but they're, you know, at best nine to 12% of the total population. That's still huge.

We're talking [00:19:00] 200 million wealthy people there. At the aggregate level, the large bulk of Chinese people, you know, aren't poor, but they also don't have pocketbooks that extend much beyond basic [00:19:15] lifestyle needs. So reforms are required there that would lift. Income, um, through, you know, topping up pensions and, and also, you know, more progressive tax schemes and [00:19:30] other things.

And, um, China has been unwilling so far to do this, and that's kind of a separate topic. We could go down a real rabbit hole there, but, uh,

[00:19:38] Steve Odland: yeah.

[00:19:39] David Hoffman: Yeah,

[00:19:40] Steve Odland: yeah. So just a couple follow ups, this, this whole notion of real estate. [00:19:45] Is, uh, is very complex. You, I, you, you did a really nice job e explaining it, but you know, there there are, there's residential real estate and there's commercial real estate.

Both of 'em are, are underwater. Um, but, but your point about the down payment is really important because, you know, in the [00:20:00] US if you put down 15%, um, you, you know, and then a lot of that, a lot of times that's insured it, it's not that it's not that much money that you put down, but when you're putting down 30%.

The first 30% decline is your money, is the, is [00:20:15] the, is the consumer or the buyer's money, and that's what's happening. So they feel poor, number one and number two, they, they really can't move because they're underwater on their, on their homes. And that's the how, that's the home side. The commercial side is the same thing.

They way overbuilt [00:20:30] and way over invested. Now those, you've got buildings that are, that are just empty. And so that's all stranded. Cash. So everything's kind of seized up here, uh, a little bit. And so it's almost a miracle that their GDP [00:20:45] is still projected to grow at 4.5% versus five. I mean, you would think, given what you've described there would be, you know, a three, 400 basis point hit, but it's, it's 50 ba you know, it, it's 50 basis points.

[00:20:59] David Hoffman: Well, [00:21:00] you know, China has. So, so they have the ability on a, what we would call a administrative level to just kind of suspend these problems. So in the US if [00:21:15] a, if a sector like real estate collapses, the way China has it would begin to transmit to other. Institutions or sectors of the economy that had linkage to them.

The Chinese authorities [00:21:30] can kind of go in there and sort of su suspend everything. So they don't, they don't experience Lehman moments, uh, per se, as, as, as, as western economies do. And that means that the. The nature of the [00:21:45] crisis is not sort of sudden seizure correction and then a, you know, a a period of pain, a, a recession and, and then a recovery instead, it, it manifests in stagnation.

Slow stagnation. Yeah. So [00:22:00] that's what you feel there. Um, and again, the Chinese numbers, what they're projecting to do, you know, with net exports as strong as they are, toggling infrastructure, um, you know, for, for most of our [00:22:15] companies. Our members, the growth rate doesn't feel anywhere near 5% to them. Um, but that's because they're probably not touching the sectors that are growing at 5%.

So we need, we need consumer markets [00:22:30] growing at 5% and then our members feel it. But if upstream infrastructure to build climate defense systems in, in, in northwest China is where they're spending the money. To drive investment. Very [00:22:45] few western companies are gonna touch that. GDP, do you, do you see what I mean?

[00:22:50] Steve Odland: Yeah. Real really important points. Now, you know, the, the trade issues are, you know, on, in the headlines every single day. And, um, you know, the tariffs [00:23:00] on Chinese goods floated all over the place for, you know, for reasons we won't go into, but that, that's been the case from Europe and from North America.

And so you've seen a lot of. Different ways of dealing with that. [00:23:15] People have tried to move their supply chains, but, but also people are still manufacturing in China and then running it through Vietnam or other, you know, nearby countries and thereby, you know, avoiding the tariffs. Talk about that whole strategy and how it affects doing [00:23:30] business in China.

[00:23:32] David Hoffman: Wow. A lot of our members, a lot of Western companies are also join enjoying the benefits of China as an [00:23:45] innovation and production and export base. So when we say diverting through Vietnam. That is happening or that happened, it may still be happening. Um, we are tracking that, but I, I [00:24:00] don't have the latest figures in front of me, but I would say, what's, what's, what's, what's actually underneath that is not so much that stuff is being produced in China and then run through Vietnam and relabeled and put on a different boat and transiting.[00:24:15]

Instead, Chinese suppliers are moving to Vietnam and setting up factories. And, and they're often bringing their Western clientele with them. [00:24:30] Um, and that's where we, we see the real development. And, and what that means, Steve, is this, is, this will bring Chinese competition to a theater near you very soon.[00:24:45]

And we're seeing.

[00:24:46] Steve Odland: Yeah. And, and, and, and this, this is all playing out, you know, on, on a global stage as people are. Absolutely. Yeah. And trying to deal with, but there, there's no more important product that's being produced and shipped around here than [00:25:00] advanced microchips. And so you see that even the, uh, the Taiwanese companies who are TMC is the primary opening up factories in China, um, as well.

So you've gotta talk about the whole microchips [00:25:15] scene as well.

[00:25:16] David Hoffman: Well, yeah, I mean they're, they're doing China for China, a a as well. Um, you know, ch on the advanced semiconductor side, uh, you know, I wouldn't say. [00:25:30] Um, anybody, you know, TSMC or any of the top US or Japanese or Korean or other firms are, have ever put their top stuff in China and, and the reason they haven't is [00:25:45] because, you know, intellectual property protection safeguards still aren't there.

And specifically. The penalties for IP infringement are just too low to be credible. So, uh, you know, one of the reasons, [00:26:00] you know, why, you know, these, these supply chains didn't ever move to China, was not because the business case wasn't there, it was because the institutional safeguards weren't. Now we've got the geopolitical influences above it [00:26:15] all, and so that that has, you know, put a damper on on that.

A change. Um. But yeah, the semiconductor, you know, China is as dependent on, uh, mainland China is, is a, [00:26:30] is as dependent on Taiwan's semiconductor supply chain as, as we are, as is the rest of the world. I often liken it to Dune, you know, um. I've seen the movie or read the book, but it's like araki and [00:26:45] semiconductors of Taiwan are like spice, um, in a way.

And, um, the Silicon Shield, um, concept that they invented, um, 30 years ago or conceptualized as a [00:27:00] means to preserve their geopolitical space. I, I guess you would say it's working, but it is, it is, um, it is a complex and, and risky issue.

[00:27:11] Steve Odland: So then wrapping up in the final couple minutes that we have [00:27:15] you taking all of that in, you know what, what's your advice for multinationals or any company that's trying to do business or develop business or grow their business in China?

[00:27:26] David Hoffman: Yeah, I mean, the main thing I would say, and we didn't really get [00:27:30] to it much today, is that Chinese competitors in manufactured products. Are really, really competitive and it's not so much over capacity based, [00:27:45] so there's too much capacity. That's why the prices are low. Actually, Chinese firms for my entire career there have always competed along dimensions of price.

It's what you experience when you go to [00:28:00] markets there and, you know, you high goal with, with sellers, it's a, it's a price kind of based. You know, merchant culture, what's changed is that Chinese design and quality has [00:28:15] risen to global standards, and they've brought that price competition now to the level of advanced products.

If, and, and it really poses if, if you remember Clay Christensen's famous book in the [00:28:30] eighties, the Innovator's Dilemma. It is bringing an innovator's dilemma to so many categories where you either confront Chinese competition by lowering your price or you see your. Cash cows eaten away where you have to [00:28:45] retreat into ever smaller niches, or you compete with them head on through innovation and faster market operations.

But it really requires a fundamental rethink of how we do business [00:29:00] because they focus on scale and unit cost advantage. We tend to focus on profit maximization. Well,

[00:29:10] Steve Odland: they, they, they also have still the labor arbitrage advantage.

[00:29:14] David Hoffman: Yeah, [00:29:15] well, they've got that too. But let me give you an example. I was in a San Diego, I don't know, a month ago, and I, there's a, there's a, a mall there, a very nice mall in La Jolla called U University Town Center.

[00:29:30] Walk by a shop, and it's a Chinese brand called Dreamy, and dreamy, makes consumer home appliances and white goods. I think of it like a Dyson. So Hairdryers fans and this, they're beautifully [00:29:45] designed. They're, gosh, you know, I don't even know, like one fifth the price. Their quality's very good. But not only this, Steve, they had like three Chinese salespeople working the store and they were out in the middle of [00:30:00] the walkway, you know, kind of handing out brochures and welcoming people in, in a very kind of China style salesmanship approach.

I thought, gosh, you bring, and it's appealing. It was, it was get bringing people into, into [00:30:15] the store and, um, you know, this is, uh, you know, it's, it was very surprising me to, for me to see a dreamy shop in San Diego already. Um, but, you know, this is something we all need to prepare [00:30:30] for and this is what our China Center is really focused on all of this year, is helping our members understand.

Um, how Chinese firms compete and how we can compete against them and, and win. And [00:30:45] taking into account the upstream parts where, where they have state support and labor arbitrage and other things. We also need to, to to, to deal with that aspect as well. And it's, um, it's a important topic [00:31:00] and, um, we're working hard to try to shine a light on it.

[00:31:04] Steve Odland: So what I hear you saying is that China has, you know, you didn't say it this in in these words, but they, they've pretty much caught up here. You know, their quality is great, their productivity is [00:31:15] great. Um, it's dealing with their internal economic issues, which won't be resolved soon, but, and it's of drag on growth, but it's still a viable, um, attractive market to do business in.

It's still a good place to do. Business [00:31:30] for, for export. 'cause a lot of the, you know, the advantages still are there. The geopolitical overlay is there, but, but that's, you know, that's just part of what's going on around the world and, you know, something that doesn't seem to [00:31:45] intrude in day-to-day business.

And, um, and then, you know, they're, uh, approaching, you know, higher levels of innovation and, and quality, which, uh, you know, has never. Has never been part of the mix before. And so watch out rest [00:32:00] of the world when, you know, price, quality function, you know, really delivers products and services that, uh, are truly competitive and maybe more attractive than Western goods.

Did I wrap that up? Okay.

[00:32:13] David Hoffman: You know, I think, I think you [00:32:15] did great. I mean, again, I'm, I'm not, um. Trying to sugarcoat it. The, the China market is big and stable, but uh, price competition is intense. So it's, you know, [00:32:30] growth is under pressure, margins are under even more, geopolitical issues are, are difficult, but I would argue manageable.

Um, and, um. On the, uh, [00:32:45] supply chain side, China offers a sandbox, a gymnasium. You know, one of our colleagues at the China Center likes to call it a gymnasium. You go to work out there because that's where, you know, if you get fit in China, you're gonna be competitive [00:33:00] globally. So I would, but getting fit is not easy.

So I'm not sort of saying like, it's all sugar candy there. No, it's really, really hard work. You're gonna have to bench press, uh, triple your own weight to succeed.

[00:33:13] Steve Odland: All right, we'll leave it [00:33:15] there. David Hoffman, head of the conference, sports China Center in Beijing. Thanks for being with us today.

[00:33:21] David Hoffman: Thanks so much, Steve.

[00:33:23] Steve Odland: Thanks to all of you for listening in to C-Suite Perspectives. I'm Steve Oland and this series has been brought to you [00:33:30] by the conference board.

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