

# China's Innovation Engine

by John Jullens and Steven Veldhoen

In 2005, only eight China-based companies ranked among the Global Innovation 1000. By 2014, the number had risen to 114—a 1,325 percent increase. Chinese companies are also increasing their R&D spending much faster than companies in other regions: The rate of increase in 2014 was 46 percent, compared with rates in the low single digits in Europe and North America. Moreover, these numbers understate the full extent of innovation activity in China, because they don't reflect the significant R&D spending in the country by multinationals headquartered in other regions. For example, in 2008, when the Global Innovation 1000 study factored in the R&D activities of multinationals in China, the country was already the fourth-largest for corporate innovation spending—and undoubtedly would be ranked even higher today.

China's emergence as an engine of innovation has been driven by a characteristically Chinese approach—one that is top-down, fast, and decisive. In the country's dynamic market, fierce rivalries have developed between domestic and multinational firms, as they compete to fulfill the needs and wants of China's tens of millions of midmarket consumers. Innovation is often a C-suite responsibility, in Chinese companies, which are trying to catch up with more experienced competitors from developed countries. And because Chinese companies must migrate

into higher-value-added activities quickly if China is to move beyond the so-called middle-income trap, innovation is also a top priority of the central government.

Our studies have found that contrary to common perceptions outside the country that associate Chinese companies with rigidity and a copycat mind-set, these companies embrace a combination of openness to outside ideas, a pragmatic approach to experimentation, and a less abandonment of failing projects. They are willing and able to rapidly adapt their business models and pursue strategic acquisitions of developed-market firms to gain the technology they need, as Lenovo has done. It's perhaps not surprising, then, that over the last three years, our China Innovation Survey results have indicated that the advantaged Need Seeker strategy is more prevalent among Chinese companies (37 percent of companies in the 2014 study) than in the Global Innovation 1000 (25 percent of companies in the 2014 study) (see Steven Veldhoen et al., "2014 China Innovation Survey: China's Innovation Is Going Global," Strategy& white paper, Sept. 2014).

These efforts are paying off: Two-thirds of the multinational executives in China who responded to our 2014 survey said some of their Chinese competitors are as good as or better than their own company at innovation. In fact, leading Chinese companies

such as Haier and Xiaomi are already developing advanced innovation capabilities, enabling them to compete for share in global markets with in-demand, high-tech products (see "The Thought Leader Interview: Zhang Ruimin," by Art Kleiner, page 96).

As China's companies globalize, they will begin to push the innovation bar higher. Eighty-seven percent of Chinese "globalizers" named innovation as one of their top three strategic priorities (31 percent reported that it is their number-one priority). They are ready to move out of China and up the value chain, especially in B2B sectors where professional buyers tend to be less brand sensitive. And again, they will do it in a way that is both characteristically Chinese and increasingly common among global companies everywhere—by acquiring and integrating capabilities in the locales to which they are expanding, rather than bringing this knowledge back home to their headquarters.

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