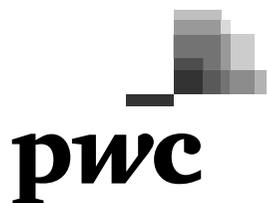


# *China's "New Normal" – Challenges and Opportunities*



Opening Address

Breakbulk China 2015



# *Foreign media coverage of China has turned notably negative over the last year or so*



OPINION

## The Twilight of China's Communist Party

President Xi Jinping may be gathering unprecedented power in China—but perhaps it is more the flaring of a candle before it gutters.

ESSAY

## The End of China's Economic Miracle?

Debt and corruption are hobbling the Asian giant.

## The New York Times

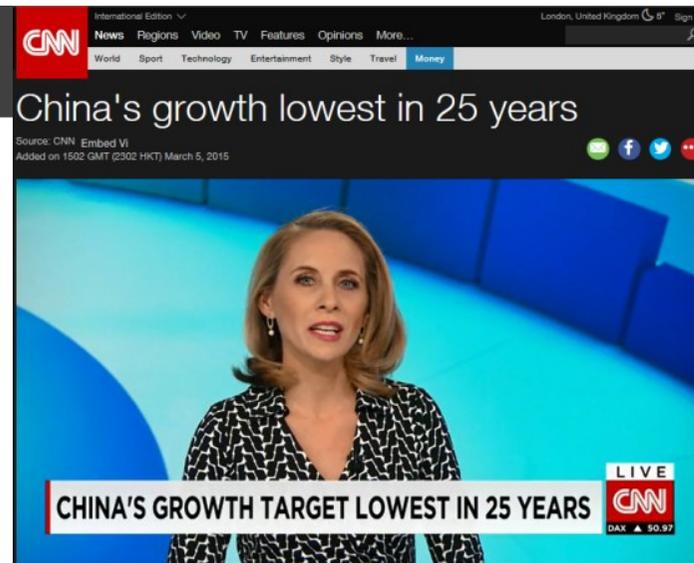
GLOBAL BUSINESS

## GlaxoSmithKline Accused of Corruption by China

By DAVID BARBOZA JULY 11, 2013

## Exports jump in China, but slide in imports signals economic weakness

BEIJING | Sun Mar 8, 2015 7:48am GMT



ENTREPRENEURS 7/31/2014 @ 8:43AM | 9,064 views

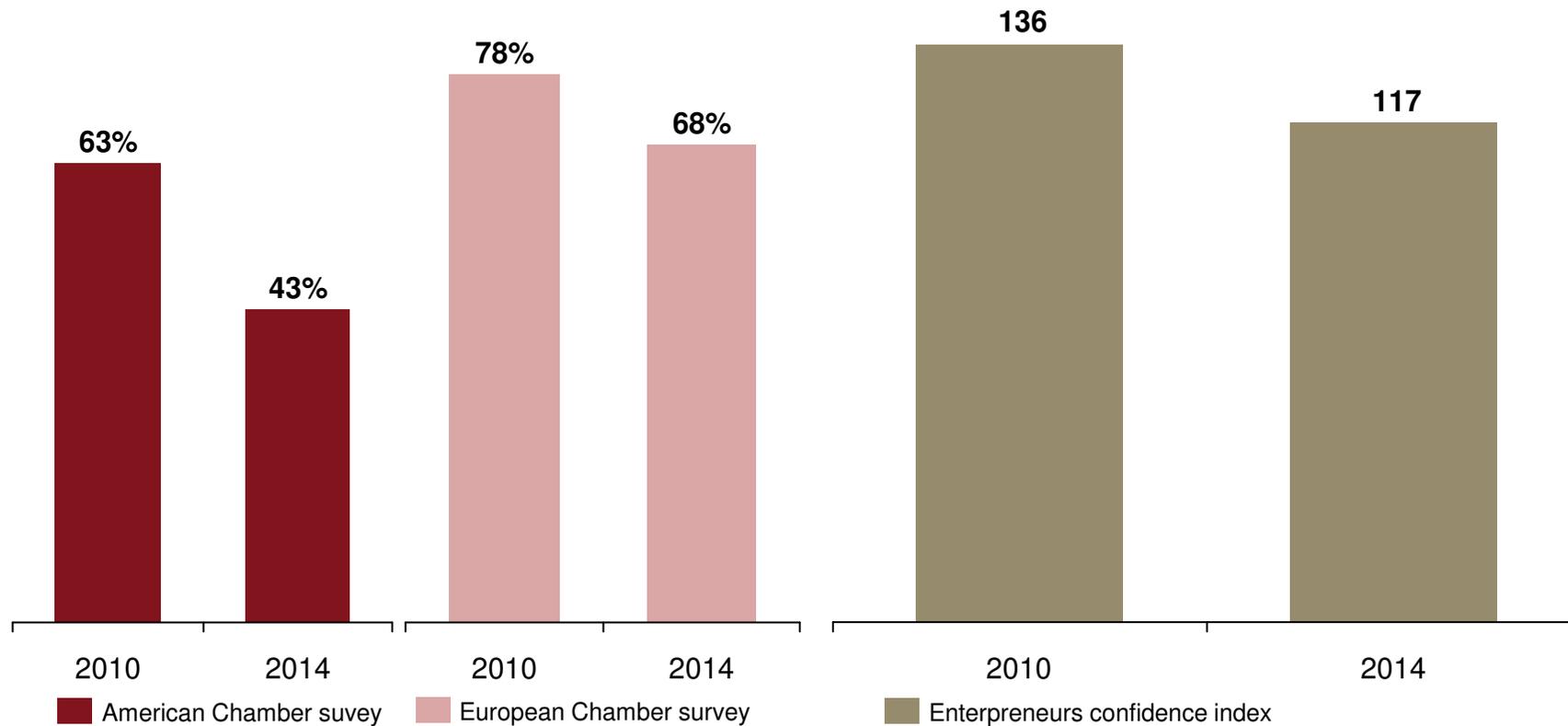
## What China's Anti-Corruption Investigation Means For International Business

Source: 2015 China business report, Strategy& analysis  
Strategy&

***The media landscape reflects a serious decline in confidence about China's future among both MNCs and domestic firms***

**Business Confidence - Foreign Multinationals**

**Business Confidence - Domestic Chinese Firms**

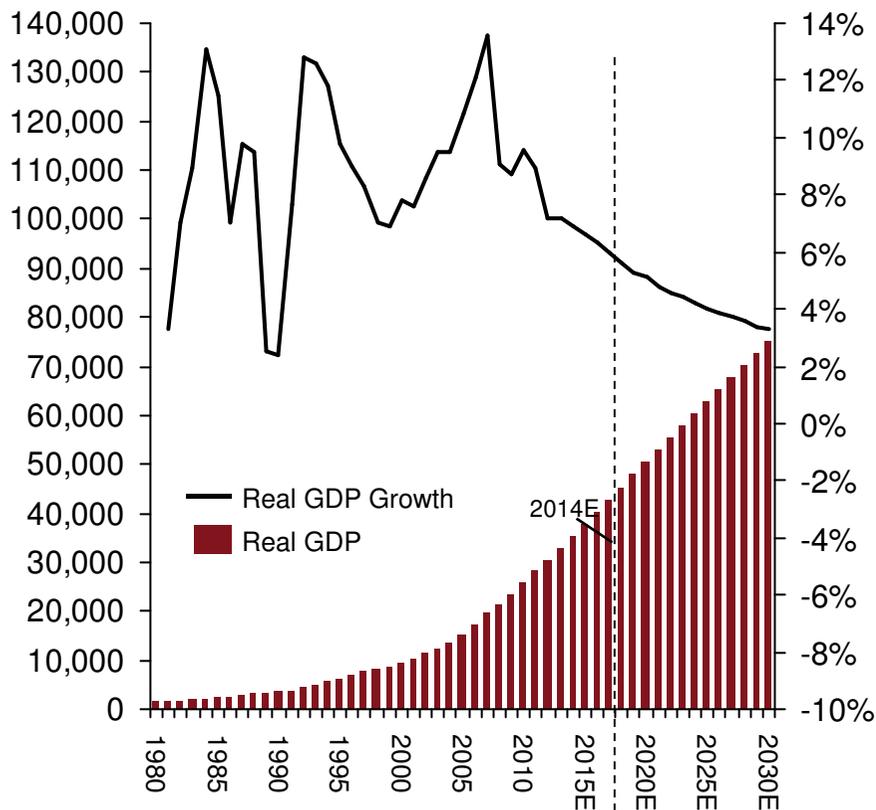


Source: American Chamber in China, European Chamber in China, Sina Finance, Strategy& analysis

Strategy&

## *The underlying reason is that China is in transition and faces significant economic, social, and political challenges*

Chinese Real GDP, 1980 – 2030E, RMB, bn



Source: The Economist Intelligence Unit

### Major Challenges

- **Economic**
  - Potential GDP growth rate declining
  - Increasing structural imbalance
  - Slow recovery elsewhere (e.g., EU)
- **Social**
  - Rising inequality (Gini coefficient)
  - Pollution / Environmental degradation
  - Safety issues (e.g., food)
- **Political**
  - Endemic corruption at all levels
  - Domestic unrest (e.g., HK, Xinjiang, Tibet)
  - Geopolitical tensions (e.g., Taiwan, Senkaku / Diaoyu, South China Sea)

# *Beijing's dilemma is how to resolve the tension between the political necessity and economic reality of high vs. low growth*

## Economic Reality

### • Supply-side

- Surplus farm labor declining
- Low capital efficiency
- Rate of technological progress declining

### • Demand-side

- Export flat and not likely to improve without major change
- Domestic consumption and service sector development hardly compensate the growth.



## Political Necessity

- Avoid hard landing of China's economy
- Control the financial system and prevent it from financial crisis
- Ensure stable employment and thus to maintain a stable society
- Build confidence and continuously attracting investment

- Increasing local government debt
- Widening income gap
- Severe environmental issues
- Instable financial system
- Growing inflation

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## ***Beijing has no choice but to implement a challenging reform program – the next 3-5 years will likely be decisive***

- 1 Slow Down** Further investment-led growth will only exacerbate China's financial, environmental, natural resources, and other problems
- 2 Clean Up** While highly successful, China's current growth model also produced numerous negative side effects - including endemic corruption, rising inequality, safety issues, severe pollution, and environmental degradation
- 3 Implement Structural Reforms** The role of the government must change from direct intervention to facilitating the ongoing transition to a more market-based economy
- 4 Increase Domestic Consumption** While domestic consumption has actually grown at a healthy rate, much more must be done to free up latent disposable income
- 5 Upgrade Industrial Base** China must become more competitive in higher value-added industries through top-down policy and bottom-up firm-specific initiatives

Source: "Will China's New Leaders Step Up to the Plate?", Jullens, *Strategy+Business*, Nov 2013

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***The new leadership team's strategy under Xi Jinping and Li Keqiang, is becoming increasingly clear***



Economic Reforms

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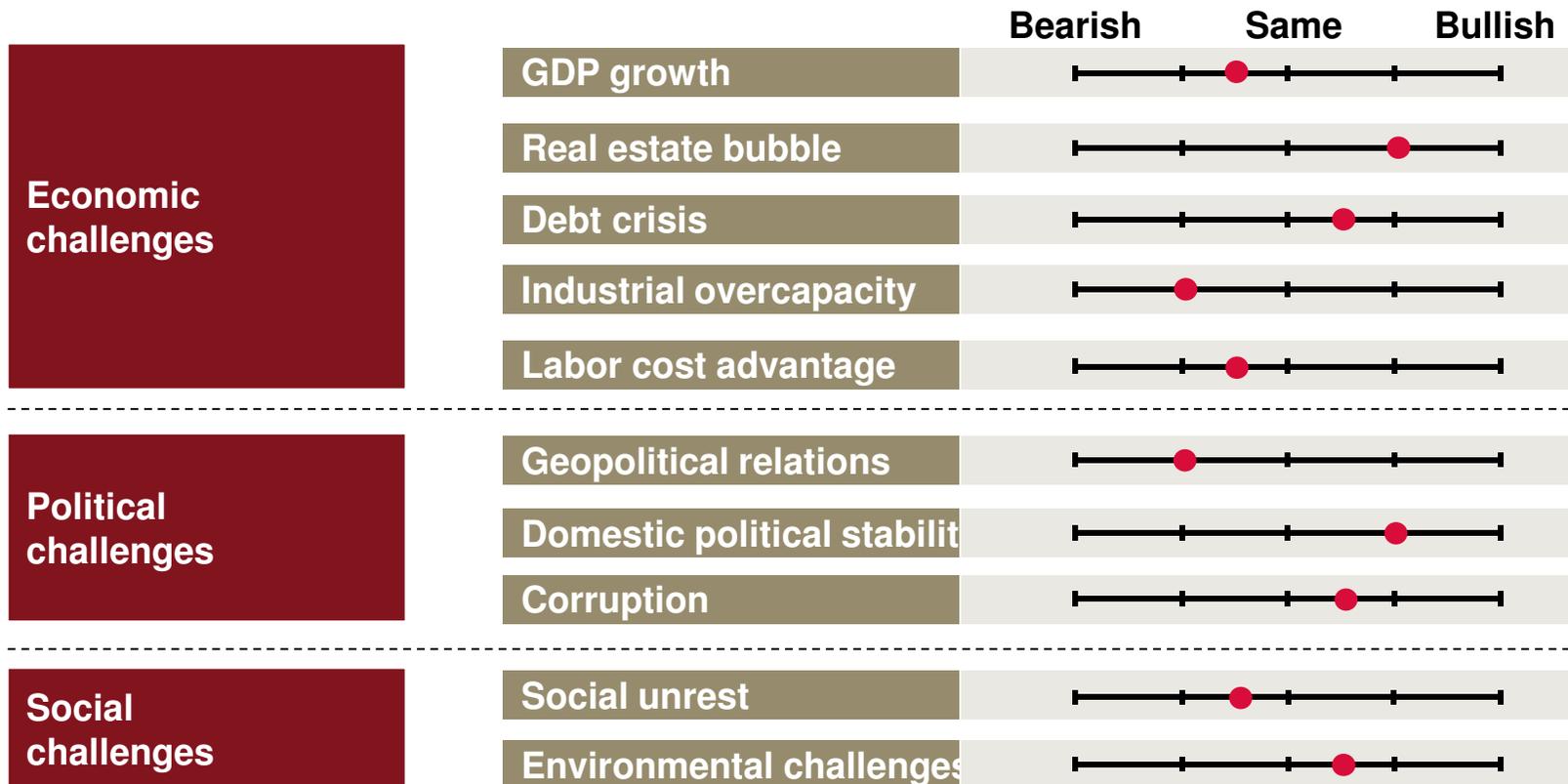
Political Stability

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The Chinese Dream

***Nevertheless, the next few years will be quite challenging – a smooth transition is unlikely***

***Personal view (next 1-3 years)***



Source: "China – Recent Developments and Mid-Term Outlook", Jullens, Kellogg School of Management, Oct 2013

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## ***The new business environment will present domestic firms and MNCs with both challenges and opportunities***

### **Domestic Firms**

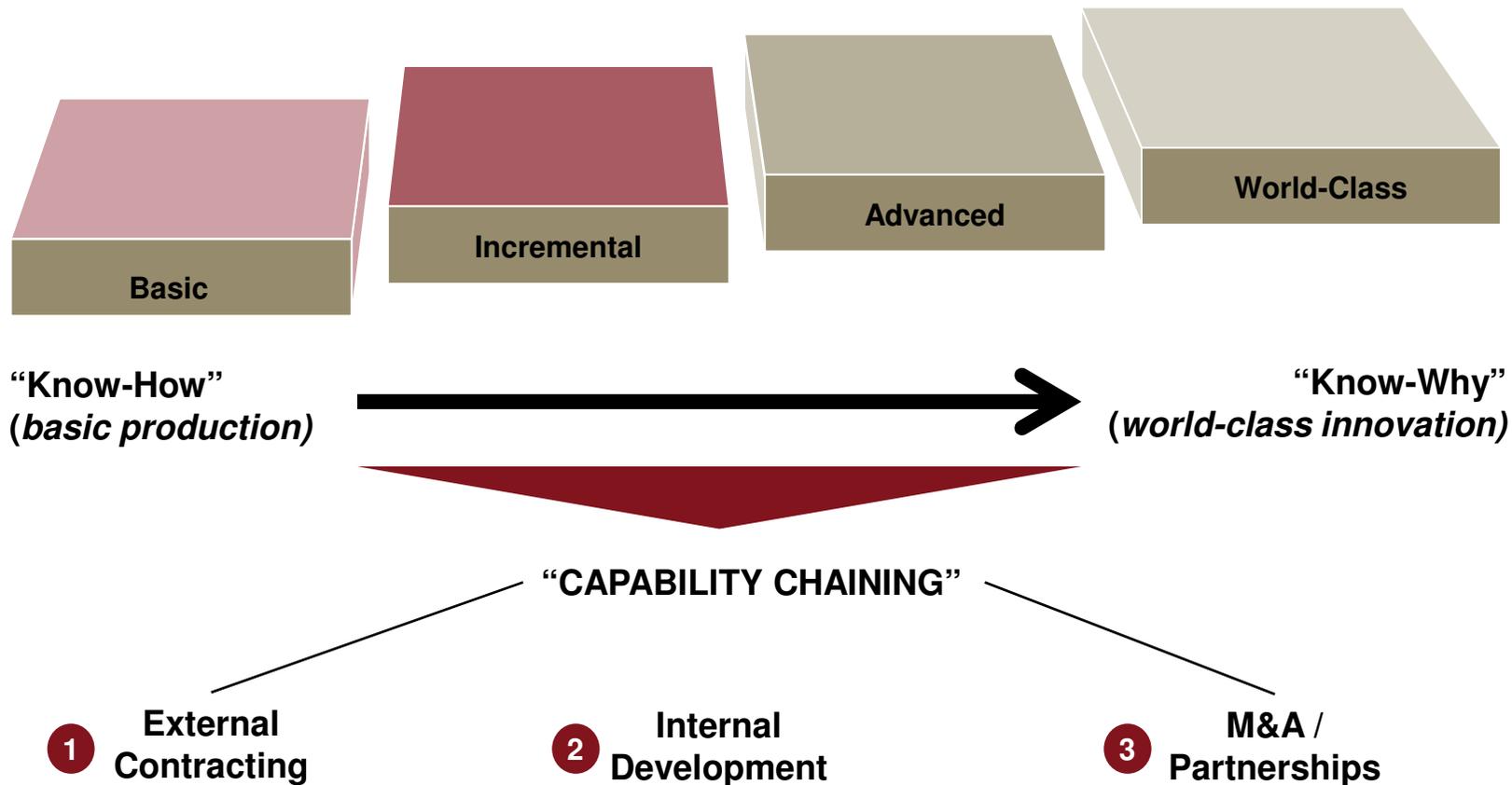
- Improve core capabilities and move up the value chain
  - *Innovation, Operational Excellence, Go-To-Market*
- Start expanding into international markets
  - *Market access*
  - *Technology / know-how transfer*
  - *Exposure to world-class performance levels*

### **Foreign MNCs**

- Develop much more granular understanding of growth opportunities and challenges
- Re-assess domestic operations to improve productivity and efficiency
- Significantly tighten operational control
- Defend position against increasingly capable Chinese competitors - both in China and elsewhere

## Domestic Firms

*Chinese firms must evolve from acquiring basic production expertise to mastering world-class capabilities themselves*



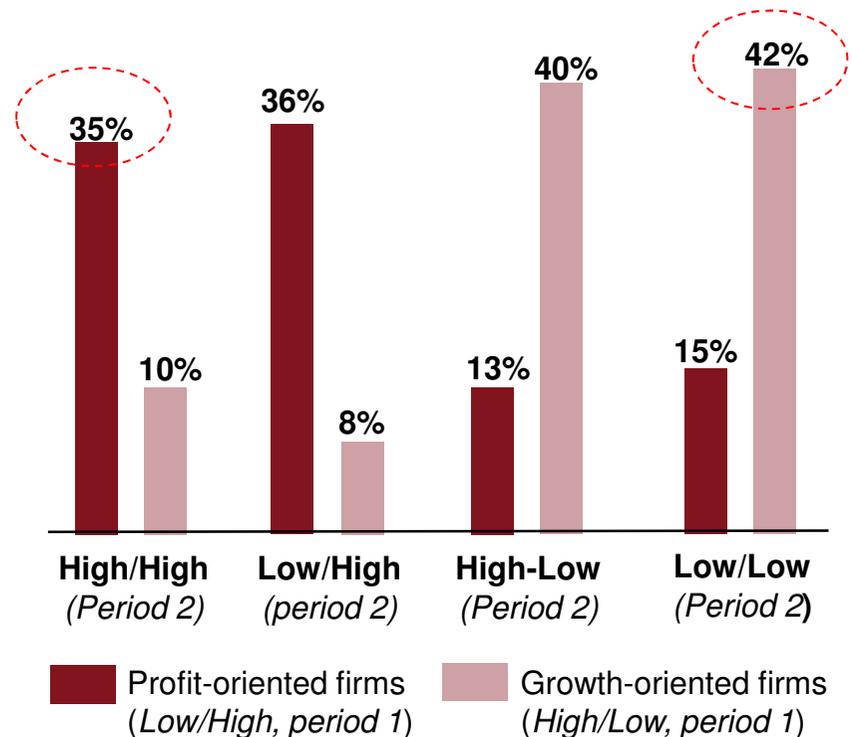
Source: Adapted from Bell and Figueiredo (“Building Innovative Capabilities in Latecomer Emerging Markets Firms: Some Key Issues”, Oxford University Press, 2012)

## Domestic Firms

# *Many emerging market firms find it difficult to manage the required “capability chaining” process*

### Profit- versus growth- oriented firms

Sales and profits growth trajectories over consecutive five-year periods ( $N = \sim 105,000$  firms in Brazil, Russia, India, and China)

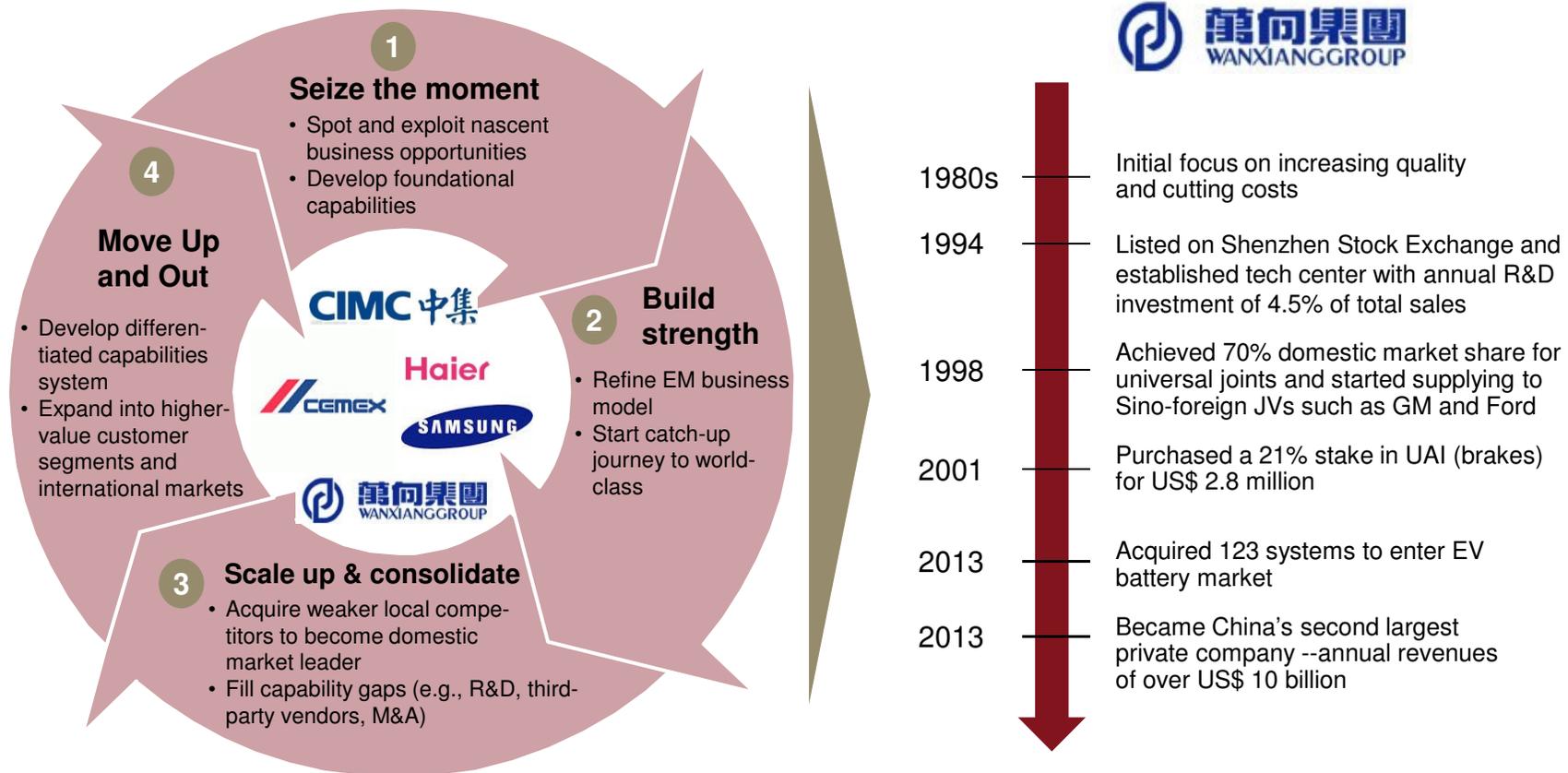


- Most emerging market firms embody an important – they are both first movers and latecomers
- In their eagerness to get ahead, many firms focus primarily on top-line growth and neglect to lay the foundation for profitability in any environment other than a rapidly expanding market
- In reality, profit-oriented firms are significantly more successful over the long-term than growth-oriented firms

Sources: “Rough Diamonds”, Park, Zhou, Ungson (2013) / “How Emerging Giants Can Take on the World”, Jullens, Harvard Business Review, Dec 2013

## Domestic Firms

***Successful emerging market firms typically follow a four-step process of developing advanced capabilities over time***



Source: "How Firms in Emerging Markets Can Play Catch-Up", Jullens, Strategy+Business, Jan 2014

### *MNCs will face a much more challenging environment in China – for many, the easy phase is mostly over*

- 1** **New Business Environment**

The new business environment will present significant business and regulatory challenges but also new profit opportunities
- 2** **Shifting demographics**

While overall population size will continue to grow, the underlying mix will change significantly – i.e., China is aging
- 3** **New technologies**

Chinese consumers are rapidly adopting new technologies such as the Internet – foreign MNCs are not necessarily advantaged
- 4** **Mid-Market = Battlefield**

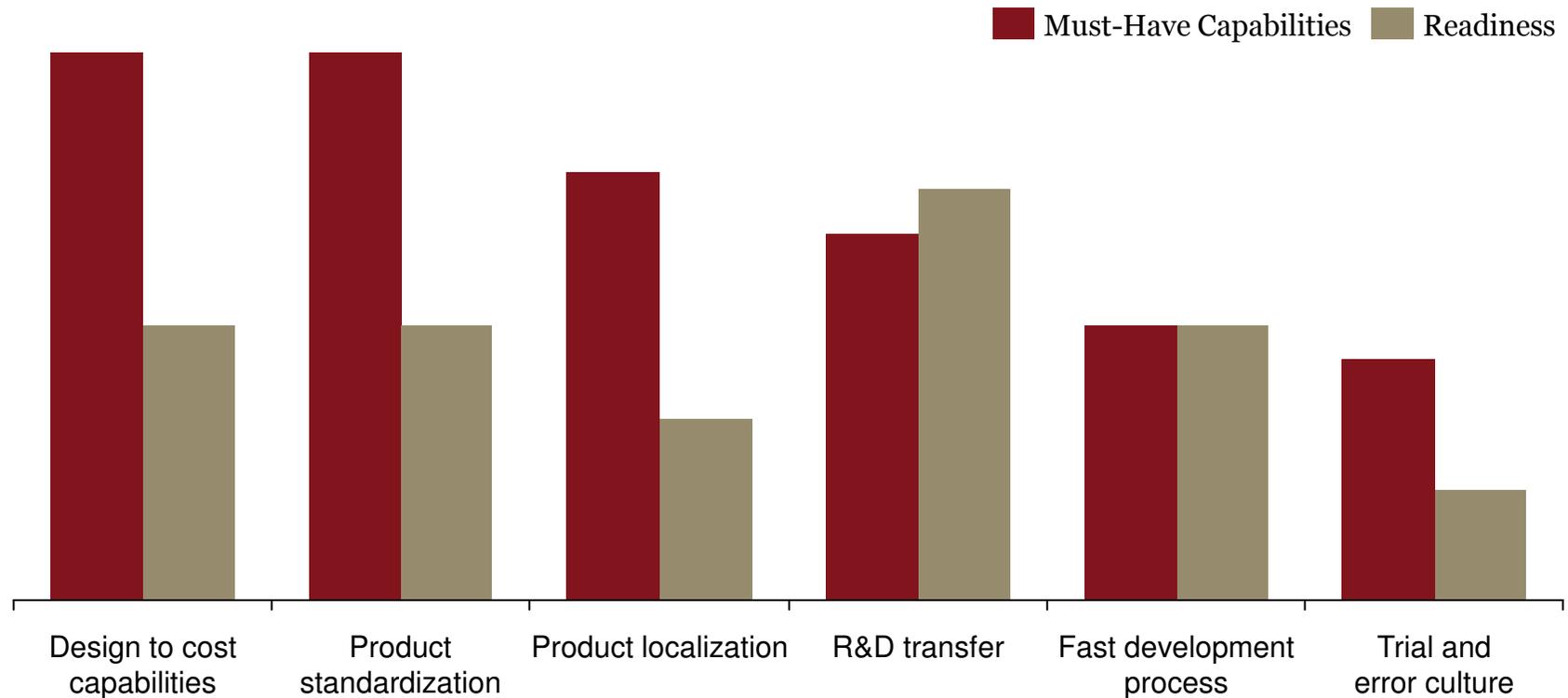
Growth will often come primarily from the rapidly developing mid-market of “Good Enough” products
- 5** **Emerging giants**

Local competitors are improving rapidly – e.g., Chinese Mid-Market Innovators and other Emerging Giants

## Foreign Multinationals

*For example, few MNCs have the capabilities required to compete in China's mid-market - "Good Enough" just isn't*

**Key Mid-Market Capabilities**  
( Ranked by Importance )



Source: Strategy& Mid-Market Study 2012/2013

Strategy&

## Foreign Multinationals

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***For MNCs, winning in China is often a function of making a series of difficult trade-offs along at least eight dimensions***

- 1 China business model** – Rethink business model to support unique local requirements, including product, price, branding, marketing, distribution, and operations
- 2 Low-price products** – Develop “low-priced” products specifically designed for Chinese (mid-market) customers, as opposed to merely introducing “low-cost” versions of existing world-class products
- 3 Value chain migration** – Transfer core activities to China to narrow cost gaps with domestic entry-level market competitors through local product development, sourcing, and manufacturing
- 4 Selective partnerships** – Consider entering into partnerships with local suppliers to fill gaps in entry-level market product portfolio, develop optimal distribution footprint, and navigate China’s unusually complex regulatory environment
- 5 Multi-brand strategy** – Consider developing a multi-brand strategy to successfully operate across premium and entry-level market price points as well as multiple product categories
- 6 Multi-channel strategy** – Develop cost-effective ways of selling across multiple channels and price points
- 7 Strong local organization** – Ensure that management is capable and sufficiently empowered to enable fast decision-making and sensitivity to local market requirements. Clarify decision rights and put in place a strong governance structure
- 8 Global mindset** – A firm’s success is tied to the mindset of its top managers. At a minimum, ensure that headquarters has at least a basic understanding of China’s unique business and regulatory context

Source: “China’s Mid-Market: Where “Good Enough” Just Isn’t”, Jullens, Strategy+Business, July 2013

## ***Finally, the current economic environment will bring both challenges and opportunities for the breakbulk industry***

### **Challenges**

- On the whole, Chinese infrastructure projects and construction will continue to slow, resulting in less need for imported steel, construction equipment and materials
- The infrastructure projects that do materialize, will likely do so much further inland than breakbulk shippers tend to venture
- Uncertain export flows will encourage container lines to continue their recent cannibalization of what were traditionally breakbulk shipments, resulting in persistent downward pressure on rates
- The very profile of the breakbulk customer will potentially shift toward more SOE and Chinese shippers, making business development a strategic challenge

### **Opportunities**

- As Chinese infrastructure firms seek new channels for future growth in Africa and S.E. Asia, export breakbulk and project shipments will likely increase in the medium term
- Long term efforts to build inland ports, long a feature of the “Go-West” strategy, are continuing to progress, providing opportunities to those who are able to venture inland
- The global expansion of the Chinese automotive sector will happen, potentially providing a boost to the Ro-Ro sector
- Further Chinese expansion into developing markets is a certainty, opportunities will exist for many years to come for those who secure the relationships

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## ***Contact information***

**John Jullens**

**Partner, Strategy&**

*Formerly Booz & Company*

Suite 2511, One Corporate Avenue  
No. 222 Hu Bin Road  
Shanghai 200021, P.R. China

Telephone: +86 21 2327 9800

Fax: +86 21 2327 9833

[john.jullens@strategyand.pwc.com](mailto:john.jullens@strategyand.pwc.com)

[www.johnjullens.com](http://www.johnjullens.com)

## **Relevant Publications**

### **Harvard Business Review**

- *“How Emerging Giants Can Take on the World”*-- Harvard Business Review, Dec 2013
- *“Is China the World’s Next Rust Belt?”* -- Harvard Business Review China, Apr 2013

### **CEIBS Business Review**

- *“Choose Your Capability Path”* -- CEIBS Business Review, Mar 2014
- *“Modern Zorro is Out”* - CEIBS Business Review, Feb 2014

### **Strategy + Business**

- *“It’s a Race to the Bottom in China’s Auto Market”* – Strategy + Business, Sep 2014
- *“How Firms in Emerging Markets Can Play Catch-Up”*- Strategy + Business, Jan 2014
- *“Why Strategy Matters in Emerging Markets After All”*-- Strategy + Business, Dec 2013
- *“China’s Mid-Market: Where “Good Enough” Just Isn’t”*-- Strategy + Business, July 2013