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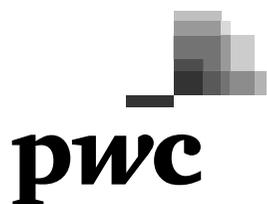
San Francisco, CA

Bloomberg BNA

# *Is the China Growth Miracle Over? Debunking the Myths*



“Perspectives on China” Symposium

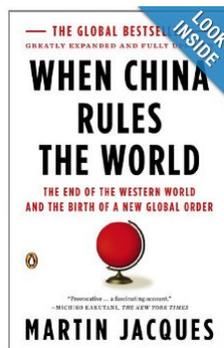


## *China pundits tend to come in two distinct flavors – True Converts and Apocalyptic Non-Believers*

### “True Converts”

- View China’s re-emergence as an economic and geopolitical superpower as more or less inevitable and with a sense of awe – and sometimes more than a little fear as well

**Martin Jacques**  
“When China Rules The World”

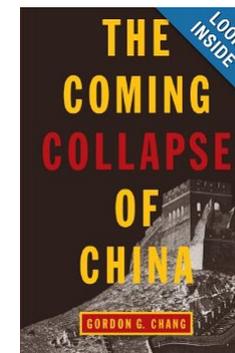


**Versus**

### “Apocalyptic Non-Believers”

- Believe that China’s “economic miracle” is nothing more than a Beijing-led Ponzi scheme that will soon collapse in spectacular fashion

**Gordon Chang**  
“The Coming Collapse of China”



Source: “China—The Mother of All Black Swans”, Jullens, Strategy+Business, Jun 2013

# *Lately, the non-believers have clearly had the upper hand*

## THE WALL STREET JOURNAL. OPINION

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

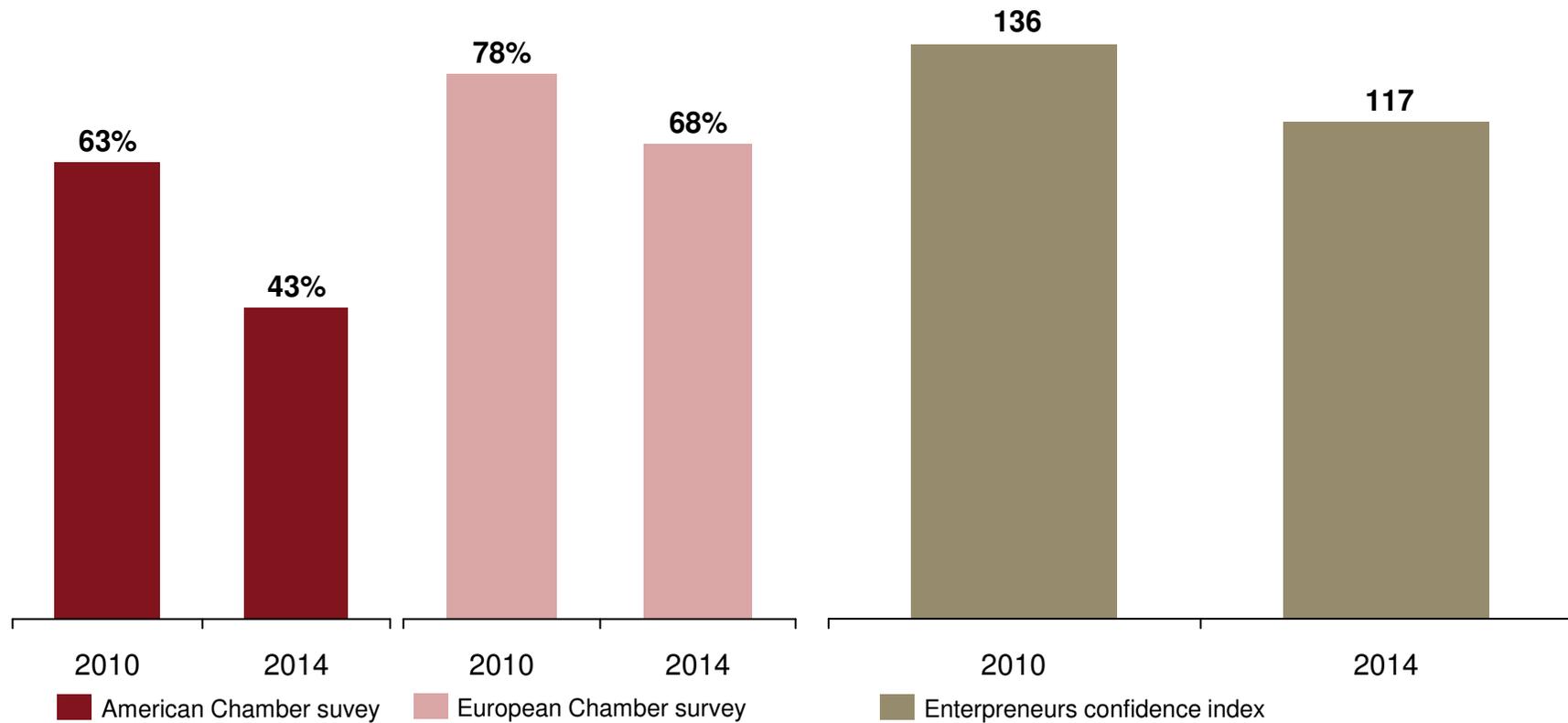
## What China's Anti-Corruption Investigation Means For International Business

Sources: *The Wall Street Journal*, *The New York Times*, *CNN*, etc.

***The media landscape does indeed reflect a notable decline in business confidence among both MNCs and domestic firms***

**Business Confidence - Foreign Multinationals**

**Business Confidence - Domestic Chinese Firms**

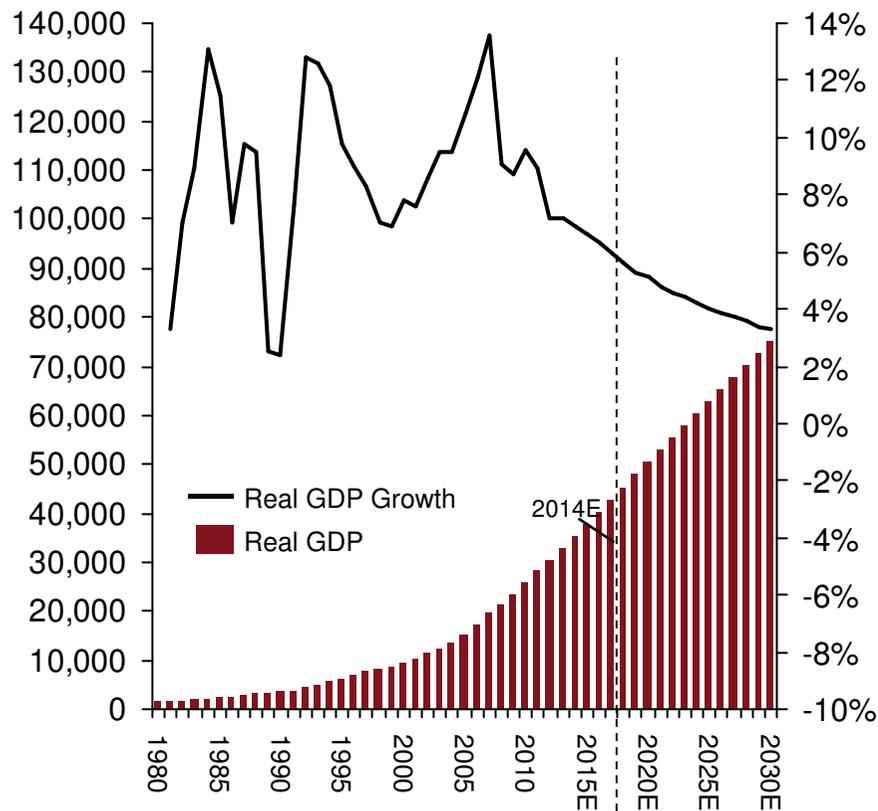


Source: American Chamber in China, European Chamber in China, Sina Finance, Strategy& analysis

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, Strategy& analysis

### 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 islands, South China Sea)

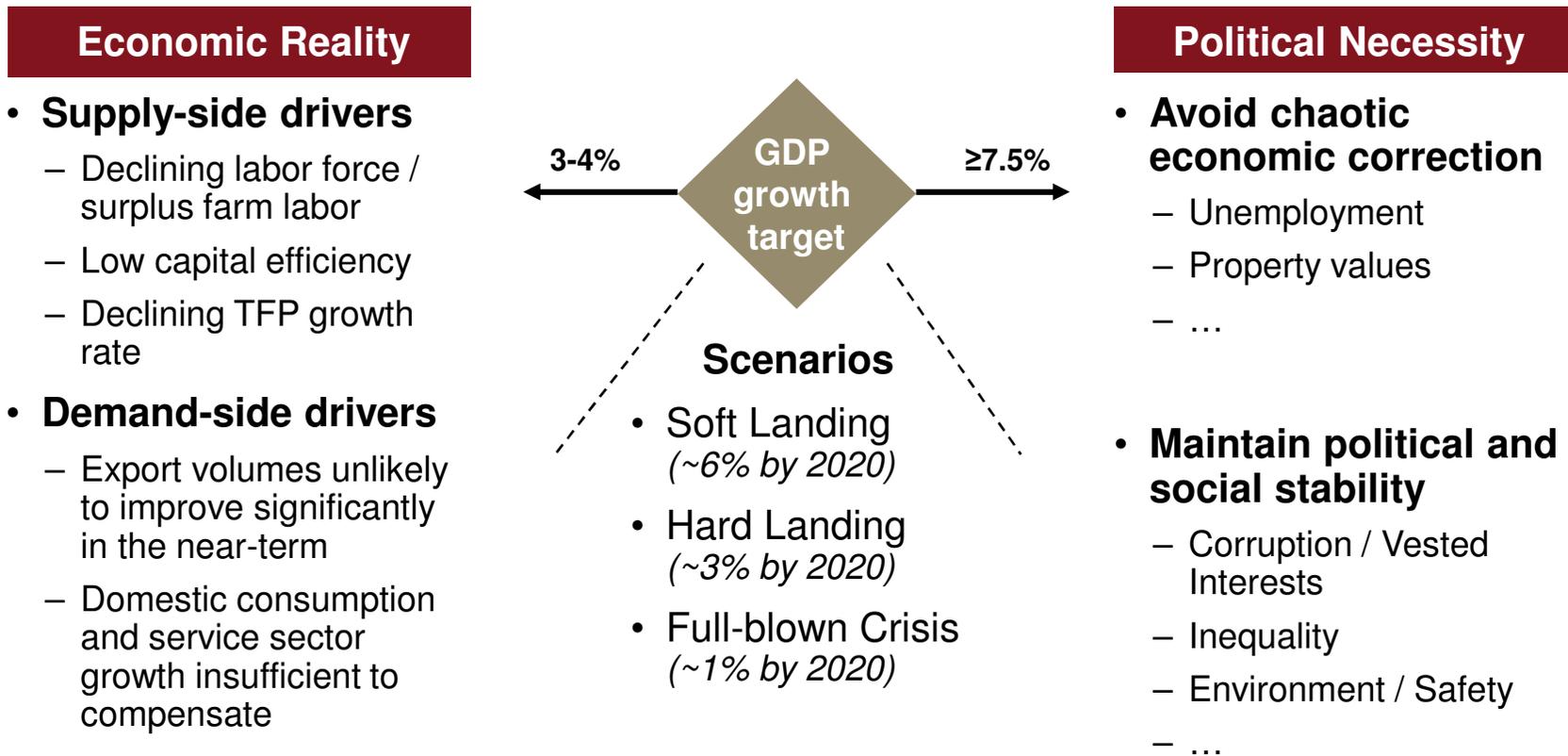
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***In fact, China has no choice but to implement a challenging reform program – the next 3-5 years will likely be decisive***

- 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** Chinese firms 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

# *Beijing's dilemma is how to balance the political necessity of high growth with the economic reality of low(er) growth*



Source: "Will China's New Leaders Step Up to the Plate?", Jullens, Strategy+Business, Nov 2013  
"Avoiding the Blind Alley" – Rosen, Asia Society Policy Institute / Rhodium Group, Oct 2014

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***There is little consensus on how to best solve these economic and political challenges – even in China itself***

**Schools of Thought Within the Chinese Elite**

**Economics**

**New Left** - challenge neoliberal economics and call for a return of the state (e.g., Cui Zhiyuan)

**vs.**

**New Right** - Pioneered gradualist reforms of the '80s and '90s and favor restarting pro-market reforms (e.g., Justin Yifu Lin)

**Politics**

**Neocons** - Feel that limiting the state leads to collective government, unable to take tough decisions or challenge vested interests (e.g., Pan Wei)

**vs.**

**Liberals** - Want to place limits on the power of the state, either through elections, the rule of law, or public participation (e.g., Sun Liping)

**Foreign Policy**

**Internationalists** - Want China to merely play a role in existing global institutions and emphasize prudence (e.g., Wang Yizhou)

**vs.**

**Nationalists** - Want China to (re-)assert itself on the global stage (e.g., Yan Xuetong)

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Source: "What Does the New China Think?", Leonard, ECFR Policy Report, Nov 2012

***However, the new leadership team's own perspective under Xi Jinping and Li Keqiang is becoming increasingly clear***



Economic Reforms

+

Political Stability

+

The Chinese Dream

## *Xi has given himself until 2020 to implement the planned reforms – early indications are reasonably positive*



### Positive Early Indications

- New reform plan considerably more ambitious than previous versions
- Implementation not left to the government, but overseen by a special party committee, chaired by Xi himself
- Unexpectedly strong crackdown on corruption and vested interests in the status quo
- No major financial stimulus (yet)

**... however, the greatest challenges lie ahead**

## *The planned reforms, and other macro trends, will have a significant impact on the general business environment*

### Reform Impact

- **Slower growth**
  - Greater competitive intensity among both foreign and domestic firms
  - More heterogeneous customer demand
  - Significant supply-side cost pressure and resulting need to improve productivity and efficiency levels
  - Lower demand for natural resources from other countries (e.g., Australia, Brazil, Russia)
- **Closer scrutiny**
  - Much tighter operational control in response to anti-corruption, anti-monopoly, and other government initiatives
- **New opportunities**
  - Financial services
  - Green technology
  - ...

### Other Trends

- **Shifting demographics**
  - China's population is aging; under-40 segment is shrinking
  - New growth opportunities to serve the unique needs of older consumers
  - However, much tougher competitive dynamics in under-forty consumer segment, including head-to-head competition and price/margin pressure
  - Need for domestic and foreign firms to optimize operations and re-think strategy and investment plans
- **New technologies**
  - China is at the cutting edge of the digital era with the largest online population
  - Digitization helps increase connectivity between urban and rural markets with exponential growth of consumer choice
  - Foreign multinationals not necessarily advantaged

## ***China's "New Normal" will present domestic firms and MNCs with significant challenges but also 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

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***Foreign MNCs have four potential strategic options – many will have no choice but to “Play to Win” in China***

**Four strategic options for MNCs**

- 1** “Stay at home”  
Remain focused on home market and leave China to other competitors
- 2** “Wait it out”  
Wait for (mid-market) demand in China to catch up with (premium) demand elsewhere
- 3** “Play to Win”  
Develop required products, capabilities, and other resources to compete successfully in China now
- 4** “If you can’t beat’ em ...”  
Partner with one or more Chinese competitors and develop the Chinese and global (mid-)markets together

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

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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, Jul 2013*

## *Partnerships with local players are often especially important and numerous win-win opportunities do exist*



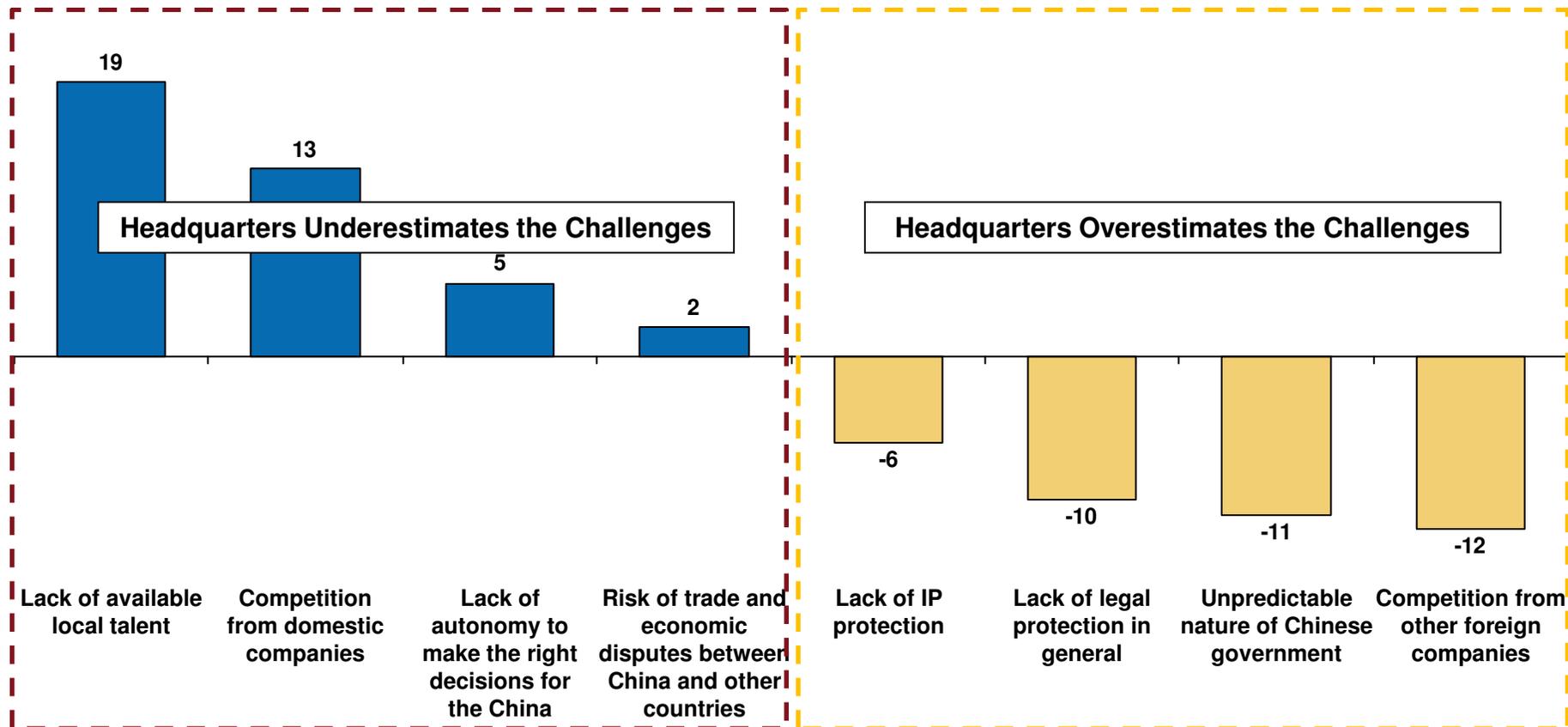
- **“Good Enough” opportunities**
  - Jointly develop low-end / mid-market versions of existing products for emerging markets
- **“Latent Demand” opportunities**
  - Jointly penetrate developed markets by activating latent demand for low-end / mid-market products
- **“Leapfrog” opportunities**
  - Capitalize on latecomer advantages to develop new products and technologies in greenfield emerging markets first
- **“Breakthrough” opportunities**
  - Combine high-end developed market and low-cost emerging market capabilities to create truly breakthrough products

Source: “Sino-Finnish Paths to International Competitiveness”, Jullens/Suonio/Tang, TEKES, Oct 2013

# *Finally, adopting the right mindset is critical for (too) many MNCs, as misunderstandings remain all too common*

## Misaligned Priorities b/w Headquarters and Managers in China, MNC

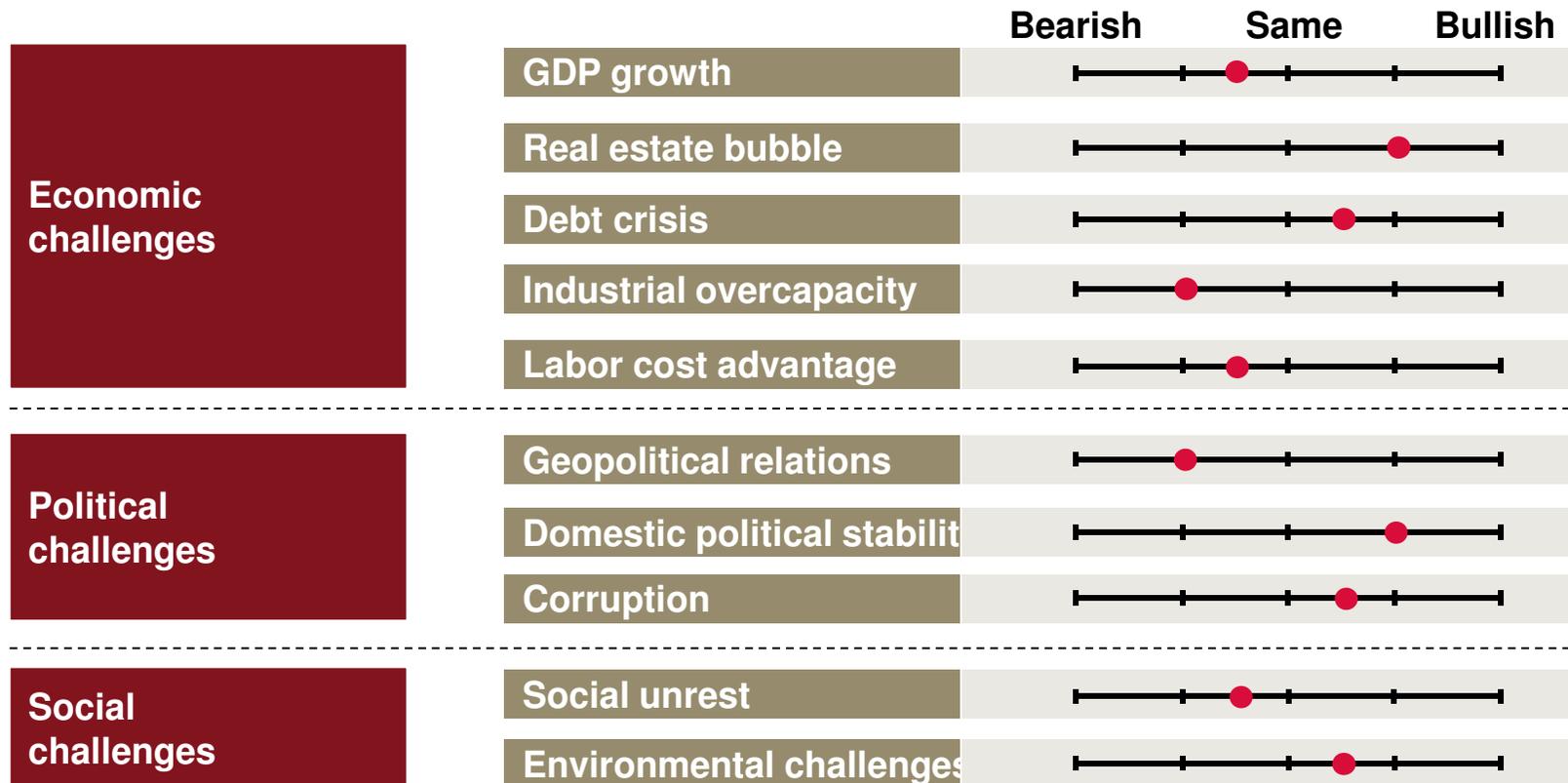
(Difference b/w Respondents based in China and All Respondents, in % respondent)



Source: EIU, Strategy& analysis

***In summary, the outlook for China is decidedly mixed, but with little chance of an economic or political meltdown***

*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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## **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