BUSINESS SWEDEN

A NEW ERA IN CHINA

NAVIGATING SHIFTING PERCEPTIONS, CHANGING REALITIES

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CONTENT

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EXECUTIVE SUMMARY

In the past few years, China has taken a more assertive role on the global stage, while at the same time, the world has also changed its perception of China. The State's role in the market has again been strengthened with state-owned (or state controlled) companies being dominant in strategically important sectors. The shifting global context coupled with a slowing economy and more complex market dynamics creates a challenging environment for Swedish companies to navigate.

Given the size of China's population, its domestic market and, despite the slowdown, there is still significant potential for further expansion in China. Swedish companies are well positioned to be key suppliers and strategic partners to support a necessary lift in productivity and capability in China's industry. Swedish solutions could also be pivotal for addressing societal challenges that China face, such as environmental pollution, an aging population and the need to upgrade its healthcare service industry.

The success and growth of Swedish companies in China is of significant importance for the health and competitiveness of Swedish industry. There are three key factors driving this. The first is the Swedish companies already large presence in China and thus importance for their overall growth. The second is that given the scale of the market in China it is becoming ever more important to succeed there to be a global leader in one's industry. Finally, for more and more companies, a presence in China is becoming a key platform for wider success in the more broad APAC region and indeed, globally.

This report details seven strategic elements for continued growth in the new business climate in China, providing a framework to consider the ongoing changes and their implications. This report aims to support companies to adapt current strategies or develop entirely new ones to win in China's "new era".

These seven strategic elements are common cornerstones in these new strategies. While all of them are not equally applicable to every company they provide a range of potential avenues to explore. Two of these are fundamental for operating in China: ensuring relevant and competitive offerings and enhancing China's role and mandate within the organisation. The remaining five can be considered enablers to propel leadership in China, and ultimately in the global marketplace.

INTRODUCTION

BACKGROUND

In 2016 Business Sweden published the report *Redefining success strategies in China – Winning in the New Normal in Chinese Industry.* That report explored the Chinese market on a strategic level and discussed how Swedish companies could stay competitive in a rapidly changing environment. It described a 'new normal' with slowing growth, intensified competition and a growing mid-market that many premium-oriented Swedish companies had not successfully penetrated.

That report has served as a useful basis for many Swedish companies as they search for new approaches to increase success in the Chinese market. But three years on much has changed – both in China and in the world. What was considered the 'new normal' has taken a turn, and we have entered a period called the 'new era'. Several of the strategic considerations that were valid in 2016 are still valid today, but additional considerations and adjustments need to be made.

ABOUT THIS REPORT

This report provides an updated view on the Chinese market with a focus on what Swedish companies need to pay attention to in this new era of doing business in China, as well as strategic considerations and recommendations for successfully navigating the market. This includes a range of issues that are relevant to both large and small Swedish companies, including an even more mature and competitive landscape, policy, regulations, technology management and digitalisation.

This new era is characterised by a global race for technological leadership, as well as shift in trend with the state and the Chinese Communist Party (CCP) again having a more pronounced role in China's economic development. It is an era of fast-paced innovation and digitalisation, but also an era of increasing friction in the global trading system.

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APPROACH

This report is based on interviews with Swedish and international companies, surveys, desktop research and insights generated through Business Sweden's continuous dialogues and engagements with Swedish and Chinese companies through our offices in Beijing, Shanghai and Hong Kong.

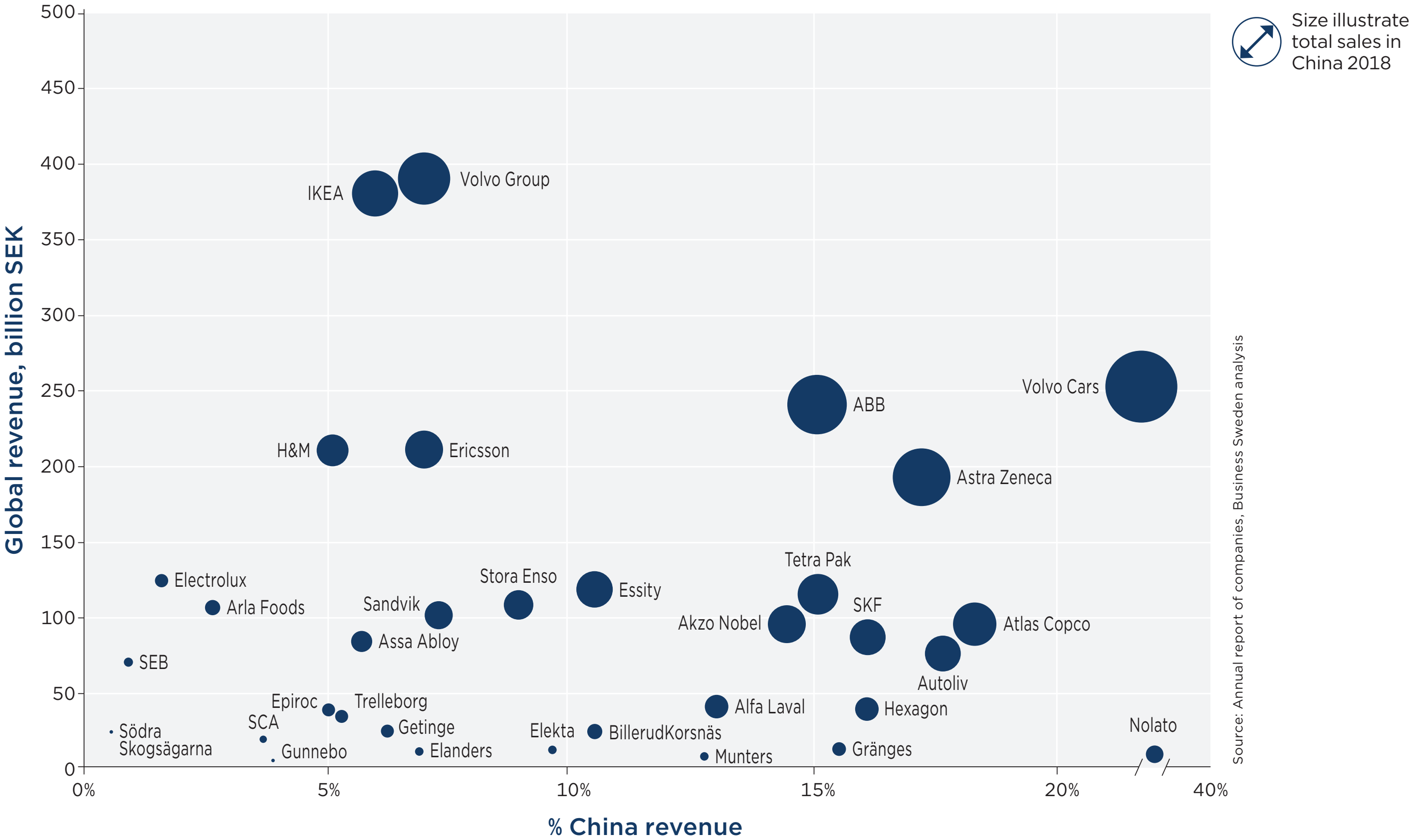
CHINA'S IMPORTANCE AS A MARKET FOR SWEDISH COMPANIES

In just a few years, China has become a more important market than ever for Swedish companies. For more than 60% of Swedish companies present in China the market is among the companies' top three globally in terms of revenue.[1]

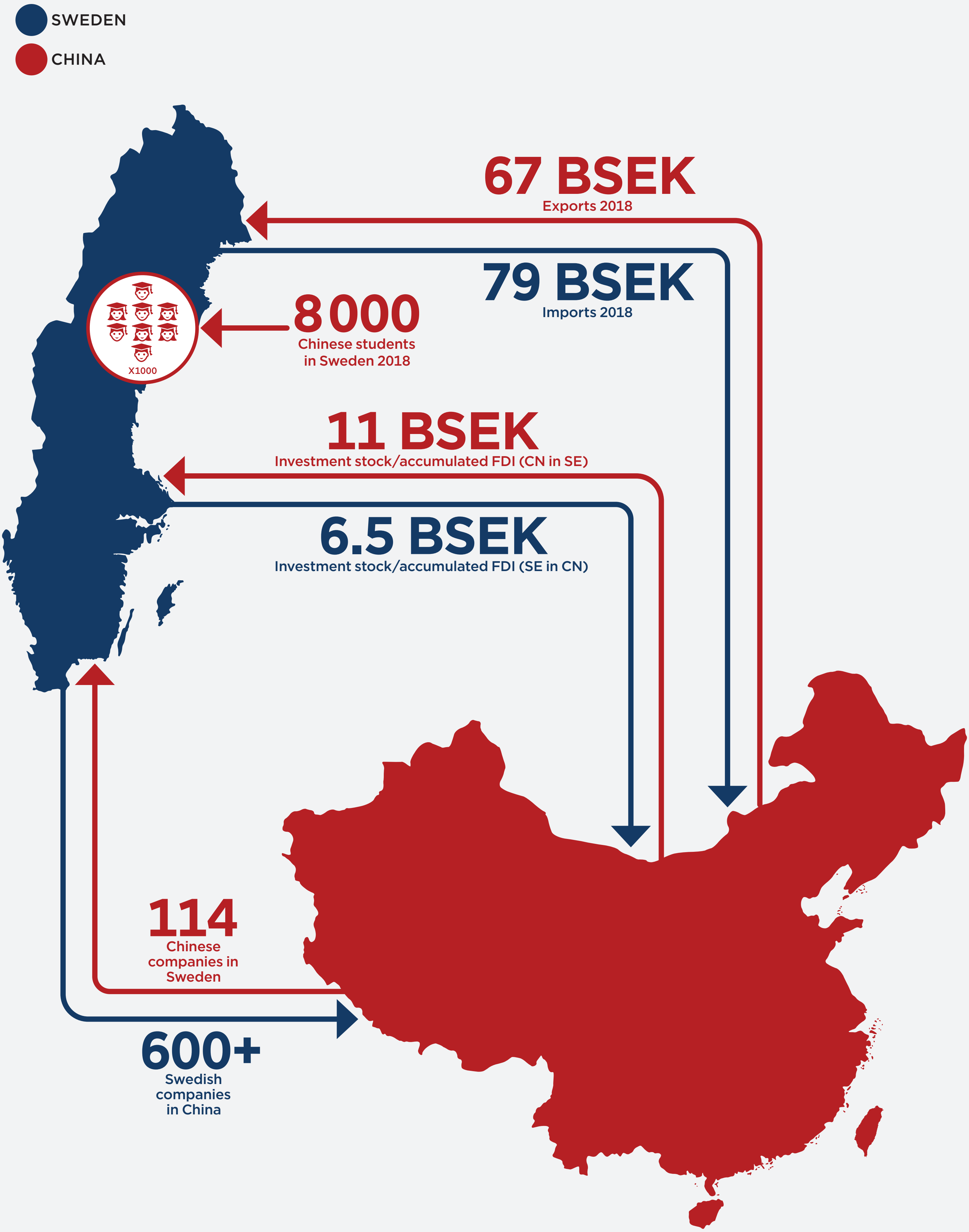
China is Sweden's most important trading partner in Asia. Exports to China grew from SEK 40 billion in 2014 to more than SEK 67 billion in 2018, representing 5% of Sweden's total exports. This amounted to a growth of 68%, considerably faster than Sweden's overall export growth during the same period.[2] When looking at the total consolidated revenue of Swedish companies in China – a broader measure than exports – this figure exceeded SEK 350 billion in 2018, i.e. around 10% of Swedish companies' global sales.[3] Several large Swedish companies now have China as their most important market globally. The importance of the Chinese market – both in terms of exports and revenue – is now approximately the same as that of the US market.

Considering both the importance and the complexity of the Chinese market we also believe that Swedish companies of all sizes and across many industries need to be more aware and informed about the current situation and how it is developing. Even Swedish companies who might not be actively doing business with China today, or do not yet have Chinese competitors abroad, are advised to learn more as the Chinese economy and companies are ever more likely to indirectly or directly impact them, their customers or their suppliers.

TODAY CHINA IS A CRITICAL MARKET FOR MANY OF SWEDEN'S LARGEST COMPANIES



STRATEGIC GLOBAL PARTNERS[4]



Swedish companies can become key suppliers and strategic partners to support a necessary lift in productivity and capability in China's industry.

WHAT'S "NEW" IN THE NEW ERA?

Until a few years ago, the general assumption or expectation among the business community was that China would continue to open up, meaning that market forces would play a more decisive role in the economy. That was the working assumption of the 'new normal'.

Now, administrative reforms are strengthening the role of the State in many areas, including economic and technological development. This is a clear new direction from what was expected and has dashed hopes of a more hands-off approach to the economy by the Chinese government.

As an example, the policy known as *Made in China 2025*, launched in 2015, laid the strategic framework for how China should move up the value chain and increase self-reliance for technologies that were deemed crucial to long-term competitiveness. It also signalled more state involvement and guidance rather than relying on market forces in achieving these objectives.

The ensuing years have also revealed a new approach to the state-owned sector, where a significant difference is made between State Owned Enterprises (SOEs) in strategic and non-strategic sectors.

THE WORLD
- China more assertive on the global stage
- World's perception of China more negative
- Global trading system friction

THE MARKET
- Slowing growth and higher uncertainty
- Reforms and stricter enforcement
- Rapid digitalisation

THE CUSTOMER
- Domestic procurement becoming more mature
- MNCs increasingly buy local
- State sector increasing and not going away

THE COMPETITOR
- Narrowing technology gap
- Local competitors becoming global
- More mature, but still highly agile

In several strategic sectors, such as aerospace and high-speed railway, SOEs are trusted to deliver technological breakthroughs and global competitiveness – and have received investments and resources accordingly. In other strategic sectors, such as Artificial Intelligence (AI) and semi-conductors, also private companies, with support from the State, are expected to deliver on this ambition. But in non-strategic sectors SOEs have seemingly not enjoyed the same favourable treatment and some companies have been left to survive on their own merit. Few have been prepared for this development and many have struggled or even gone bankrupt.

The picture is not fully clear when it comes to the role of foreign companies. Over the past few years, China has reduced the "negative list" for foreign investments. From 2015 – 2018 the number of prohibited sectors reduced from 36 categories to 27, and restricted sectors from 38 to 21. Despite this liberalisation of the Chinese economy on paper, there is a sentiment among some business leaders that it has become less welcoming or even de-facto more restrictive.

In terms of technology leadership, it has become clear that China is shifting focus away from what are seen as core technologies today. Instead, major efforts are being put into new technologies such as solid-state batteries and autonomous driving – two areas that will be essential to automotive leadership in the 21st century. Over the past years the pace of digitalisation has also been rapid, especially in e-commerce and mobile payments – areas where China is now at the forefront globally.

The Chinese Government's white paper *China and the World in the New Era* outlines its engagement with the new world in the new era, showing how it has become more assertive and adept at articulating its vision of development.[5] Both the Belt and Road Initiative (BRI) and the Asia Infrastructure Investment Bank (AIIB) are examples of this in practice. But the new vision has even higher ambitions: to rejuvenate the Chinese nation and become a global leader in several areas of national strategic importance. By 2049, the 100th anniversary of the People's Republic of China, the government aims to turn China into a 'fully developed economy'. This is a top priority of the government and a key part of President Xi Jinping's "China Dream" concept.

These factors have created a highly dynamic environment with both opportunities and challenges for Swedish companies. For some Swedish companies, China's investments to achieve technology leadership has led to a larger demand for advanced equipment, services and know-how. On the other hand Swedish companies with technologies that intersect with China's ambitions have found themselves with an unprecedented challenge.

For either scenario, Swedish companies need to consider how they will be impacted and create and adapt strategies to minimise risk and maximise opportunities. The following sections will provide more details and examples on these changes.

THE WORLD IS CHANGING

In just a few decades, China has reached a level of international influence it has not enjoyed in centuries. But this has also been met by a significant backlash. Some Western countries blame China for the loss of manufacturing jobs in their respective economies, while Chinese investments are increasingly met with scepticism and scrutiny. It is difficult to understand the new era without understanding the full context of China's engagement with the world and its implications.

CHINA MORE ASSERTIVE ON THE GLOBAL STAGE

China has become a significant global player. China's share of global GDP has grown from 4% to 15% in less than 20 years. With 17% of the global population and economic growth more than twice the global average – this share is expected to continue growing.

> *"CHINA'S AMBITION IS CLEAR, AND WE DO NOT SEE THAT THIS WILL CHANGE."*
>
> *– Foreign diplomat*

This development process has seen China evolve from being a base for manufacturing and exports to become the world's biggest market in many sectors. Similarly, China's trade and investment relations with the rest of the world have quickly graduated from export-import relationships into a much more complex web of interconnections – including outbound investment, development aid, overseas infrastructure construction, military presence, active and assertive participation in international organisations and increasingly setting industry standards.

During the first decades of Reform and Opening Up (referring to market reforms initiated in 1978), China mostly integrated and participated in the existing world order – while the country is now actively shaping and increasing its influence in global multilateral settings. A clear sign of China's increasingly international confidence and assertiveness is the BRI and the setup of AIIB. Both initiatives promote China's vision of development with a clear focus on infrastructure development.

But China's involvement in the world is not only about state-directed initiatives. Many private Chinese companies have proven successful in markets neglected or ignored by Western competitors. For instance, Beijing-based Xiaomi, a private consumer goods and tech company, is the market leader for smartphones in India with 29% of smartphone shipments.[6] Similarly, there are numerous examples of private companies following the lead of Chinese SOE investments into Africa. These advances are not limited to emerging markets, with Chinese companies such as Huawei, BYD and DJI making inroads in mature western markets.

WORLD'S PERCEPTION OF CHINA MORE NEGATIVE

As China's role on the world stage has become more visible, the world's perception of China has changed. China instils "fascination, greed, and fear" in the outside world all at the same time.[7]

While most people are amazed by China's achievement of developing its economy and seeing 800 million people leave absolute poverty over the last 40 years, many also see at least part of the advances in innovation and technology owing to the "generous state subsidies, significant market protection and a long record of unfair trade practices".[8]

Industrial policies such as Made in China 2025 and other protectionist measures have caused concern in the US and Europe. Made in China 2025 is a strategic plan aimed at transitioning the Chinese manufacturing industry from low-end to more advanced high-end products and technology solutions. Although this type of industrial policy is not new in China (other examples being the Five-Year Plans as well as The National Medium- and Long-Term Program for Science and Technology Development 2006-2020), China's scale and new role seem to have led to a different view of these in recent years. This backlash is also in response to China's attainment of a higher level of technological competitiveness and confidence in articulating its ambition. This is seen as stepping away from Deng Xiaoping's approach of "hide your strengths and bide your time". It is unlikely that China will shift away from its model of State capitalism, which is increasingly becoming a large point of friction in its relationships with the US and the EU.

> *"IT IS NOT STRANGE THAT WE SEE A LOT OF ACQUISITIONS IN THE AREAS RELATED TO MADE IN CHINA 2025… THIS AREA WILL SEE A LOT OF GROWTH GIVEN THE STATE'S INVOLVEMENT, SO EVERYONE IS TRYING TO CAPITALISE ON THIS."*
>
> *– Chinese investor*

There are widely separate views on China's new role on the world stage, which ranges from a 'strategic partner' to a 'systemic rival'. While the US is on one side of the spectrum, many developing countries see China as a welcome addition to traditional Western partners and perceived failure of aid programs[9]. Developing nations, for example, have showed considerably stronger enthusiasm for the BRI.

It is not only government's perceptions of China that are shifting, those of the general public are also showing important trends. These have been captured in reports like the 2019 survey by Pew Research Center showing a significant change towards a less favourable opinion of China in North America, the EU (especially north-western countries) and parts of Asia-Pacific. Even in emerging markets like Indonesia, Philippines, Kenya and Tunisia a considerably

How will China's international relations impact your business?

Have you asked yourself the following questions?

- What opportunities and challenges for your business arise from China's increased presence globally? (investments, standard setting, economic landscape etc.)
- How is your board of directors' and management team's view of China affected when the world's view is changed?
- Have you developed scenarios for how to adapt your footprint and supply chain in case of prolonged or increasing trade friction?

more negative view was evident. At the same time, countries including Italy, Nigeria, Israel and Poland shifted towards a more positive view.[10]

It is also important to understand the difference between how the world views China and how China views itself. While many see China as a behemoth with vast resources, China itself often measures itself in terms of GPD per capita and consider itself far away from other leading economies.

GLOBAL TRADING SYSTEM FRICTION

Public opinion in the world has become more hostile to globalisation, with the result of a new wave of elected governments opposing openness, free-trade and other liberal values. Even the current US administration, a country that traditionally has been a champion for free-trade, has changed its attitude and is ignoring international institutions and rules that itself was part of setting up.

The protracted friction and backlash against China have led to the acceleration of its 'self-reliance' drive. The idea of being self-reliant in terms of economy, human and natural resources, technology, capacity for autonomous goal setting and decision-making etc. has been at the core of the CCP for 70 years.[11] With recent backlash and disruption to supply chains, China's sense that it cannot be dependent on other countries has become stronger. And this in turn reinforces the belief among many Western counterparts that they cannot trust China either.

To manage this uncertainty foreign companies will need to re-think how they operate. A regionalisation of supply-chains can already be seen, with some companies adjusting, as much as possible, towards having one 'China free supply chain' and one 'in China supply chain'. Changing policies can have serious implications, as Dow Chemical Company experienced when the Chinese government redirected natural gas needed for their operations to heat houses in Beijing during harsh 2017 winter. This resulted in a three-month disruption to their global supply chain, showing Dow that reliance on China could be problematic. Similarly, several companies suddenly affected by new tariffs or regulations have restructured their supply chains.

The most obvious example of this friction is of course the US-China trade conflict that started in 2018. Although the pretext for the conflict is the US trade deficit with China, the underlying challenge including ideological, technological as well as perceived or real market access barriers runs deeper than that.

Given China's growing role in the world, it is realistic to assume that all countries and companies will be affected. To mitigate risk, a proactive China strategy that is not static and that is not based on old beliefs is essential.

"IT WAS NOT HARD TO BUILD A BUSINESS WHEN SECTORS SAW DOUBLE-DIGIT GROWTH. IT IS MUCH HARDER NOW AND WE WILL SEE MANY COMPANIES STRUGGLING."

– Finnish service provider

THE MARKET IS CHANGING

The Chinese market is constantly evolving at a rapid pace. Despite economic growth slowing, China is still a very attractive market in many sectors. The government continuously introduces and carries out reforms that changes the conditions for foreign firms in the market. One of the most striking changes in the Chinese market in recent years is rapid digitalisation, both in sales and marketing as well as in a broader sense throughout industry.

SLOWING GROWTH AND HIGHER UNCERTAINTY

The Chinese growth rate has been gradually slowing during recent years with real GDP growth at 6.6% in 2018 being the slowest since 1990.[12] This slowdown is a natural consequence of the economy maturing, but also a consequence of policy makers addressing the earlier rapid build-up of debt with more limited credit growth as a result. A central goal of the Chinese government is to shift the economy from primarily investment-led growth to focus more on domestic consumption and services.

While the growth is slowing on a national level, it is also apparent that Chinese regions and clusters are growing at different speeds on the consumer side and in industry. Traditional heavy industry and manufacturing are no longer undisputed backbones of the economy, while several technology clusters are growing rapidly. It is therefore important to approach China not on a country level, but rather on a more granular province or city-cluster level.

Despite slowing growth, China continues to be the major driver of world economic growth and accounted for around 30% of global growth in 2018.[13] This is due to the absolute size of China's current economy. At that size, 5% annual growth would equal adding approximately one Sweden to its economy every 10 months and one Germany every six years.

REFORMS AND STRICTER ENFORCEMENT

Ever since Deng Xiaoping launched the landmark Reform and Opening Up policy in 1978, this has been a core part of the CCP's communication on economic policy. But the meaning of the term 'reform' continues to evolve. Previously it was mostly perceived and expected as a process to give more room for market forces, encouraging entrepreneurship and reducing the power and importance of the state-owned economy. Today, the term only partly carries the same meaning, and is used to refer to changes more generally, even those that might describe ways to strengthen the State's grip on the economy. This is evident in sectors deemed to be of strategic importance, such as aerospace and high-speed railway where in recent years the government has consolidated several SOEs – in effect recreating the monopolies or duopolies that were removed earlier in the Reform and Opening Up process.

"CHINA HAS GONE FROM A BIG COUNTRY THAT IS GROWING VERY FAST, TO BECOMING A VERY BIG COUNTRY THAT IS GROWING FAST."

– Swedish company representative

China is constantly reforming its economy and addressing challenges that threaten to destabilise continued economic growth. The below examples of ongoing reforms and changes are not an exhaustive list, but an overview of key initiatives and an indication of some of the changes companies need to follow and understand what impact they will have on their relevant industry segments.

With national programs and reforms contributing to strengthening of the State, several market actors are wondering if it is 'reform and opening' or rather 'reform and closing'. Many foreign observers have disappointedly given up hope that China will open up and become a more liberal market driven economy like those in the West.

RAPID DIGITALISATION

China has taken a global lead in e-commerce, accounting for more than 40% of the world's total e-commerce transactions in 2017.[15] The digital eco-system has been led by the local internet giants Baidu, Alibaba and Tencent (also referred to as the BATs).

KEY POLICIES AND REFORMS[14]

FINANCIAL DELEVERAGING/FINANCIAL SUPPLY SIDE REFORM (FSSR)

In 2015, China launched a structural deleveraging campaign with the goal of mitigating economic risks stemming from a long period of rapid credit growth. An important impact of this has been that many private companies have had a harder time accessing credit compared to SOEs.

ENVIRONMENTAL LAWS AND ENFORCEMENT

Laws and enforcement have become much stricter in an attempt to address serious environmental issues. For companies with more sustainable solutions this creates new opportunities but at the same time it brings challenges, e.g. in terms of supply chain disruptions and new costs.

SUPPLY-SIDE REFORM

A wide program of reforms with the stated objective to address systemic overcapacity by improving the usage of resources, consolidating industries and creating healthy competition while also transitioning to a sustainable, consumption driven economy.

FOREIGN INVESTMENT LAW (FIL)

The FIL is said to be aimed at levelling the playing field for foreign investors and Chinese firms by promoting stability, transparency, predictability and fair competition. However, due to parts being vague and implementation details unclear, its implications are still uncertain.

REDUCED NEGATIVE LIST FOR INVESTMENTS

The Chinese government continues to update the negative and prohibited lists, now containing fewer restrictions on foreign investment than before. In addition, an extended Catalogue of Encouraged Industries for Foreign Investment has also been released with information where foreign investments are encouraged.

CYBER SECURITY

A highly prioritised area for the government and rapid changes to the legal system. However, major uncertainties remain and concerns over trade secrets for instance, are being raised. Given rapid digitalisation and the importance of data, foreign firms need to follow this closely.

CORPORATE SOCIAL CREDIT SYSTEM

By combining many different data sources all companies will be assessed on a wide range of factors to decide their social credit system rating. Good ratings will bring benefits while poor ratings can restrict a company's ability to operate successfully. Fear among the international business community is that it can be used as a political tool against foreign companies.

These companies are now leveraging their deep-seated understanding of managing customer data from B2C e-commerce into the B2B segment with digital procurement. Already some dominant platforms have emerged, such as imall.1688.com (Alibaba), imall.jd.com (JD) and Epec.com (Sinopec's procurement platform).

China is also making rapid progress in digitalisation with advances in areas like 'Smart Manufacturing'. Chinese factories account for one-third of the 'manufacturing lighthouses' or primary drivers for adopting new technology in the fourth industrial revolution.[16]

With rapid rollout of 5G and IoT, China is becoming an early market of connected and smart devices and equipment. It is estimated that China currently account for 64% of all IoT connections in the world, or approximately 960 million devices.[17]

The government has a stated ambition to become a world leader in AI and Big Data and is pushing companies to both lead the development and implement solutions. Apart from having benefited from a clear national AI strategy, Chinese AI firms have also received more funding than US companies and in 2016 China's government established a USD 30 billion VC fund in Shenzhen dedicated to AI.[18]

China not only has a growing, well-educated work force to support these advances in digitalisation, automation and AI, but also many niche specialty competencies that are hard to find in other countries. Given this talent pool, the Chinese R&D ecosystem is becoming globally competitive.

How will market dynamics impact your business?

Have you asked yourself the following questions?

- How is the growth in your industry impacted by the overall slowdown and have you assessed various scenarios?
- Do you have processes in place to monitor and adapt to changing regulations?
- Do you have a digital strategy in place that is adapted to the specific local requirements in China?

CUSTOMERS ARE CHANGING

Just as the market continues to evolve, so are customers. They are more mature, know what they are looking for and use local solution providers when possible. Contrary to common beliefs, the state sector is expanding and strengthening its grip in several sectors.

DOMESTIC PROCUREMENT BECOMING MATURE

Chinese customers are becoming increasingly mature buyers and aware of what they want. Many sectors in China could previously be divided into clear segments, such as premium, mid-market and entry-level. Swedish companies typically populated the premium market. However, in several sectors there is no longer a clear divide between premium or mid-market, and the customers are rather looking for 'fit for purpose'. This means that a premium solution can be needed for part of a project or a manufacturing process, while for other parts, a mid-market solution will do the job. Solely relying on a premium solution or a separate mid-market offering will, in many sectors, lead to lost opportunities as customers demand a mixed offering.

Customers also put high value to local presence and responsiveness. Long lead-time normally is a disqualifying factor, and in some cases, large customers demand onsite support 24/7. As customers are increasingly working with online procurement, companies also need to ensure they have the right digital presence. Given that the digital ecosystem is vastly different in China, it is simply not possible to manage this from a distance and only rely on a global digital sales and marketing strategy created for another market.

Many Chinese customers calculate cost and return on investment based on project duration, but there is a growing segment of customers increasingly considering life-cycle value. More mature customers can benefit from business values associated with more advanced economies, such as productivity, sustainability and safety. The prospect to sell services is improving – i.e. a focus on OPEX rather than CAPEX might be realised in some projects.

MULTINATIONALS INCREASINGLY BUY LOCAL

The reasons why SOEs and multinational companies (MNCs) are increasingly buying local has somewhat shifted over the past years. Previously, overcapacity and increased focus on cost-saving was a key reason for switching to local suppliers. Companies realised that if a factory was not operating at full capacity, it was not necessary to have the most productive equipment, i.e. premium solutions. Now, in some cases, the local alternatives have become better and the differentiation of foreign solutions is not always obvious.

Most MNCs have been in China for a long time and have become mature enough to buy local. Foreign suppliers that are not present in China run a high risk of being substituted for local alternatives, especially non-core components and products. Although foreign suppliers in some cases might be protected due to specifications set globally rather than in China, this advantage cannot be relied on. As more and more innovation and product development takes place in China, local alternatives will be in a better position to be included in the product specification from the start.

Local suppliers can provide benefits such as rapid responsiveness, local know-how and willingness to tailor solutions, which enable MNCs to compete with local competitors and stay relevant in the Chinese market. Perhaps less obvious is that having local suppliers can be turned into a selling point when MNCs are participating in state funded projects or when selling to SOEs. For example, projects along the BRI favour Chinese-owned suppliers. If an MNC can show that a large enough share is local content, this can be the argument that counters this non-explicit requirement.

Another factor driving the buy-local trend is general market development. Each time there is a slowdown in a market segment, cost-pressure means another round of localisation.

STATE SECTOR INCREASING AND NOT GOING AWAY

During 2009–2015 non-SOEs accounted for the largest share of Fixed Asset Investments in China, however SOEs have out-paced private sector investments since then. In 2018, centrally controlled SOEs also recorded record revenue and profits.[19] The private sector in China has been struggling over the past few years due to reduced access to credit amid a slowing economy. Chinese banks are more willing to grant funds to SOEs because those loans are implicitly guaranteed by the government. This shift to the State is problematic as the private sector is also playing an important role in China's job creation and innovation drive.[20]

PRIVATE SECTOR CONTRIBUTION TO JOB CREATION AND INNOVATION

60% of China's GDP

70% of innovation

80% of urban employment

90% of new jobs

Made in China 2025 aims to position China as leader in 10 high-tech sectors. At the core of this initiative are the selected 'National Champions' who will contribute to increasing the Chinese content of core components and materials to 40% by 2020 and 70% by 2025.[21] The companies have important positions in strategic industries and are protected and supported by the state with access to cheap credit, R&D funding and a pipeline of projects. This illustrates China's continued reliance on SOEs for economic development. Foreign companies competing with National Champions face a tough battle given the preferential treatment they receive. On the other hand, SOEs have been an important customer of Swedish companies and will continue to be so.

In the new era, industrial nationalisation and privatisation is happening at the same time. Since the beginning of 2018 until mid-2019, 21 private companies have sold large stakes to SOEs.[22] Of these, 10 companies are effectively nationalised, while several struggling SOEs have been encouraged to open up for mixed ownership. The most prominent example is China Unicom who sold shares to 14 private investors. Although the state's ownership share has been reduced from 63% to almost half, many of the private investors are de facto JVs controlled by the State.

How are you adapting to changing customer needs?

Have you asked yourself the following questions?

- Do you have a product portfolio that ensures leading solutions while also providing depth from premium to mid-market?
- Do you have the right setup to stay relevant for your international customers in China?
- Do you have the right capabilities in place to win with large, complex SOEs?

COMPETITORS ARE CHANGING

Chinese competitors are in several cases narrowing the technology gap more rapidly than previously expected, some organically and others through acquisitions. Internationalisation usually adds to the Chinese companies' competitiveness as they add volume and can increase their R&D spending. As Chinese companies become more mature, differentiation becomes more challenging for foreign companies.

NARROWING TECHNOLOGY GAP

Findings from Team Sweden's Business Climate Survey for Swedish companies in China 2019 suggest that Chinese companies are now the most common competitors to Swedish companies in China. China has invested heavily in new technologies and digital solutions during the past few years and is currently second in the world for R&D spending after the US, overtaking the EU in 2015.[23] The speed of development in China is fast and the technological gap between Western and local companies are in many industries narrowing rapidly. In other industries the Chinese competition has already surpassed global peers.

China's investment in and rapid technological advancement crosses industry boundaries and has already seen them implement long-term sustainable solutions both locally and globally:

– China has set up over 25,000 kilometres of high-speed railway lines since 2008, more than the total high-speed lines operating in the rest of the world.[24]

– Chinese company DJI Technology has developed very fast and now holds more than 70% of the global drone industry market share.[25]

– More than half of the world's electric buses are running in Shenzhen and China accounts for 98% of all electric buses on the roads globally.[26]

– Chinese electric vehicle manufacturer BYD has started selling electric busses in Europe. In 2013 it won a tender to supply Amsterdam's Schiphol Airport with 35 electric buses and in 2019 to Brussels Airport Company, operator of Zaventem Airport ordered 30 buses. BYD has in total sold more than 600 electric buses in Europe, including to the Swedish market.[27]

Where the technology gap is too great, Chinese companies also make use of acquisitions to access the technology needed, like the acquisition of Kuka, a German robotics manufacturer, executed by the Midea Group in 2017.

Overseas M&A by Chinese firms have been active in number of sectors but by deal value*, they have been most active in:

– Telecom, media and technology (TMT) 34%

– Life sciences 18%

– Mining and metals 17%.[28]

"THE FIRST THING I DID WHEN I GOT HERE [Shanghai] WAS TO REPLACE ALL OUR GERMAN SUPPLIERS THAT WERE NOT PRESENT IN CHINA WITH CHINESE ALTERNATIVES."

– General Manager for German industry group

With EUR 6 billion, Sweden was the seventh largest destination for Chinese FDI transactions in the EU between 2000 and 2018.[29]

As a consequence of the focused innovation and also adoption in the market, foreign companies will face even tougher competition from Chinese companies. There is already a belief among some Swedish companies that foreign companies will need to licence or acquire technology from Chinese companies. A positive effect with Chinese companies moving up the 'innovation ladder' is that these firms and the Chinese government care more about IP and IP laws.

LOCAL COMPETITORS BECOMING GLOBAL

In the Forbes Fortune Global 500 Companies 2019, China accounted for 119 companies by revenue, on par with the US with 121. The revenue source for these Chinese Fortune 500 companies is still to a large extent domestic with less than 20% of their revenue coming from overseas, although this share is increasing.[31] This indicates that most Chinese firms are still dependent on the domestic market and have not

"WE SEE MORE MATURE CUSTOMERS TODAY! WITH INCREASING COST LEVELS, WE SEE GREATER DEMAND FOR UPTIME AND RELIABILITY. THEY ALSO WANT CONNECTED SOLUTIONS TO MEASURE PERFORMANCE."

– Swedish company representative

yet fully integrated globally. With the domestic market slowing and many industry segments increasingly being saturated, Chinese companies naturally look abroad for new growth opportunities.

Strategic initiatives by the Chinese government such as the BRI are aimed at expanding Chinese firms reach and promoting investments abroad. The initiative does not only present direct opportunities for involved companies, but also indirect opportunities for others by improved logistics and access to new markets. Southeast Asian countries are closely linked with China through regional supply chains and it has become a key region of investments by Chinese companies in manufacturing, financial services and e-commerce.[31] China and ASEAN have upgraded the China-ASEAN Free Trade Area, which already has implemented zero tariffs on more than 90% of goods traded between the countries.

Expanding abroad is not an easy task for most Chinese companies, which Alibaba's challenges in South East Asia prove.[32] But for those who succeed, increased volume adds to their competitiveness. This is becoming evident for Swedish companies as competitors are expanding in South East Asia and, due to increased economies of scale, can lower prices further in China.

For other Swedish companies, Chinese companies venturing overseas can mean new business opportunities, either through sales or partnerships. Some deals have exemplified that this can form the basis for deal logic in M&A. Some Chinese companies have used Swedish companies' expertise, distribution channels and service networks for expansion abroad, while they in return have given increased access to the Chinese market for joint win-win domestically.

MORE MATURE, BUT STILL HIGHLY AGILE

Requirements on compliance with environmental laws, tax regulation and social insurance have increased significantly over the past years. This development has contributed to making Chinese companies more mature and has also, in some areas, evened the playing field in relation to foreign companies. This has made Chinese companies more prepared with international standards as they expand abroad. At the same time, it has forced them to incur costs to comply which is leading to a reduced difference in price with foreign companies.

The generational shift in management is leading to an increased maturity at Chinese companies as an increasing number of management teams are now highly educated and have international experience from working with MNCs.

While many Chinese companies have matured, they are still highly agile and work at 'China speed'. The use of technology to drive agile decision-making is being implemented and at one particular company they can make board decisions over WeChat in a matter of hours rather than in quarterly board meetings. Although that carries other downsides in terms of governance, the speed is difficult to match.

How is increasing competitiveness of Chinese companies affecting your business?

Have you asked yourself the following questions?

- How big is the technology gap to your most prominent Chinese competitors and how will you stay ahead and differentiate?
- Where outside of China do you face Chinese competitors and how can you use experience from meeting them in their home market?
- Have you recently assessed opportunities for partnerships or acquisitions that can increase success both in China and elsewhere?

IMPLICATIONS

Our findings show that many Swedish companies have had positive development in China and the majority of business leaders also have an optimistic outlook for the market. In 2018, on average, sales in China represented 10% of global sales for large Swedish companies. While this is significant and makes China a critical market for many companies, there is potential to increase this substantially going forward. To be a future global leader in any industry or sector, it will be critical to be a leading company in China. Swedish companies need to be bolder to grow business, but the challenge is doing this while the market dynamics are becoming more difficult and uncertain. A more strategic approach rather than opportunistic mode is required.

"IT'S TOUGH FOR PRIVATE CHINESE COMPANIES. WE HAVE BEEN FORCED TO SELL OFF INVESTMENTS TO SOES IN ORDER TO STAY IN THE GAME."

– Chinese company representative

The changes occurring in the new era of China are creating a particular set of implications which can be the starting point for developing a strategy to grow business and become a leader in the Chinese market.

A more polarised and uncertain world requires increased attention, readiness and reassessment of established practices

Since the 2008-2009 financial crisis, globalisation has been rolled-back and assumptions that a global footprint can be optimised globally needs to be stress-tested. Companies need to reconsider how to balance investments regionally as China cannot be relied on as a global manufacturing hub. Equally, supplying key components to China from the EU or the US can be a difficult equation, demonstrated by the steel sector which is subject to Chinese tariffs in both regions.

The uncertainty goes far beyond supply chains as it affects political rhetoric, customer sentiments, investments and other growth drivers.

A more complex and mature market requires long-term commitment combined with short-term adaptability and speed

With market maturity comes increased competition and saturation. During the period when many sectors were enjoying double-digit growth, the barriers to building a business were practically non-existent. The situation now demands high operational efficiency and compliance with higher standards and environmental regulations. On top of this comes wide-sweeping reforms and tightening enforcement, which are being implemented differently across the country. A more complex market requires a more strategic, yet pragmatic approach to operating a business.

Companies will need to continuously monitor and anticipate how new policy will affect its business and be ready to respond with quick actions. Participation in standardisation committees to set industry standards is one way to proactively shape the environment. If not managed properly, it can become a disqualifier in procurement processes both in China and along the Belt and Road.

As customer preferences and purchasing behaviours are changing, Swedish companies need to adapt offerings and accelerate digital enablement.
As the tastes of Chinese customers within both B2C and B2B segments evolves, companies need to rethink how to continue to be relevant.

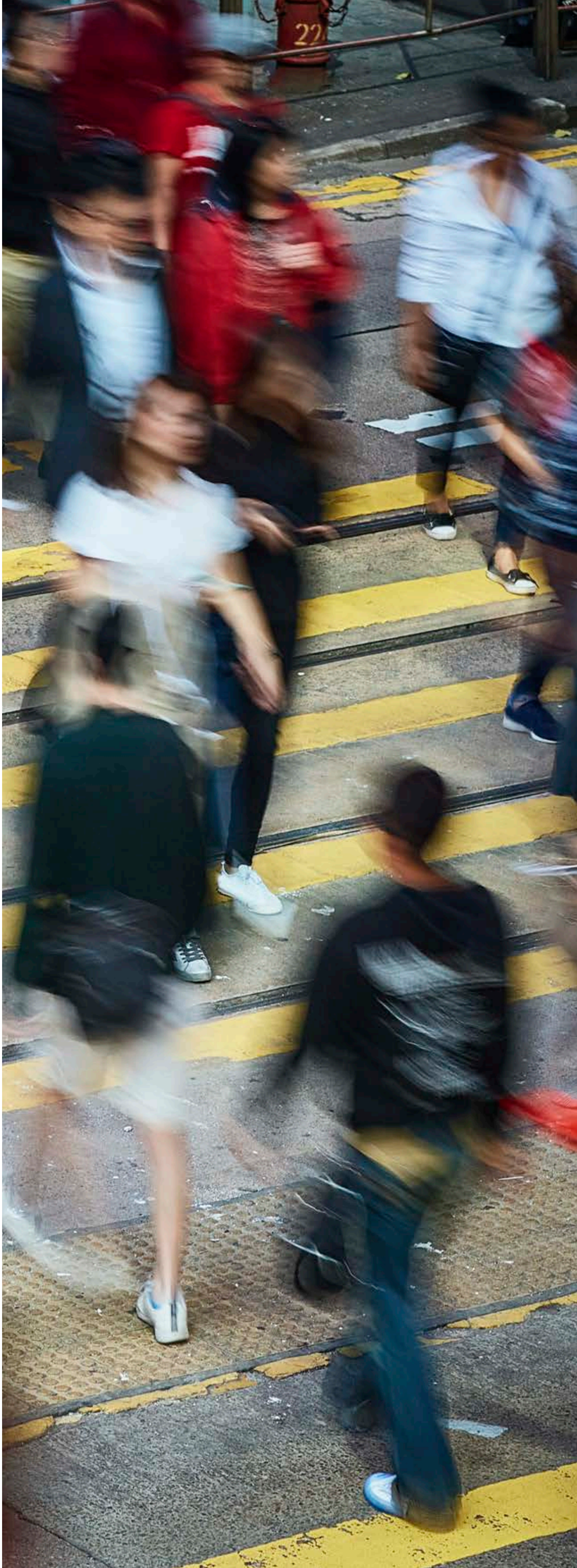
Two fundamental shifts have happened over the past few years:

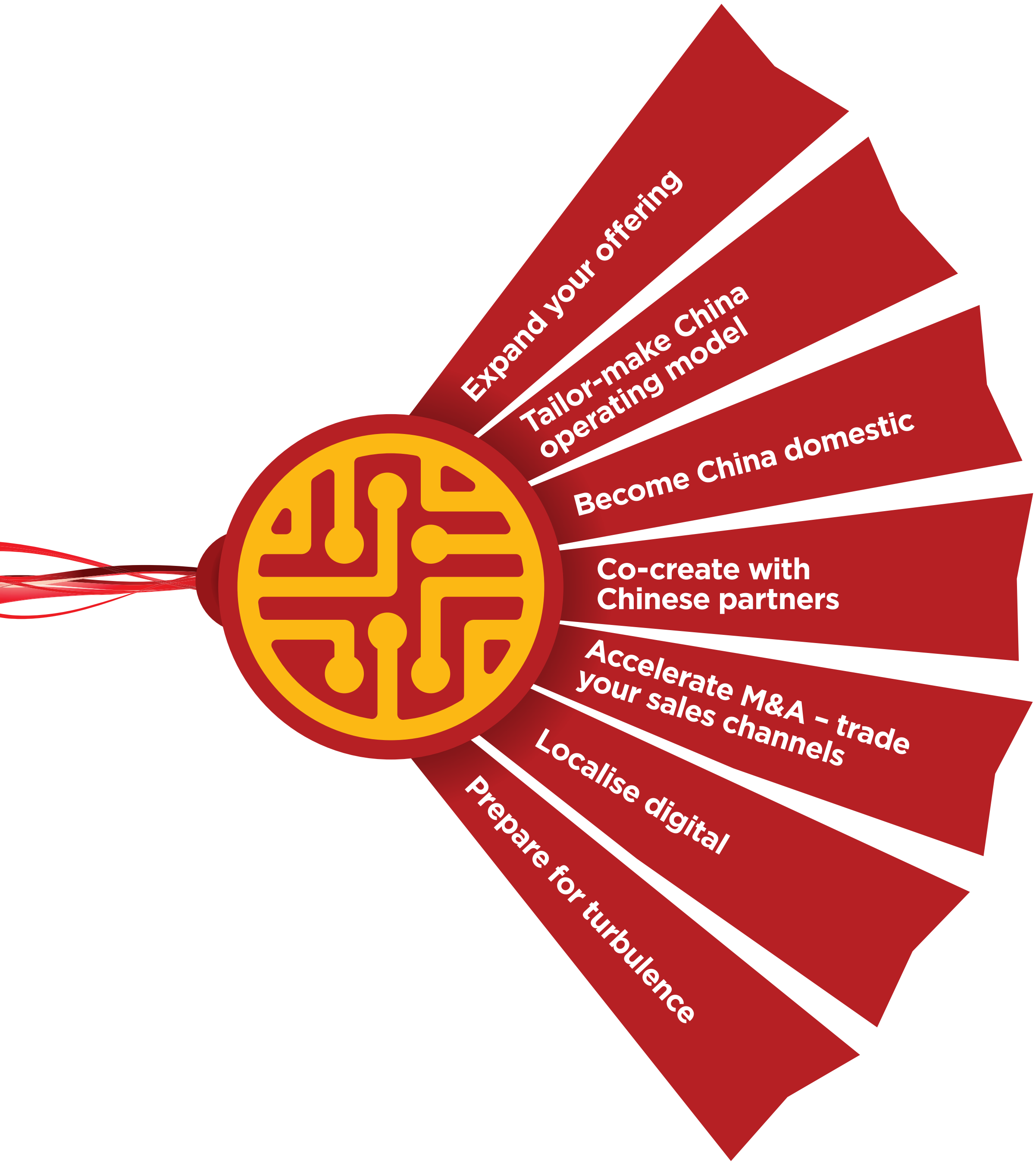
1. An increased sophistication of buyers and fit-for-purpose approach mixed with highest productivity solutions with good enough products
2. Procurement and purchasing decisions have increasingly been influenced by online channels and driven through digital tools.

Swedish companies that are not able to offer the mix of their premium and mid-market portfolios, or aren't visible online, will have a challenge keeping up with competitors that do.

With increasing presence from Chinese companies abroad, Swedish companies need to leverage experience working with Chinese customers, partners and competitors to other markets.
Given China's role regionally and globally, as well as the 'go out' strategy, China cannot be viewed in isolation. A regional or even global approach is needed to unlock the full potential and ensure that opportunities are not missed. As Chinese companies become more global, it is important to leverage experience in China from working with Chinese partners, customers and competitors and use these in other markets. Failing to do this can become a costly mistake. Opportunities will be missed, and orders will be lost to Chinese competitors as they venture into new markets.

For most companies, China is simply just too big to ignore. Even if you do not have operations in China, you need to have a China strategy.





STRATEGIES FOR GROWING IN THE NEW ERA

The new era clearly presents Swedish companies with new challenges regarding vague market regulation, changing legislation, domestic policies and increasingly intense and capable Chinese competition. But Swedish companies are in a good position to adapt to these challenges and could even turn these into opportunities.

Business Sweden has seven strategic recommendations for growing in the new Chinese business landscape. These are not 'one-size-fit-all' or stand-alone solutions, but rather a set of common strategies to be considered when developing a long-term strategy for China.

EXPAND YOUR OFFERING

Swedish companies have been successful in China for a reason; for primarily providing the best solutions and offerings with world leading technology. Swedish companies have also been able to understand customer needs or been part of developing whole industries. Tetra Pak developing China's dairy industry is the stand out example of this. Swedish companies have also gradually ventured into the mid-market with 'value offerings' to match a wider customer base and protect their premium offering. This engagement needs to continue.

To stay relevant, Swedish companies will increasingly need to mix their premium and mid-market offerings to both customer and project. The previously 'good enough' attitude has been replaced by a strengthened "fit for purpose" requirement. As the Chinese market is becoming more mature, services will also become more important, both for the premium and the mid-market applications. For many companies this will be perceived as a challenge with a risk of the multi-brand portfolio cannibalising on the premium. But the alternative of not being relevant is a bigger risk.

As Chinese customers mature, they are increasingly receptive to consider new business models. This include examples such as leasing or other financing solutions, bundled service contracts or even performance-based models. For many companies the time is right to develop more value-added services.

As China is becoming a 'leading market' for some products and solutions, Swedish companies will benefit from developing these areas with China in mind but leveraging them elsewhere first. Key development areas are electrification, IoT, Smart Manufacturing and other areas where China will move fast.

TAILOR-MAKE CHINA OPERATING MODEL

Given its high relevance to Swedish companies' global revenue, Swedish executive management teams and boards of directors can't ignore China's importance and role in the world. There are few examples of Swedish company executives being localised in China and only one example of a CEO from an A-listed company being located in the market. This will need to change, especially when local experience is more crucial than ever. As China is a top 3 global market for the majority of Swedish companies, at least one person from the executive management team should be located in the market.

In addition to strong leadership with clear mandate the organizational structure needs to be considered. Many Swedish companies are organized around product or customer segments in matrix structures. In China however the experience is often that these structures are less effective, being too slow or inflexible, and thus a localized version with clearer hierarchies are needed.

China's role in the organisation should not be viewed in isolation. Experience from working with partners and customers as well as fighting against competitors in China needs to be leveraged throughout the organisation, in both emerging as well as mature markets. When China is viewed in isolation, there is the risk of missing opportunities as well as a limited effectiveness in dealing with China related opportunities and challenges overseas. Especially as Chinese customer venture abroad, a collaboration between the team in China and other markets needs to be strengthened. It might even mean having Chinese staff placed abroad. Not viewing China in isolation also applies for M&A activities when acquisition of local players should focus on the synergies of scale-up outside of China. Equally, for R&D, many start out adapting to the local but soon become relevant for the global market.

BECOME CHINA DOMESTIC

Adapting speed and agility is key to becoming truly efficient and competitive in China. Lengthy internal processes for decision making, slow R&D processes with limited local mandates and other processes can be good for risk control but are well-proven recipes for irrelevance in the Chinese market. Consider setting in place a framework that ensures speed in China, while limiting potential downside risk to the Chinese market to be more relevant and agile. This framework should come with zero tolerance for failure in compliance, accounting standards, business ethics and other key values while allowing for faster iteration and adaptation to local needs.

Given the friction in the trading system, there are times when fronting with a foreign brand will be considered a disqualifier for large government-funded strategic projects. Companies with a multi-brand portfolio with domestic brands, should remain domestic – be careful in fully integrating an acquisition into the global business and consider significant independence while enhancing its capabilities.

CO-CREATE WITH CHINESE PARTNERS

Swedish companies should step up their R&D activities in China for several reasons:

– to adapt and develop products for the local market,

– to tap into the talent pool that exists in China, and

– to understand what future technologies are "in the works"

China is taking the global lead in some areas of technology and being at the heart of the development will be crucial in keeping up or retaining a place at the top.

Business Sweden's report Beyond Boundaries describes how business and product life cycles become shorter and market leaders increasingly struggle to stay relevant as well as how digitalisation has disrupted conventional industries and lowered entry barriers. The report also showcases how demand-driven innovation reduces time to market and lowers risk which is of importance in fast-growing Asian economies. These findings demonstrate that to stay relevant it is key to tap into vetted networks and access best-in-class innovation partners. China will be one of the key markets in this network-based innovation model going forward.

ACCELERATE M&A – TRADE YOUR SALES CHANNELS

Research shows that companies with poor inorganic growth struggle to keep up and risk losing their leading position to market actors who use M&A as a tool to accelerate growth and sharpen their relevance. This is also true in China.

The old trend of Chinese companies acquiring foreign technology to stay relevant is also starting to happen in reverse. Swedish companies are observing that for some technologies, Chinese companies with fast and agile R&D (i.e. a trial-and-error approach), are able to develop new product innovations also relevant outside of China. This forces Swedish companies to either speed up their own development efforts or acquire companies possessing new technologies.

Expanding beyond China's boarders has proven difficult for many Chinese companies as they have followed the 'go out' strategy promoted by the Chinese state. This challenge to internationalise offers a unique opportunity for Swedish companies to 'trade their global sales channel'; providing support in overseas market expansion in exchange for local support in the Chinese market. Swedish companies' edge in global markets can be an excellent platform for supporting customers and partners with their 'go out' strategy, and the strengthened relationship should result in more opportunities together also in China. Some well-known examples are:

– Vinda and Essity

– SDLG and Volvo Construction Equipment, and

– Dongfeng and Volvo Trucks

Past experiences of failed joint ventures (JVs) have left an overall bitter taste for foreign companies. However, when mutually beneficial collaboration opportunities in forms of JVs or strategic partnerships with Chinese companies present themselves, these should be explored.

Having a Chinese investment is another option that is often overlooked. To some companies, having access to Chinese capital and capabilities can be a game-changer. Volvo Cars is the primary example, but even limiting an investment to expansion in China or APAC region could increase the scale and likelihood of success.

LOCALISE DIGITAL

It has been recognised that China is at the forefront of e-commerce and other consumer oriented digital services. This has had a reinforcing effect which has further driven development of new technologies in China. The experience from e-commerce has also created new expectations from users for adoption of similar solutions in their workplace, where digital sales and marketing are increasingly deployed by industrial companies.

Many companies question if they should be the first to move or watch and learn from competitors. While keeping pace with Chinese competitors can be tough and requires large investments, it is a clear risk to be left behind if not enough attention is given to this area. It is better to do something now, than wait until it is too late. Several Swedish companies have localised marketing in WeChat or other local online platforms and have started selling standard products online. The next steps will be to offer solutions that need more technical or consultative sales and ensure that the offline generates alignment with online procurement requirements.

Digitalisation and e-commerce in China have been developed in a highly regulated market, where other platforms that those in the West have come to dominate. Therefore, a 'one size fit all' digital strategy that is built on global solutions and platforms will not be successful in China. Digitalisation needs to be addressed locally. If done well, it can have positive spillover effects on digitalisation efforts and activities in other markets.

Several risks remain with 'digital China', specifically concerning cyber security law, the corporate social credit system and cyber theft. Companies need to understand and prepare for the effort required to follow changing regulation around data management when working with digital initiatives in China.

PREPARE FOR TURBULENCE

Political, geopolitical, economic and business-related challenges mean uncertainties and complexities are higher than they have been for some time. This is not likely to change in the next five years so Swedish companies need to factor this into operations and business plans. Management teams need to have a healthy debate about where on the risk scale the company should place itself. A carefully measured approach is recommended, as being too careful and restrictive could mean loss of business while being too aggressive could mean risking it all.

Implementing scenario-based planning at a higher level will help address complexities. Companies also need improve their understanding for political risks and ability to navigate these given China's more strained relations with many other countries. Developing and improve capabilities to manage governmental relations can prove crucial.

Diversifying with a 'China +1' strategy will for many companies be a needed insurance against disruption, to create insulation from worsening trade friction and avoid disruptions to supply chains. Some companies are even forced to think in terms of 'China free' and 'China-tailored' supply chains. China-tailored may not mean 'made within China', but can also be relevant to other markets that have trade agreements with China.

"WE EXPECT MORE ALLIANCES WHERE THE CHINESE COMPANIES ARE CONTRIBUTING WITH THE TECHNOLOGY AND FOREIGN COMPANIES THE ACCESS TO THE GLOBAL MARKET."

– Swedish company representative

NEW ERA, NEW MODUS OPERANDI

The new era marks a clear trend shift in some areas, while for other areas previous trends have been further accentuated. The slowing growth, increasing competitiveness of Chinese companies and the “go out” strategy are examples of previous trends that have persisted. The largest shifts are being seen in China’s relationship with the world, how the state has shifted back towards guiding large parts of the economy, and the rapid implementation of digitalisation and ’smart industry’.

It is imperative that a tailored and modified strategy is implemented if Swedish companies want to succeed in the new context. This is a non-negotiable given the ever-increasing importance of China to Swedish trade and investment. In uncertain times and markets there is a need for adaptability while still committing to the long-term and pursing a clear vision.

China continues to stir emotions, some valid and some misinformed. A fact-based approach is recommended so opportunities in China are not missed. It is not the time for either a passive ‘wait and see’ or an overly aggressive approach, but a proactive and bold way forward which will ultimately deliver the highest rewards for those Swedish companies willing to tackle the critical issues in the short and long-term.

ABOUT BUSINESS SWEDEN

Business Sweden's purpose is to help Swedish companies grow global sales and international companies invest and expand in Sweden. Swedish companies can trust us to shorten time to market, find new revenue streams and minimise risks. We offer strategic advice and hands-on support in more than 50 markets.

Business Sweden has 15 offices across APAC and covers most markets in the region. Business Sweden is owned by the Swedish Government and the industrial sector, a partnership that provides access to contacts and networks at all levels.

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CONSIDERATIONS FOR SUSTAINABLE BUSINESS PRACTICES

The global demand and drive towards sustainable business growth is becoming a critical factor for success. Sweden and Swedish companies have and continue to hold a strong reputation in this area, and it should be a key aspect of any global growth plans.

Every market has unique characteristics that influence business operations, growth opportunities and long-term viability.

Before you enter the Chinese market, it is advisable to have a strategy in place to manage both macro and micro market related issues. This strategy should address all or a combination of, sustainability, legal and customs practices. In China, there is a shift towards adopting and enforcing sustainable business practices across the environment, economic and social spheres.

To reduce the risks of business malpractice and ensure you continue to meet international and Swedish standards and maintain economic stability, it is important to have a region-specific sustainability strategy.

A tailored sustainability strategy must address economic, human rights and labour condition issues and how your company aims to work with local suppliers to address these. It should also outline how you plan to meet and exceed environmental sustainability in accordance with applicable global and regional legislation.

China has a unique legislative system which defines and impacts how international companies can operate. Different signed trade agreements and tariffs also exist that may affect different industries or regions. A complete analysis of your legal responsibilities and the implications of these should be conducted before entering the market.

BUSINESS SWEDEN

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2019 231

We help Swedish companies grow global sales and international companies invest and expand in Sweden.

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