

# The New China

Impressions from a fast-changing,  
modern business world

This morning I got up early to go on a long bike tour around Dian Shan Lake, halfway between Shanghai and Suzhou, in search of nature and tranquility. I escape the busy and bustling life in Shanghai, a city with an official 25 million residents – some say it is at least 40 million – squeezed into an area of some 80 km in diameter. Around the lake I find the first traces of nature and traditional Chinese country life.

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As I cycle along, I see old Chinese villages and big stretches of farmland. I pass people who are washing both their food and their clothes in the natural waterways of this wetland-like area. I see many scooters and even more cars. Cars are everywhere but hardly any bicycles. Bicycles are now rusty and are for the elderly generation to use. Or, if you do see younger people riding them, they are fancy, well-known name-brand bikes. This ancient paradise rests among a number of big construction sites, bringing the modern city life style to the more remote country. Many compounds with newly-built modern villas in Tuscan, American or Scandinavian style have already been finished here – many of them still uninhabited. As I drop into a local village restaurant for dinner, two couples invite me to dine and chat with them. They tell me that they love the lake, so they bought a villa here. Prices are rising fast due to speculative investments, so you had better buy quickly. At night the promenade by the lake is packed with people dancing, walking and enjoying this natural treasure. Many come in their expensive, luxury cars of German or Italian origin. Today's bike tour certainly shows me how fast China has changed in the last 20 years. It is so different. ▶





## Facts and figures

As of the end of March 2016, China had an estimated 735 million square meters of unsold property.

(source: NBS)

In 2016 BMW and MINI sold 516,355 cars in China.

(source: finanzen.net)

200 million e-bikes are in use in China.

(source: bloomberg.com)

55.61 percent of the total population of China lived in cities in 2015. In 2005 it was 42.52 percent.

(source: statista.com)

## China innovates

Only a few years ago the stereotype of Chinese copying but not innovating mostly went unchallenged. This has changed. In 2016 Huawei was ranked within the top 50 most innovative companies in the world by the journal »Fastcompany« for the third time – replacing archrival Cisco. And in the year before, Tencent, Huawei and Lenovo made it to the edition of Boston Consulting Group's 50 most innovative firms.

According to Thomson Reuters, China is the global leader in pharmaceutical innovation. The country is successful, Thomson Reuters believes, because it has fostered a healthy mix of partnerships, pharmaceutical industry innovation and scientific research. In 2015, five of the top ten global organizations for filing pharmaceutical patents were located in China.

## The role of the state

What sets Chinese innovation apart from innovation in the West is the driving role of the state in China. Industries favored for development by state planners have easy access to cheap capital as well as land and they receive lavish export subsidies or other support.

In the past China's state-sponsored innovation programs did not create much progress and high-flying objectives were repeatedly missed. These days, however, things look different. While there are plenty of

ailing firms, among them many large state-owned enterprises, a new generation of highly innovative, market-driven and agile companies from the Internet and electronics industries like Tencent, Baidu and Xiaomi has emerged and these companies are developing rapidly into globally competitive corporations. The innovation capability has also risen due to heavy state investments in education and research. According to a recent survey conducted by the scientific journal »Nature«, Chinese universities are amongst the world's top universities in natural and life sciences. International co-operations with and acquisitions of foreign companies now play a crucial role in the innovation drive. Recent acquisitions of the German manufacturers enterprises Kuka, Aixtron and Manz aim at strengthening China's innovation capability in areas such as robotics, semiconductors and automation.

## Aiming for gold and silver

China's ascent is best highlighted by its advances in supercomputing, which are supposed to have a large impact on the country's scientific and technological progress. Today, China's Sunway TaihuLight supercomputer tops the ranking of the world's fastest machines, making it the first-ever Chinese homegrown computer to grab the number one spot. The TaihuLight is roughly three times as fast as the second ranked Tianhe-2, also made in China.

## Chinese giants in the making

Chinese industry as a whole is still a far cry from the advanced levels of the leading industrial nations. Some of the larger enterprises, however, the likes of Sany, Haier, ZTE and Midea, are catching up, rapidly increasing their international competitiveness or have already established themselves as global players with ambitions to world market leadership, as Huawei has. Chinese state planners wish to see more industrial giants emerge and develop into global players, like the South Korean Chaebol's Hyundai, Samsung and others.

## China at the crossroads

Overcapacities of hardly conceivable dimensions in industries like steel and cement or construction machinery, mounting levels of corporate debts, a strong currency and, most importantly, relatively high labor costs have undermined the international competitiveness of many industries in China, where productivity is still much lower than in more mature industrialized economies. Only huge productivity gains can ensure long-term growth and competitiveness of manufacturing in China, a recent McKinsey report says. This calls for fundamental changes in the ways of production.

## Industry 4.0 in China

Automation, digitalization, electric mobility, alternative energies and life sciences are at the forefront of a state-sponsored innovation drive which is expected to push China into the ranks of the world's most innovative and developed nations by around 2045. One key strategy for achieving this is »Made in China 2025,« the Chinese equivalent to the German »Industry 4.0« concept of digitalization in industry.

The future of the factory has already arrived at Sany's Changsha plant located in Central China, where the country's largest manufacturer of machinery and equipment produces pavers and cement mixers. One of Sany's many factories is completely digitalized; all machines are interconnected and continuously collect data which is essential for optimizing the production process, setting an example of the intelligent factory of the future that organizes and optimizes itself automatically.

Industry experts like Jost Wuebbeke of the Mercator Institute for China Studies see the country entering a new age in terms of industrial production, with most manufacturing enterprises still transitioning from Industry 2.0 to Industry 3.0, from traditional mass to computer-aided manufacturing. Presently, only 60 percent of companies apply industry software like Enterprise Resource Planning (ERP) and Manufacturing Execution Systems (MES). Even the current level of automation is still low. While companies in China apply only 36 robots per 10,000 employees on average, it is 300 to 400 units per 10,000 employees in South Korea, Germany, the United States and Japan. The plan is to change this quickly. As early as in 2020, China wants to become one of the ten nations with the highest density of robots in industrial manufacturing and rapidly expand local production.

While the speed of change can be more than impressive in China, it is neither possible nor advisable to leapfrog from Industry 2.0 to Industry 4.0 – a reason why the highly ambitious state program known as »Made in China in 2025« also has its critics.

## Where is the money?

Alibaba grew by providing great services at no cost. It also vanquished eBay in China by not charging the buyer or the seller to conduct business in its Taobao marketplace. Free services are hard to compete with. Today, Alibaba is profitable but makes relatively little revenue, considering the volume of goods and services sold across its various marketplaces.

The story repeats itself with Didi Chuxing and Uber. Uber's failure to compete with Didi Chuxing was partly caused by management mistakes, but mostly due to aggressive and non-sustainable marketing policies. Highly expensive customer loyalty programs incurred massive losses for Uber and its rivals, including Didi Chuxing. As Uber's shareholders were no longer ready to tolerate those losses in the Chinese marketplace, they opted for a merger with Didi Chuxing instead.

In their race for scale and speed, Chinese digital companies tend to sacrifice revenues, profits, and operational rigor. Cheap money, massive organic growth and friendly government policies can hide a multitude of operational sins, especially a lack of profitability, and create business models which are not sustainable without generous government intervention. ►

## If you can't beat them, join them

Uber's merger with Didi Chuxing could set a trend. Some observers believe that more and more multinational corporations will seek the co-operation of their Chinese rivals to team up with them in the Chinese marketplace as well as in research and development. With decreasing profits in a slowing economy, even fiercer competition and disruptive technological change ahead, the call for more alliances and collaboration, especially for sharing R&D costs, makes sense. In a country known for failed joint ventures and poor protection of intellectual property rights, however, such a strategy is for sure not without risk.

Much is at stake, even the future of whole industries. Consumer interest is still far from being strong but electric mobility could first take off in China – the government not only provides subsidies, but also cares for charging stations in large metropolitan areas. If electric mobility becomes a Chinese success story – and the Chinese government is betting on it – the co-operation between BYD and Daimler-Benz might play a crucial part in it.

### The outlook: a divided country?

China's development over the past twenty years tells the story of wealth creation without any historical precedent. While certain regions still stayed poor or went through deep crises, on the whole this historical transformation has seen left-behinds, but relatively few losers and many, many winners. This might change with the immense loss of jobs in manufacturing due to the closure of bankrupt state-owned companies and the progress towards greater automation and digitalization.

With job producing industries like construction, labor-intensive export and other manufacturing industries running out of steam and the state-owned enterprises getting forced to trim their labor hoarding, the future of labor in China looks very grim and the terrifying specter of a deeply divided country with many social conflicts is arising.

Consequently, there is also a lot of stagnation on the political level. Regional governments intervene to protect state firms and the local labor market, which leaves private enterprises less space to grow and flourish. ●



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