

POST-COVID RECOVERY IN CHINA

Opportunities for European Companies in 2020



The scale of Covid-19's impact on global economies has still not fully become clear. China as the first victim came to an almost complete standstill for several weeks between January and March. Now, other major economies are also severely impacted, most likely throughout Q2 and beyond. But while some regions are still struggling with local outbreaks and containment measures, **China has shifted gears into rebound mode**. With relatively few new cases, both government and businesses are now focusing on revitalizing the economy and utilizing the resulting catch-up effects.

After passing this resilience test, **the coming recovery offers tremendous opportunities for vigilant foreign companies**. Long-term trends already prevalent before the crisis will bounce back and might even gain speed. Shifting consumer preferences, government regulations and business policies, will create and boost entirely new business models. In particular, **EAC identified opportunities in the following industries and sectors in China:**

- Medical Instruments & Health Care
- Consumer Products (especially e-Commerce)
- Online Sales Channels for Industrial B2B Products
- Remote Work, Education & MICE events
- 3D Printing & Flexible Production
- Smart and Electric Mobility Concepts
- Robotics (especially service robots and cobots)

Thus, despite challenges in other regions, it is imperative for globally operating companies to remain committed to China and act now. Crisis times always offer a chance to re-think organizations and business models in order to be prepared for future growth. European firms need to **pro-actively prepare and develop the right strategy** to fully participate in the post-Covid market landscape. Only with **continued attention they can avoid losing market share in a “back-to-normal” environment** and being left behind by rapidly innovating Chinese competitors.

ALL MAJOR ECONOMIC INDICATORS WERE AFFECTED BY THE SHUTDOWN IN CHINA

THE SHUTDOWN AND ITS MACRO-ECONOMIC EFFECTS

After a nationwide shutdown of several weeks, first data points from China provide an indication of the upcoming economic turbulences worldwide. After a strong performance in December, all major indicators of economic activity dropped significantly in January and February 2020 compared to the same period last year.

Exhibit 1 | China Economic Indicators (Change YoY)

Key KPIs (YoY)	Dec 2019 vs. Dec 2018	Jan & Feb 2020 vs. Jan & Feb 2019
Exports	7.6%	-17.2%
Imports	16.3%	-4.0%
Fixed Asset Investments	5.4%	-24.5%
Industrial Output	6.9%	-13.5%
Industrial Profits	-6.3%	-38.3%
Retail Sales	8.0%	-20.5%
Property Investment	7.3%	-16.3%

Source: National Bureau of Statistics China

SIGNIFICANT MID-TERM GLOBAL ECONOMIC IMPACT OF COVID-19 IN 2020 IS EVIDENT

The latest forecasts now predict the Chinese economy to grow far below its original 6% target this year – the lowest since 1976 and heavily impacted by a sharp decline in Q1.

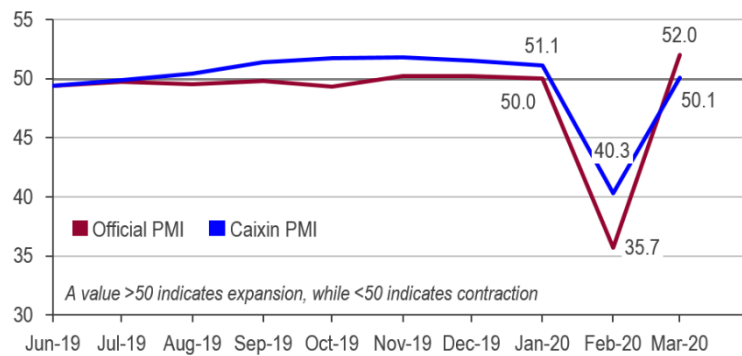
There will be a **massive hit to global economic activity** from necessary measures to slow the spread of the pandemic. Given China’s role as the world’s largest manufacturer and exporter (13% of world exports), supply chains have already been partially disrupted. Global trade will continue to be affected as long as outbreaks in new countries occur and travel/ logistics restrictions change on an ad-hoc basis. Thus, estimates of global GDP growth are revised on a regular basis. For the US and Europe, a contraction in the first two quarters of 2020 can be estimated. For instance, Goldman Sachs expects an annualized 34% decline in US GDP in Q2 2020.

EARLY INDICATORS SHOW THAT CHINESE INDUSTRY ALREADY IS GETTING BACK TO NORMAL

The spread of the virus appears to be largely contained in China. Axel-Adrian Roestel, Head of Portfolio Management at Huber, Reuss & Associates in Munich: *“There is strong evidence that its economy is stabilizing and that production has restarted, especially in the coastal areas.”* The official resumption of work rate for industrial enterprises was almost 99% in late March according to China’s Ministry of Industry and Information Technology. In a survey conducted in March, 65% of Chinese companies are expecting improved profits in Q2.

Another sign of positive sentiment was China’s **Purchasing Managers’ Index** (weighted towards large state-owned firms), which bounced back to 52.0 in March from its February low at 35.7. The Caixin manufacturing PMI, a private index focused more on small, private manufacturers, rose to 50.1 in March from 40.3 in February. While not confirming a recovery, the PMI is a common early indicator of business sentiment.

Exhibit 2 | China Official & Caixin Manufacturing PMI



Sources: National Bureau of Statistics China, Caixin

STATE SECTOR RECOVERED FIRST, WITH SERVICES AND CONSUMPTION STILL LAGGING BEHIND

The state sector recovered first: High-frequency indicators in sectors like steel or power production are back to levels from a year ago. Daily coal consumption of major electricity producers and air pollution levels are getting close to normal levels. Thus, the mid-term damage of supply chain disruption should be limited.

On the services and consumer side there is still a longer way to go: Intercity transportation as well as air travel is still tremendously below normal. Improvements can be observed, but from a low basis. A slow recovery has been seen with regards to capacity utilization of airlines. While the domestic passenger load factor has been rising to around 70% of normal capacity, the passenger load factor of international flights is more than 40% below normal. Cross-border flights have been restricted and Chinese consumers are likely to cut back on their travel abroad for at least a few months.

AIR TRAVEL, BOTH DOMESTIC AND INTERNATIONAL IS ONLY SLOW TO RECOVER

Volumes of new and existing home sales plunged more than 40% YoY until mid-March, raising fears that the **property market**, which accounts for a quarter of GDP and has a significant private wealth effect, tears down consumers and leads to defaults of developers. Portfolio Manager Axel-Adrian Roestel: *“However, new sales of land and property in tier-1 cities bounced back at the end of Q1 feeding hope for a slow but steady recovery.”*

Exhibit 3 | Early Recovery Indicators



Source: EAC research

CHINA APPLIED DRASTIC MEASURES FROM WHICH IT IS BENEFITTING NOW

Due to drastic measures applied to contain the virus and the relatively fortunate timing around the usually slow Chinese New Year period, as of now the Chinese economy does not seem to require an all-it-takes **public stimulus program** like in Europe or the United States. At the time of writing, the government has not yet announced an official major

fiscal spending program but supports the economy via subsidies and tax cuts. Furthermore, the central bank recently injected liquidity into the financial system via open-market operations and cut interest rates on loans.

**BOTH INDUSTRIAL AND
CONSUMER-FOCUSED
COMPANIES CAN PROFIT
FROM A CATCH-UP EFFECT**

In summary, after the radical shut-down of the European industry since early March 2020, the re-start in **China could offer a certain potential to partly compensate for turnover losses in Europe and the US.** GDP is expected to contract in Q1 but likely to then bounce back in a V-shape. Current annual forecasts at time of writing range from 0.2% to 4.8% growth in 2020 and from 5.9% to 8.4% in 2021.

In the mid-term, both industrial and consumer-focused companies might be able to profit from a **catch-up effect** driven by rebounding consumer demand and selectively increased government spending. For instance, Volkswagen has resumed production at almost all its plants in China and quadrupled its sales in March compared to the previous month.

WHICH INDUSTRIES BENEFIT OVERPROPORTIONALLY?

As a close observer of recent developments in China, EAC has identified several key sectors and trends that have so far shown resilience and might even gain traction due to shifting markets and customer preferences. These include medical instruments and health care, consumer products driven by e-commerce, online sales channels for industrial products, remote work and meeting concepts, flexible and decentralized production using 3D printing, smart mobility technologies, as well as new forms of robots. Dietmar Kusch, Partner at EAC Munich: *“European companies can benefit from these developments with the right strategy and a pro-active mindset.”*

**THE MEDICAL INDUSTRY’S
POTENTIAL IN CHINA WILL
INCREASE EVEN FURTHER**

Medical Instruments & Health Care: Boasting a projected value of 2.1 trillion EUR in 2030, China’s healthcare market has been a major growth opportunity for foreign companies. For instance, German drugmaker Boehringer Ingelheim plans to open a digital laboratory in Shanghai in July 2020 as part of its efforts to further penetrate the Chinese market.

Learnings from the epidemic might lead to additional investments into the country’s healthcare system as well as medical infrastructure. For example, one crisis winner was telemedicine as Chinese turned to their smartphones for medical consultations. Digital health services and healthcare apps with products from cloud computing-based analysis of medical images to online doctor consultations also saw higher user numbers. According to Nielsen data, 3 out of 4 Chinese plan to spend more on sport and fitness in future, 60% will increase spending on regular medical check-ups.

► ***Benefitting from an aging and increasingly wealthy population as well as rising hygiene and health awareness, the Chinese medical sector will show consistent future growth in***

which foreign companies will be able to participate with the right strategy.

PRIVATE CONSUMPTION HAS REPLACED EXPORTS AS ONE OF THE MAIN GROWTH DRIVERS FOR THE CHINESE ECONOMY

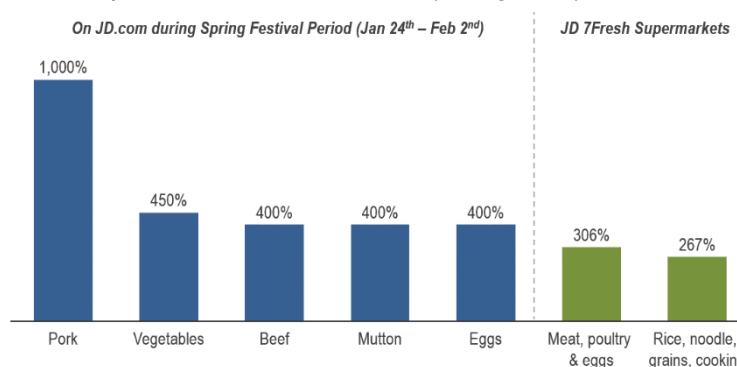
Consumer Products (esp. e-Commerce): Before the virus impact, retail sales had shown a consistently strong performance (8% YoY growth in 2019). Especially in 2nd and 3rd tier cities, disposable income had grown, consumer confidence overall was strong and willingness to spend high. Private consumption accounted for ~40% of GDP in 2019.

Despite increased uncertainty and cautiousness, consumer spending has shown to be quite resilient during the crisis, especially online. Contrary to the overall decline in retail sales, physical sales on online platforms managed to grow by 3% YoY in January and February. E-commerce accounts for around 14% of total retail spending.

THE LOCKDOWN PERIOD HAS ACCELERATED THE ALREADY PREVALENT TREND OF FRESH FOOD DELIVERY

During the quarantine, product groups such as cosmetics and skin care, toys and games, or fresh food benefited over-proportionally. Online platforms Alibaba and JD.com reported that online sales of grocery, fresh produce and consumer essentials grew by more than 300%. In a Nielsen survey, 89% of respondents said that they will be more willing to keep buying daily necessities and fresh products online once the pandemic and lockdown is over.

Exhibit 4 | Sales of Fresh Food Items (Change YoY)



Source: JD.com

BOTH DOMESTIC AND INTERNATIONAL COMPANIES RAPIDLY SWITCHED TO ONLINE MARKETING AND BRANDING ACTIVITIES

China had been a leader in e-commerce and digital sales channels for a long time, but the lockdown-induced disruption has sped up this trend further. Within only a few weeks both domestic and international companies rapidly switched to increased online marketing and branding activities.

For example, a cosmetic company successfully redeployed its beauty advisors to become online influencers to engage customers virtually and drive sales online instead of at stores. In another case, a confectionary manufacturer accelerated its digital transformation efforts by reinvesting resources originally planned for offline campaigns into digital marketing, WeChat programs and partnerships with online-to-offline platforms.

Similarly, beverage multinationals AB InBev and Budweiser shifted resources to invest in marketing to boost demand for at-home consumption, e-commerce and omnichannel sales. This involved a re-

alignment of cross-category promotions and the launch of new experiences like e-gaming events and DJ livestreams that consumers could participate in from home. Even Ikea, traditionally not willing to join a third-party platform, has recognized the necessity for a stronger online presence and opened an official store on Tmall in early March.

► **Especially in the fast-changing consumer space, Chinese players are rapidly innovating to adapt to new customer preferences and behaviors. Covid-19 is the last reminder for European companies to adopt digital business models and an online-first approach.**

ONLINE SALES CHANNELS ARE INCREASING IN IMPORTANCE ALSO FOR INDUSTRIAL GOODS

Online Sales Channels for B2B: In the past decade, news headlines and business reports have been preoccupied with the rapid growth of B2C or retail-related e-commerce in China. But under the radar, the country's B2B e-commerce sector grew by more than 70% YoY to 8 billion EUR in 2018. Niche B2B-focused platforms (such as 1688 or HC 360) will inevitably play a crucial role in the development of industrial brands across the value chain.

It has already become clear that players with e-commerce functionality are among the winners of the crisis: Showing strong performance already before the impact of epidemic, digital (B2B) offerings have made a quicker rebound and have gained market traction.

Exhibit 5 | Selected Chinese Digital B2B Platforms

APART FROM WHOLISTIC PLATFORMS, SPECIALIZED B2B OFFERINGS EXIST FOR SEVERAL INDUSTRIES



Source: EAC research

► **Now is the right time for foreign companies in sectors such as chemicals, raw materials or machine building to investigate industry-specific platforms and develop digital sales channels.**

3D Printing & Flexible Production: Even before Covid-19, the Chinese government had been actively pushing 3D printing technology. With state-backed development initiatives and fast-moving private enterprises, China is trying to catch up with global industry leaders in the US and Germany. Several advancements have already been made in application industries such as automotive, aerospace, medical or construction. Evidence for emerging opportunities are investments in Chinese 3D printing start-ups by both BASF and Evonik in 2019.

3D PRINTING AS A KEY TECHNOLOGY TO INCREASE LOCALIZATION AND FLEXIBILITY

The virus impact has resulted in two learnings for Smart Manufacturing in which 3D Printing could play a major role:

- (1) Flexibility, allowing to quickly fill gaps in traditional supply chains, or produce completely different products. This practice has been used by several manufacturers (e.g. EV-maker BYD) to switch production to masks, hand sanitizer or ventilators. In the future, 3D printing could further extend these possibilities to flexibly react to changing market demand.
- (2) Decentralization, reducing the dependency on a few large production plants with the aim of a more anti-fragile and localized manufacturing footprint. Small units of 3D printers could be located very close to the final target market and reduce logistics cost.

► ***China is rapidly experimenting with 3D printing. The country offers interesting use cases as well as high potential in several application segments (automotive, medical, aerospace, etc.) for European printer manufacturers, material or service providers.***

HAS SOCIAL DISTANCING LASTINGLY ALTERED THE WAY CHINESE WORK, LEARN AND INTERACT?

Remote Work, Education & MICE Events: One immediate impact of the virus outbreak and its subsequent social-distancing measures as well as hygiene regulations was a change in how businesses work. In the coming months, knowledge workers might stick with the collaboration tools they were introduced to during time spent working from home. Co-working software from tech companies such as Alibaba, Tencent, Baidu or ByteDance has seen a spike in downloads and user numbers (e.g. WeChat Work +570% YoY growth). School and university classrooms were completely shifted online, which is likely to have a lasting influence on the education industry.

Besides, especially the meetings and exhibitions industry was hit hard as events in China were suspended and exhibition centers closed, leading to an anticipated effective loss of 25% of business. Even worse, the MICE industry is likely to be the last to go back to normal. Although painful, these months offer venues, organizers and service providers the opportunity to work on new digital formats such as video conferences, webinars and virtual shows – a trend that had already been started and will further accelerate out of necessity now.

► ***Chinese people have been quick to adapt to new ways of increasingly virtual interaction. European companies, esp. in the MICE and education industry, need to stay up-to-date and increase their digitization efforts in order to remain relevant.***

Smart and Electric Mobility Concepts: Despite the current market slump and a car sales drop of more than 80% in February 2020, China will stay a key mobility market and leader for innovative transportation concepts. In the short-term, the market is already starting to slowly recover and might offer an opportunity for foreign manufacturers to compensate for their losses in Europe and the US. In the mid-to-long-term, China's *New-Energy Vehicle Plan 2021-2035* broadly promotes

**CHINA WILL STAY A
LEADER IN NEW MOBILITY
LIKE ELECTRIC VEHICLES
& AUTONOMOUS DRIVING**

new energy vehicle development and sets the target for NEVs to account for 25% of all car sales in 2025. While European carmakers currently lobby to delay the EU's CO2 emission targets, China is instead extending its subsidies for electric vehicles.

In addition, several Chinese tech players and start-ups are leading in the development of autonomous mobility solutions and have been actively testing prototypes on the streets. For example, in early 2020 Robert Bosch Venture Capital announced an investment into Beijing-based UISEE, a supplier of automated driving systems. Along with the ongoing urbanization trend, there is also continuing investment into construction of high-speed railway lines and urban metro systems.

Whatever the mode of transportation, proper ventilation and air filtration is likely to become vital to prevent future outbreaks, especially when riders share the same vehicle or cabin. There might be a trend towards ride sharing to avoid mass transportation. Car manufacturers are already starting to position themselves with solutions to attract worried customers. For example, Chinese car maker Geely claims one of its electric SUVs possesses an N95-rated air filtration system.

► ***In a dynamic mobility environment, European OEMs and suppliers should avoid using the current situation as an excuse to slow down their push towards smart and green vehicles.***

**COMPANIES WILL
INCREASINGLY RELY ON
THE HYGIENE PROVIDED
BY ROBOTS**

Robotics: On a slightly longer timescale, social distancing measures and higher awareness about the spread of bacteria might lead to a surge in the popularity of service robots or so-called "cobots", robots intended to work closely to humans. These could make a tremendous difference in hospitals, providing relief for medical staff and protection from infections. A "smart" field hospital with robots connected by IoT has been trialed in Wuhan during the outbreak. The technology-savvy Chinese are quick to implement these tools in other areas as well, such as public places, reception desks and restaurants or coffee shops. In some shopping malls, shoppers can order bubble tea prepared in front of their eyes by a robot. Coupled with the already ubiquitous cashless payment in China, this ensures a fully automated and thus hygienic order process.

On an industrial level, robots might be increasingly used in hygiene sensitive industries such as food production. Remote maintenance is also likely to gain importance. The speed of automation in Chinese factories as well as in daily life will further intensify.

► ***The large market size in China coupled with the current sentiment offers tremendous opportunities for both large and specialized foreign robotics companies, especially with a focus on service robots. However, local competition in the mid-market is growing.***

ACTION DEMAND FOR FOREIGN COMPANIES

OPPORTUNITY FOR
ORGANIZATIONAL
CHANGE AND ADAPTION
OF BUSINESS MODEL

How can businesses react to these opportunities during the economic rebound in China? Besides short-term measures such as limiting negative impact and ensuring liquidity, EAC sees two main areas for action: strategic organizational improvements and an even stronger focus on digitization.

COVID-19 AS LAST
REMINDER TO ADOPT
DIGITAL TRANSFORMATION

Times of isolation and economic slowdown offer the opportunity for businesses to improve efficiency and build resilience for future crises. Daniel Berger, Partner at EAC Shanghai: *“Companies suddenly have the chance to re-think their current business model, re-assess their regional setup, human capital, and management structures, as well as re-build internal processes.”* For example, a Chinese travel agency did not reduce headcount but encouraged its staff to use their time to upgrade working systems as well as design new products and services to be better prepared for the eventual recovery. Other companies learned to make use of Big Data to differentiate speed and level of investments by channel and region, while monitoring progress on a city level.

Due to an acceleration of Chinese consumer habits shifting to digital channels and e-commerce, **expansion of online business and digital readiness as well as a critical review of existing sales channels are necessary**. As industries are disrupted and existing processes re-designed, even companies without a strong focus on private consumers will have to make a shift towards offline-to-online business models.

OPPORTUNITIES ARE
EVIDENT, BUT THREE
RISK SCENARIOS REMAIN

Despite positive indications for a quick recovery, **three inter-connected risk scenarios need to be considered:**

- (1) There could be a second major virus outbreak in China, in particular driven by imported cases. But tight border controls are in place and suspected persons are tested and put in quarantine immediately. People behave cautiously, and offices are cleaned at any sign someone is infected.
- (2) The impact of the shutdown could have hurt China's economy more than expected and worsened challenges that had already been looming in the background, e.g. increasing debt levels of companies and private households or the property market.
- (3) The critical situation in Europe and the US will certainly lead to a demand shock and thus a big challenge for China's export-oriented businesses, especially in the Southern and Coastal provinces.

PARTICIPATION IN THE
ECONOMIC REBOUND WILL
REQUIRE ATTENTION AND
INVESTMENTS

All in all, **foreign companies present in China are advised to stay alert and pro-active** to be able to profit from the highly likely V-shaped recovery. Otherwise, local competitors, which already were in a good position for the increasingly digital business environment before the crisis, might get a head start now. Even with a critical situation in Europe and the US, **companies should not neglect necessary investments into their local China setup, online channels or dealer network** to maintain and improve their market position.

Please contact us, if you would like to discuss your China strategy 2020
or specifically the opportunities mentioned in this report.



Dietmar Kusch

Partner
Munich Office

Dietmar.Kusch@eac-consulting.de



Daniel Berger

Partner
Shanghai Office

Daniel.Berger@eac-consulting.de

EAC MUNICH

EAC - Euro Asia Consulting PartG
Widenmayerstrasse 29
80538 München
Phone +49 89 92 29 93-0
eac-muc@eac-consulting.de

EAC SHANGHAI

EAC - Euro Asia Consulting
Sunyoung Centre, Rm. 801
398 Jiangsu Road
200050 Shanghai/ China
Phone +86 21 63 50 81 50
eac-sha@eac-consulting.de

EAC MUMBAI

EAC - Euro Asia Consulting Pvt. Ltd.
306-310 Peninsula Plaza A/16,
Veera Industrial Estate
Andheri (West), 400053 Mumbai /India
Phone +91 22 26 74 24 91
eac-mum@eac-consulting.de

EAC MOSCOW

EAC - Euro Asia Consulting OOO
Melnitskiy Per. 1
105120 Moscow / Russia
Phone +7 495 6401 013
eac-mos@eac-consulting.de