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# CHINA IN 2021

## OUR ANNUAL RECAP OF KEY MARKET DEVELOPMENTS THAT EXECUTIVES SHOULD KNOW ABOUT

December 2021,

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JUMP TO CHAPTER

# FOREWORD

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Dear Readers and Business Partners,

After the eventful 2020, who would have expected 2021 to bring even greater changes? This was certainly the case for China, where we have witnessed a flood of new (geo-)political, regulatory and economic developments over the last months. This year truly marked the arrival of a “new normal” at last.

Since an all-encompassing summary is impossible and most likely soon outdated anyway, let us just briefly state our take on the chasm that business in China is currently facing: dynamic growth for most of our clients and a remaining high strategic priority of the Chinese market have resulted in continuous investment and commitment. At the same time, especially foreign companies are often struggling with an increasingly challenging business environment and are getting cautious about international tensions. Last but not least, ongoing COVID-related travel restrictions between China and the rest of the world also do their part to disrupt effective exchange and decision-making.

Just like last year we have prepared this comprehensive review report based on some of our insights from presentations, online events and our consulting practice on the ground. If you would like to receive more of our market perspective, please consider signing up for the monthly EAC newsletter “China Business Briefing”.

Thank you for your support, and all the best for the next year!

Your EAC Shanghai Team

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# THE BIG PICTURE – REVIEW OF PREDICTIONS

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## Let's take a look at our attention points and predictions from last years' China Review…

**Reality Check:** ***The new FYP has indeed caused lots of waves; some insights we also summarize in this report***

**Reality Check:** ***Although more moderate in his tone, Joe Biden has so far mostly continued the China policy of his predecessor***

**What We Keep Our Eyes On In 2021**

**Publication of 14th Five Year Plan**
- We already know the high-level goals, but what specific, potentially disrupting targets will the new plan include?
- More important: how will it be implemented by ministries and provinces?

**Biden Presidency & Trade**
- What kind of tone will Joe Biden set in its communication with China?
- How will the Trade War develop?

**Tech Regulation**
- Was Ant Financials' "postponed" IPO only the start of a wave of new regulations for China's tech giants in an attempt to curb their power?

**SOE Loan Defaults**
- After the loan defaults of several SOEs in late 2020, how will the government handle the increasing debt load next year?
- Will they allow more defaults to achieve financial prudence?

**Investments after COVID-Shock**
- Which countries will MNEs pick for their first foreign investments after business normalization?

**Roll-out of Digital Yuan**
- After first tests in 2020, will the DECP be officially rolled-out next year?
- If yes, what kind of impact will it have on the already mature digital payment landscape in China and could it set a global benchmark?

**Reality Check:** ***Defaults of SOEs have not become a major problem so far, but attention has now shifted to the solvency of real estate developers***

**Reality Check:** ***Clear "Yes" here, business regulation was one of the key topics this year***

**Reality Check:** ***Businesses have still been heavily impacted by supply chain issues, but are also back at investing both within China and also across the APAC region***

**Reality Check:** ***There have been numerous additional tests and pilot schemes of the Digital Yuan in 2021, but so far we have not seen any breakthroughs in adoption***

*Source: EAC*

# THE BIG PICTURE – FOCUS TOPICS IN 2021

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**The market landscape in China is changing dynamically, but despite growing challenges the country continues to be a major growth opportunity for multinational companies**

## FOCUS AREAS THIS YEAR

**Increasing Business Regulation:** *A Red "New Deal"?*

- Stricter government scrutiny and regulatory challenges to large and important industry sectors such as technology, education and real estate
- *Crackdown on China's rich and famous* (e.g. Jack Ma, several movie stars)
- Revival of "*common prosperity*" policy approach to fix inequality
- The party is trying to assert control – but also to break monopolies, limit economic risks and increase worker & consumer rights

**China Image & Attractiveness:** *Isolation instead of opening?*

- Covid-19 *travel restrictions* affect especially expatriates and foreign companies sending staff to China – Back to normal only in mid-2022?
- *Deteriorating image of China* in the West (pandemic handling, wolf warrior diplomacy, etc.)
- *Perceived end of "opening up"* trend and shift towards more isolation and "China First" (e.g. Dual Circulation Policy)
- Change of preferential *income tax policy* for foreigners in 2022
- Increasing *exodus of foreign professionals* from China

## PARALLEL TOPICS

**Sustainability:** *Global climate sinner or savior?*
Carbon Neutrality 2060 goal and focus within the 14thFYP

**Innovation:** *From application to innovation leader?*
Advances in energy, consumer technology, space exploration, etc.

**Domestic Competition:** *wake-up call for foreign brands?*
Chinese companies profiting from changing consumer sentiments

**Demographics:** *Getting old before becoming wealthy?*
Release of 2020 Census results & announcement of 3rd child policy

*Source: EAC*

# THE BIG PICTURE – CHINA NARRATIVES

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## International cover pages in 2021 especially reflect foreign perspectives on the country's changing approach to business regulation and geopolitics – Unfavorable views of China are on the rise

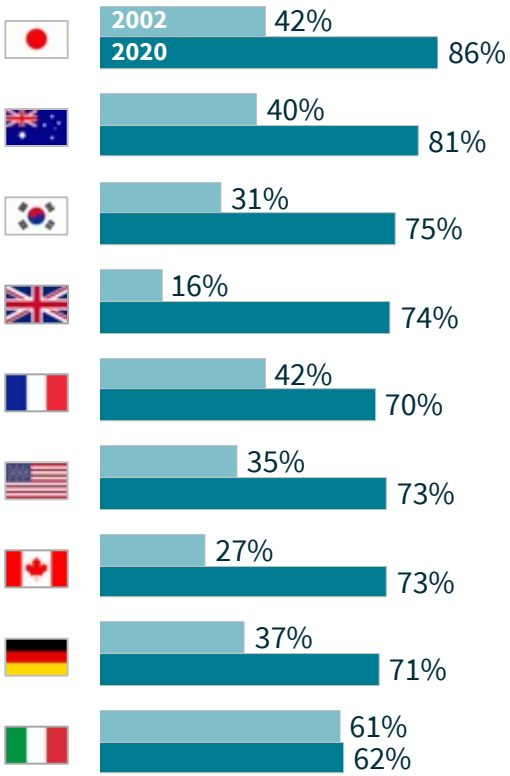








***Share of population having a very or somewhat unfavorable view on China*** *(2002 vs. 2020)*




*Source: EAC research, Pew Research Center*

# THE BIG PICTURE – RECOVERY OR NOT? (1/2)

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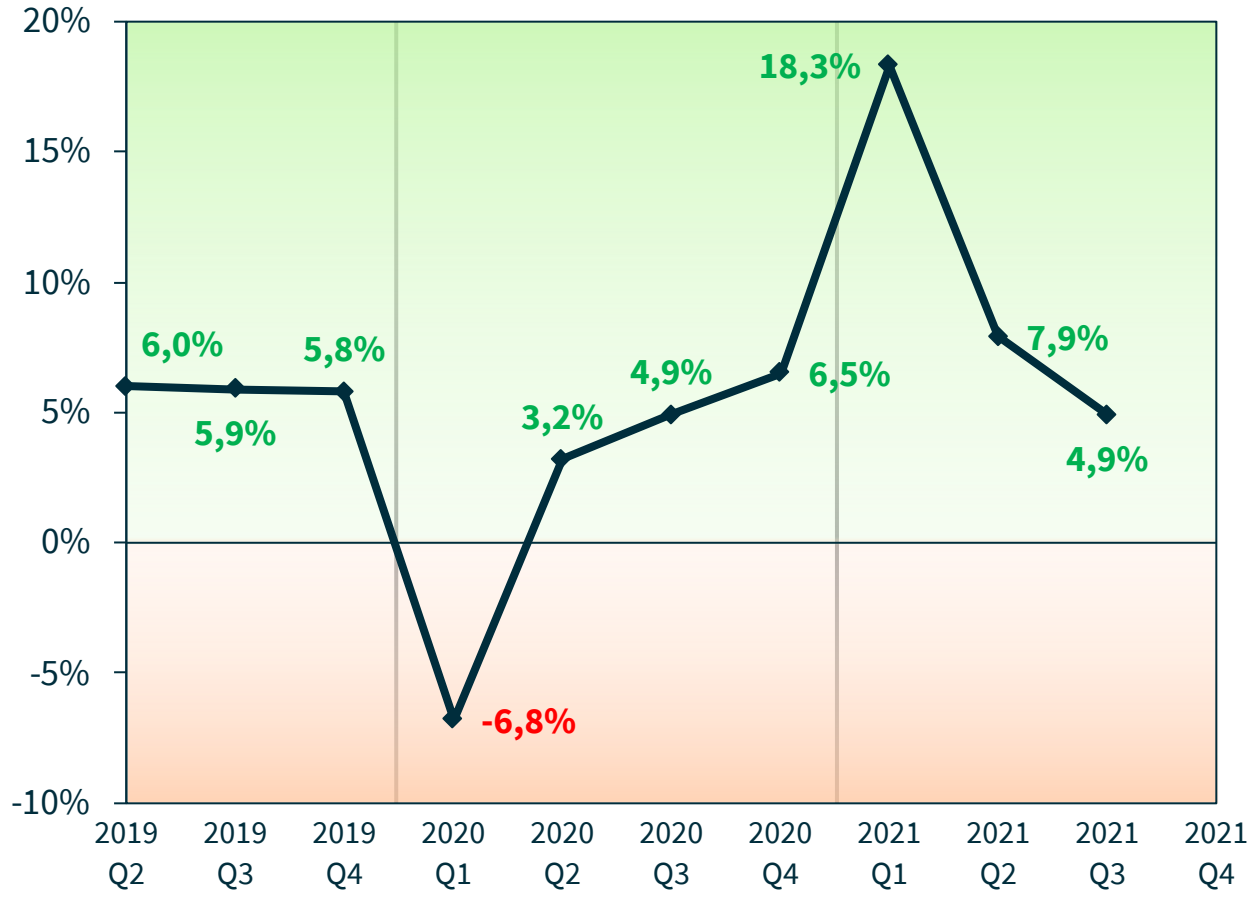
**China saw a V-shaped recovery in 2020, but economy came under pressure in 2021 by several factors – Annual GDP growth forecast for this year is below the 8.1% estimation consensus from last December**

**CHINA QUARTERLY GDP GROWTH** (YEAR-ON-YEAR)




- **Quick V-shaped recovery** after COVID-19 breakout in Q1 2020
- **Catch-up effects** in late 2020 and 2021 mostly output-driven
- Rising **pressure on growth** in Q3 2021 (only 0.2% growth QoQ)
- Long-term **GDP growth is slowing down** (4-6% forecasted)
- Shift from export to **domestic consumption as growth driver**

*Source: IMF, China National Statistics, EAC research*

# THE BIG PICTURE – RECOVERY OR NOT? (2/2)

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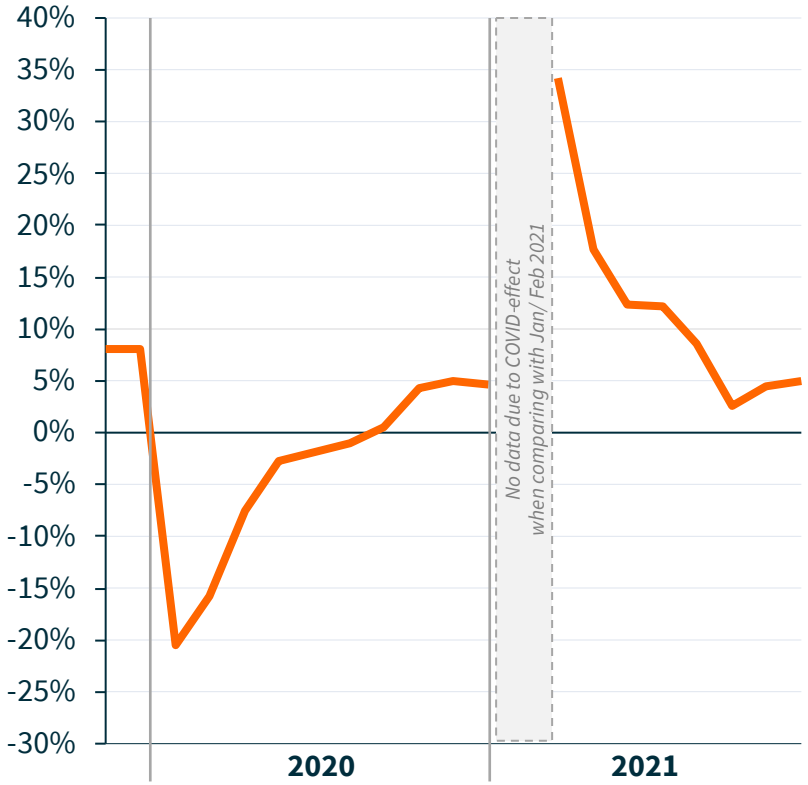
**While trade was performing reasonably well, retail sales and industrial production came under pressure this year, negatively affected for example by regional COVID-outbreaks and the real estate downturn**

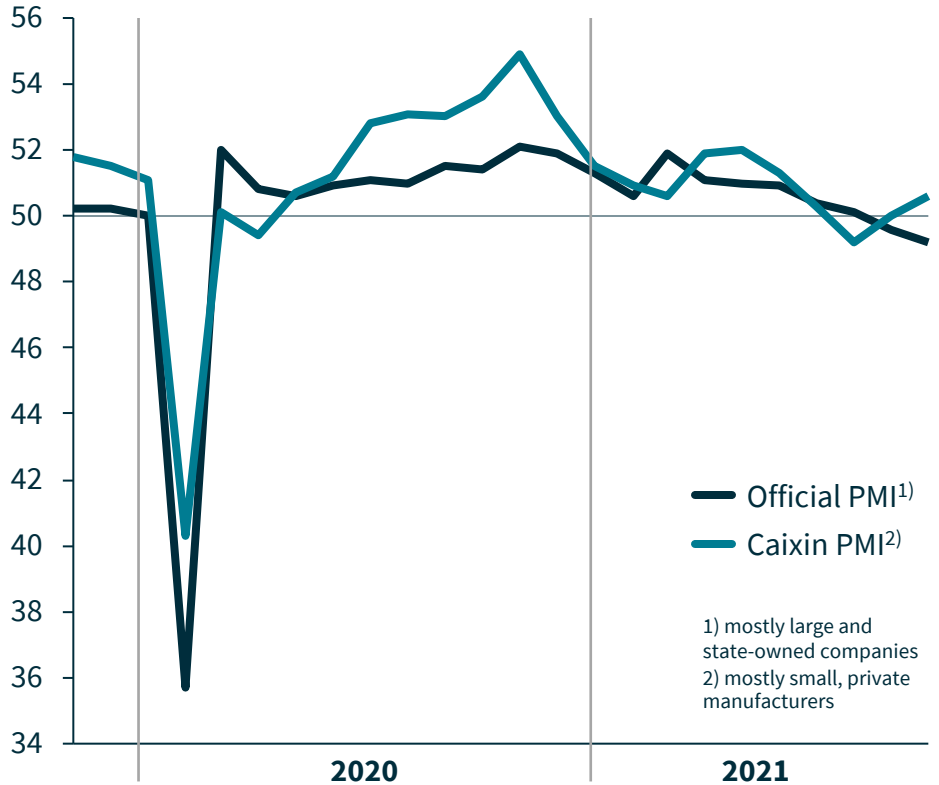
## RETAIL SALES GROWTH

*Monthly year-on-year development*




## PURCHASING MANAGER INDEX (PMI)

*Values >50 indicate a positive outlook, <50 a negative outlook*




*Source: China Bureau of Statistics*

Note: January and February combined in official data

# THE BIG PICTURE – GROWTH, CONSUMPTION, REAL ESTATE

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**While transitioning to a more sustainable growth model, China remains the global growth engine, esp. driven by increasing private consumption – But real estate industry might be facing tougher times**

## MACRO-ECONOMIC ENVIRONMENT

- **Global Growth Engine:** China contributed ~30% to global GDP growth between 2016 and 2019
- **Quick Recovery after COVID:** V-shaped rebound after COVID-shock, especially driven by supply-side
- **Long-term Growth Potential:** Despite GDP growth slowing down to ~6%, China is forecasted to overtake the US as the world's largest economy between 2028 and 2033
- **GDP Composition:** China is trying to shift from an investment-led to a more consumption-focused growth model

**POSITIVE**

## CONSUMPTION PATTERNS

- **Regionalization:** key city clusters in China are driving growth, while the North-South gap is widening
- **Rising Urban Middle-Class**: disposable incomes and urbanization increasing steadily; middle-class accounts for ~50% of urban households
- **Premiumization**: consumption upgrade especially in tier-1 cities
- **Rise of Domestic Brands**: Rising trust and patriotic sentiment towards Chinese brands strongly increased in last 5 years and accelerated by COVID
- **Digitization**: “always online”, social e-commerce, connected devices, openness for new technologies

**POSITIVE**

## REAL ESTATE INDUSTRY

- **Economic Importance**: real estate accounts for ~15% of GDP and is often used to stimulate the economy, but government aims to cool down sector
- **Occupancy Rates** of apartment is only 71%, government trying to push developers to sell out stock first
- **Home Ownership:** despite high prices, people still prefer buy rather than rent
- **Pre-furbished Apartments:** plans to increase the share of pre-furbished apartments (currently 30-50%)
- **Increased Regulation & Scrutiny** incl. financing of developers (debt issues), newly-listed home prices, title transfers and possible Property Tax

**NEUTRAL**

*Source: EAC*

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# 14TH FIVE-YEAR PLAN – LOOKING BACK

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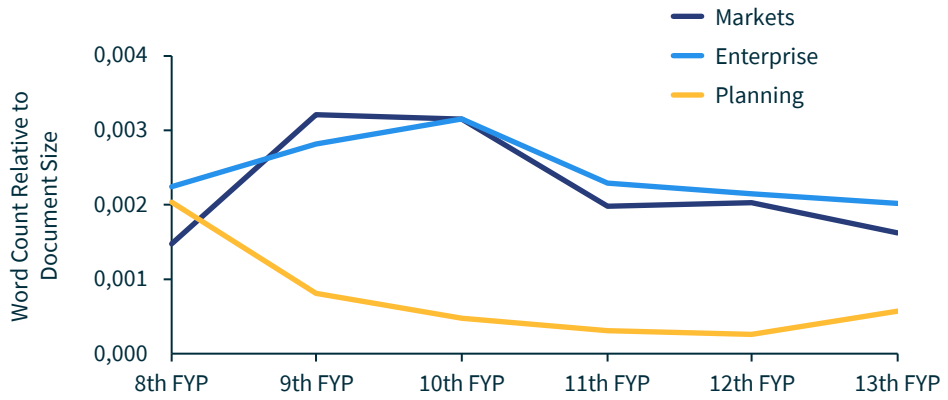
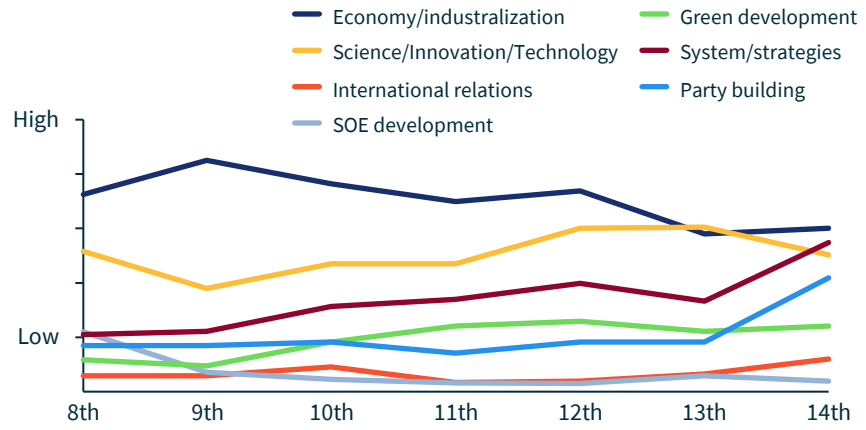
**While "Innovation" has seen sharp growth since the 8th FYP, the 14th FYP indicates a notable rise in "International Relations" and "Party Building" with "Economy/Industrialization" continue to dominate**

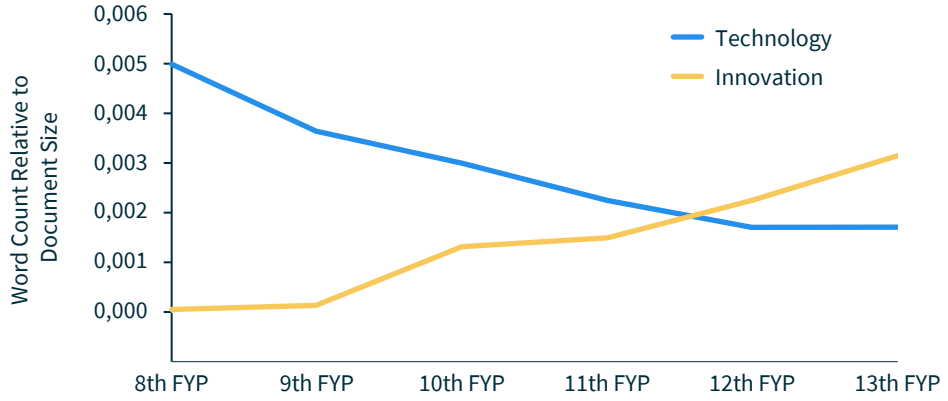
## MORE EMPHASIS ON "MARKETS" AND "ENTERPRISE"



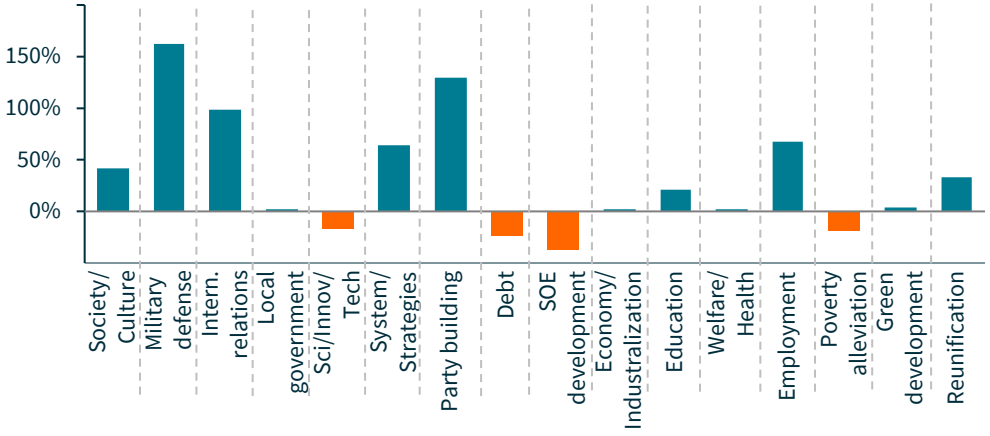

## KEY PRIORITIES FROM 8TH TO 14TH FYP




## "TECHNOLOGY" DECLINES, "INNOVATION" RISES




## SHIFTING PRIORITIES BETWEEN THE 13TH AND 14TH FYP




*Source: MacroPolo*

# 14TH FIVE-YEAR PLAN – OVERVIEW

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**The 14th Five-Year Plan (FYP) contains less quantitative growth targets than 13th FYP but rather focuses on economic and environmental improvements concerning quality, innovation and sustainability**

## KEY ECONOMIC HIGHLIGHTS

- **Innovation Development**
- **Industry Upgrade & Modernization**
- ***'Dual Circulation'***
- **Market Economy Reform**
- **Boost Rural Economy**
- **Balance Regional Economy**
- **Enhance Soft Power**
- **Boost Green Economy & Sustainability**
- **Deepen Opening-up**
- **Improve Living Standards**

## INTERPRETATION 14TH FIVE YEAR PLAN

- The 14th FYP reflects the rising uncertainty that China is facing in the global political and economic landscape:
  - **Scientific and technological revolution** and **industrial transformation**
  - Adjustment in the balance of international forces leading to an **increasingly complex international environment**
- Thus, the 14th FYP primarily emphasizes **innovation in strategic industries** and **stimulation of 'Dual Circulation'** to reduce reliance on global market
- A shift from 'speed-centric' to **'quality-centric' direction**:
  - **Science and technology powerhouse**
  - **High quality manufacturing power** with **digital capabilities**
  - **Ecological and environmental protection leader** to fulfil carbon neutral by 2060
  - **Socially stable** via reducing rural-urban economic divide and improving public services om the fields of education, employment, and social security etc.

*Source: EAC research*

# 14TH FIVE-YEAR PLAN – DEEP-DIVE INNOVATION

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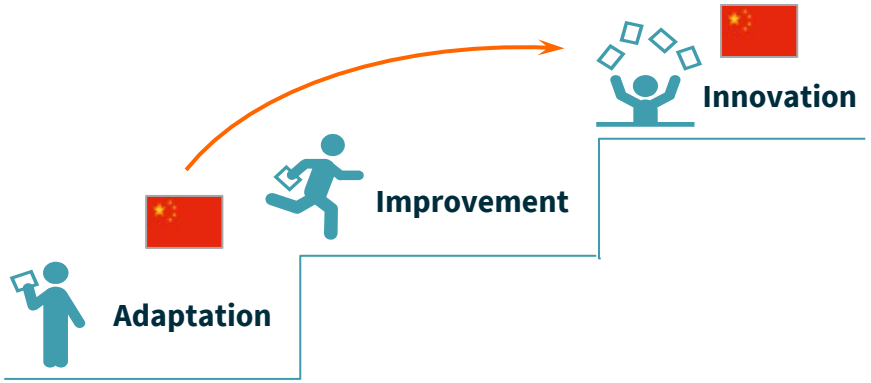
## Innovation is targeted to be the core driver to push modernization of Chinese industries; increasing R&D spending and focusing on cutting-edge technologies reflects the development direction

### 14TH FYP SUSTAINABILITY INITIATIVES

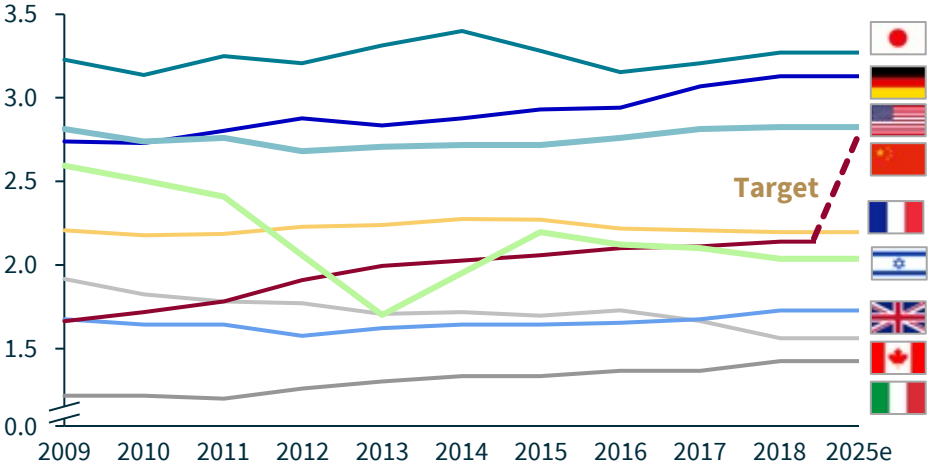
- **Reinforce technology leadership in strategic sectors** incl. AI, quantum information, IC, life science etc.
- Empower **enterprises** to be **innovation centres** obtaining resources from gov. and research institutes, e**ncourage corporate R&D spending and introduce related incentives**
- **Push system reform** facilitating healthier innovation environment, e.g. enhancing IP protection and supporting talent cultivation
- **Target 2035 – to become global innovation leader**

***Destined to leapfrog from adaptation to real innovation leader***




### IMPLICATIONS ON INDUSTRIES

***Increasing R&D spending per GDP (%) to similar level of USA***




***Focused cutting-edge technologies***

| | | | |
|---|---|---|---|
| Artificial intelligence | Quantum Information | Integrated Circuit | Brain Science |
| Life Science | Bio Breeding | Aerospace Technology | Deep Ocean Exploration |

*Source: EAC research*

# 14TH FIVE-YEAR PLAN – DEEP-DIVE DUAL CIRCULATION

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**Reflecting the rising uncertainty facing in the global political and economic landscape, China has issued 'Dual Circulation' targeting to be more self-reliant, especially in strategic sectors**

## Internal circulation

**BOOST DOMESTIC DEMAND**

- Individual consumption encouragement
- Investment stimulation

**SUPPLY CHAIN UPGRADE**

- Innovation push
- Supply side reform to cut down redundant supply
- Support for SMEs

**IMPROVE DOMESTIC TRADING ENVIRONMENT**

***Core target: decrease dependence on foreign countries***

## External circulation

- **Open domestic markets to foreign investors** in most sectors
- **Reduce coverage of negative list** significantly
- **Lower import tariffs and non-tariff barriers**
- **Stronger control on trade balance esp. in strategic sectors**

**Potential impact on MNCs**

- CN suppliers could be preferred unless local operations of MNCs have been enhanced
- Competition from local suppliers with increasing innovation and investments
- Business opportunities to support domestic supply chain upgrade
- Benefiting from healthier domestic business environment

*Source: EAC research*

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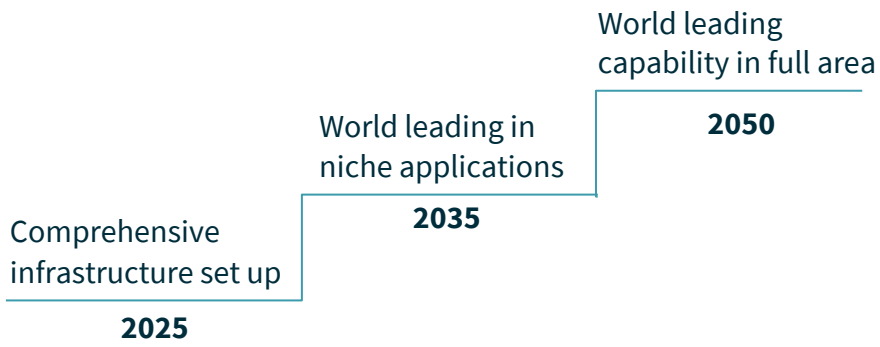
# Industry upgrade is a lasting topic with focus to modernize manufacturers with greener, intelligent and safe solutions

## 14TH FYP INDUSTRY UPGRADE INITIATIVES

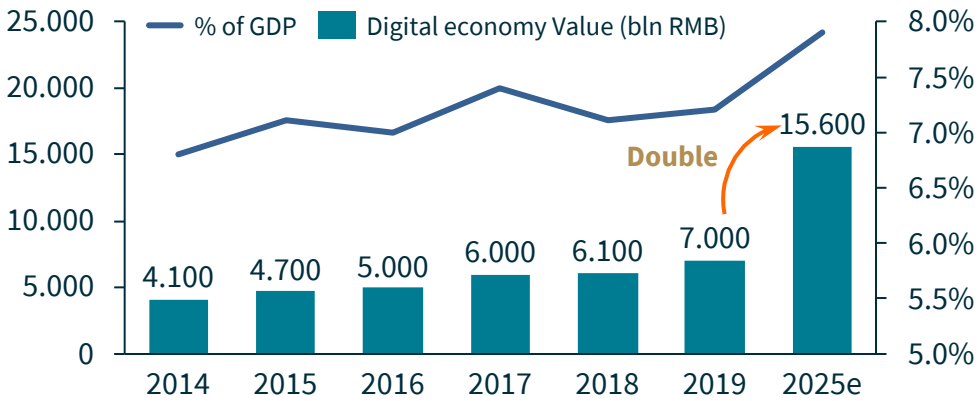
- **Modernize, optimize and upgrade industrial chains** and **supply chains** to make them more innovative, more value-added, safer and more reliable
- **Establish emerging industrial chains** and **make traditional industries more high-end, intelligent and green**
- **To boost digital economy** and **its integration with industries**
- **To speed up infrastructure construction** in 5G, the industrial internet and big data centres etc.

***The industrial internet development roadmap***



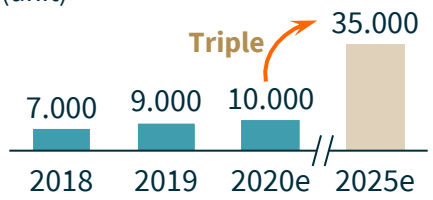

## IMPLICATIONS ON INDUSTRIES

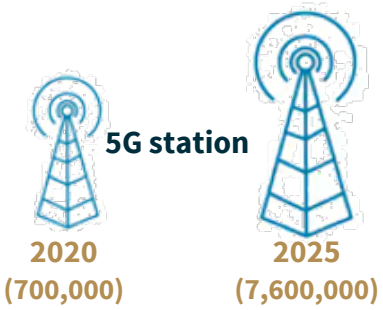
***Digital economy to double to support industry upgrade***




*Intelligent manufacturing robots, machine vision and assembly solutions will witness robust growth esp. in innovative areas*

**Collaborative robot consumption**
(unit)




*Source: EAC research*

# 14TH FIVE-YEAR PLAN – IMPLICATIONS FOR FOREIGN COMPANIES

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**In order to stay competitive, foreign companies need to further localize their offerings and organizational setups, as well as dynamically utilize newly emerging business opportunities**

1

## ENHANCE LOCALIZATION

- Only relying on export business could be risky under the current trading environment
- 'To become more Chinese' in order to eliminate risks against potential preference to domestic suppliers

2

## GRASP NEW BUSINESS OPPORTUNITIES

- Assisting Chinese supply chain upgrade towards premium, intelligent and green solutions
- 'Green economy', incl. sustainable energy (PV, solar and wind energy), NEV technology, and carbon elimination solutions

3

## UTILIZE CHINESE LEADING TECHNOLOGIES FOR GLOBAL PRODUCT PORTFOLIO

- ICT industry with 5G, cloud service solutions etc.
- Connected, autonomous, shared and electrification technologies

*Source: EAC*

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# TRADE & INVESTMENT – IMPORTANCE OF TRADE

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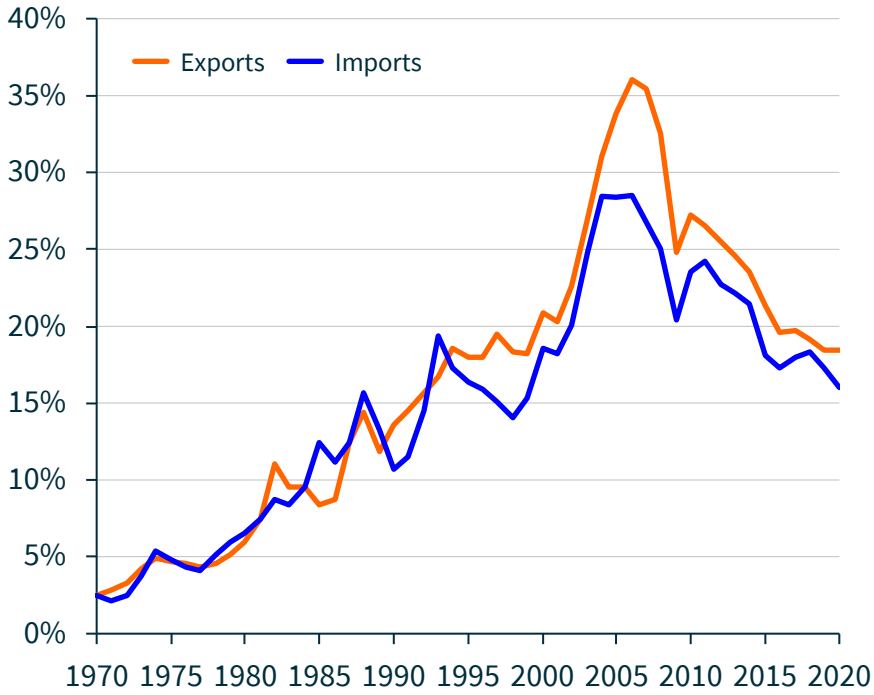
## China has started to shift from an export-led to a consumption-led growth model, but the country is still highly engaged in foreign trade – with a strong increase especially during the pandemic

### IMPORTANCE OF EXPORTS HAS DECREASED…

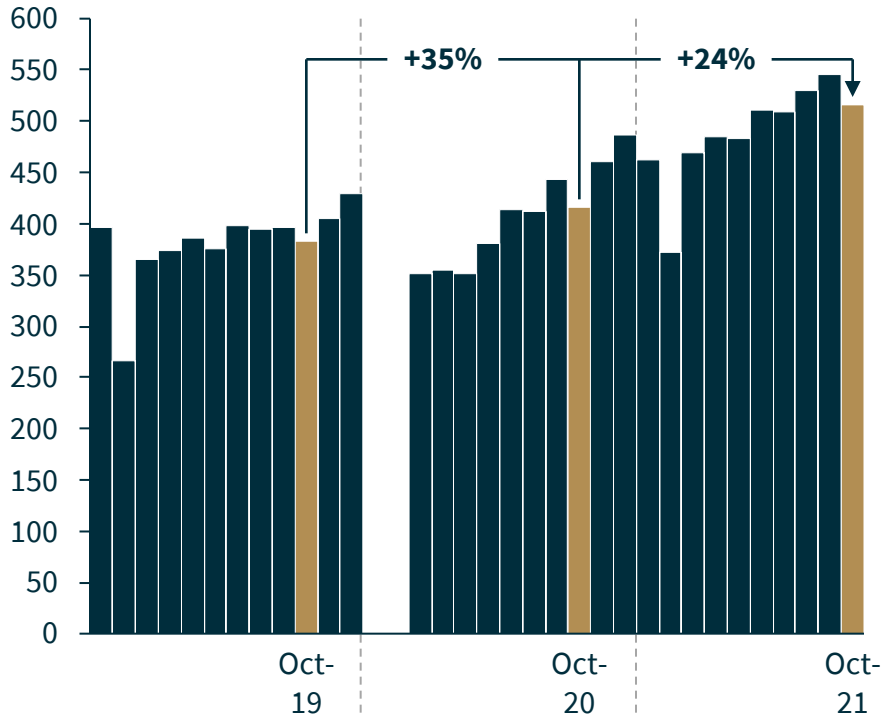
**Share of GDP**




**Growth model change:** While exports remain , China has started to shift from an export-led to a consumption-led GDP consumption

### …BUT TRADE IS STILL GOING STRONG

**Total Trade Value** (bln USD)




**No decoupling or isolation for now:** the total value of exports and imports has risen strongly over the past two years

*Source: China Bureau of Statistics, World Bank*

# TRADE & INVESTMENT – IMPORT DEEP-DIVE

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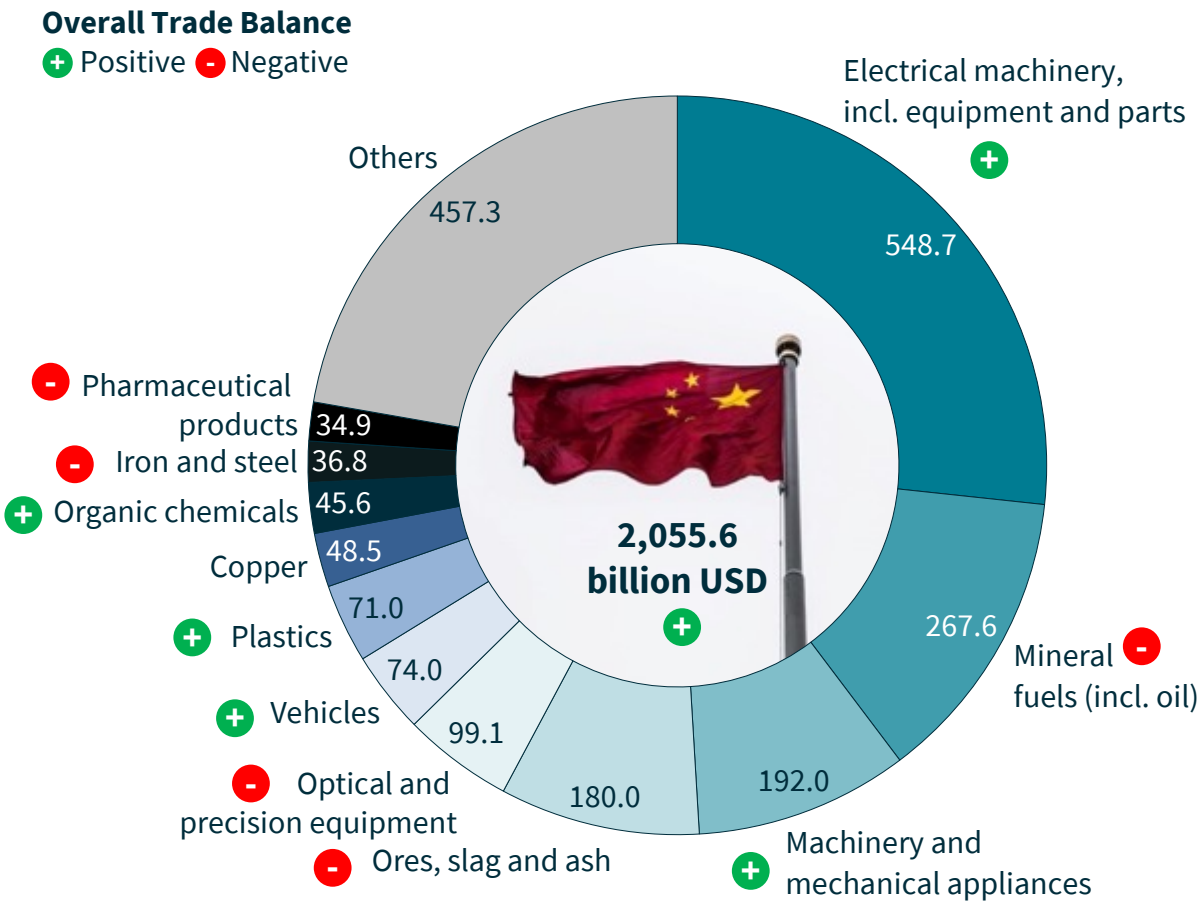
## China is still heavily relying on imports in the areas of machinery, commodities and specialized equipment – Among its top ten import sources, it has a positive trade balance with only two of them

**VALUE IMPORTED IN 2020 BY PRODUCT CATEGORY** (BLN USD)




**TOP 10 IMPORT COUNTRIES**

| Source Country/ Territory | China Import Volume (USD, 2020) | |
|---|---|---|
| Taiwan | 200.6 bln | - |
| Japan | 174.8 bln | - |
| South Korea | 172.8 bln | - |
| United States | 136.0 bln | + |
| Australia | 114.8 bln | - |
| Germany | 105.3 bln | - |
| Brazil | 84.0 bln | - |
| Vietnam | 78.5 bln | + |
| Malaysia | 74.7 bln | - |
| Russia | 57.2 bln | - |

**Overall Trade Balance**
+ Positive - Negative

*Source: ICT Trade Map*

# TRADE & INVESTMENT – RCEP

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## RCEP signing in November 2020 signaled that the US is not needed to lead economic cooperation and international trade, and will allow China and Japan to shape regional economic development


Countries: **15**

Population: **2.2 bln**

Combined GDP: **26.2 tln USD**

Share of global trade: **28%**

Share of global economic output: **30%**

### Regional Comprehensive Economic Partnership

| | |
|---|---|
| **PARTNERS** | ▪ FTA connecting **ASEAN** with **South Korea, Japan, Australia** and **New Zealand**<br>▪ Regional answer to the **failed TPP agreement** and complementation of exiting CPTPP FTA |
| **PURPOSE** | ▪ **Eliminate tariff and non-tariff barriers** on substantially all trade in goods and services<br>▪ Create a liberal, facilitative, and competitive **investment environment** in the region |
| **COVERAGE** | ▪ **Trade in goods and services**, investment<br>▪ Economic and **technical cooperation**<br>▪ **Intellectual property**, competition, legal and institutional matters |
| **IMPACT CHINA** | ▪ Will allow the largest economies of **China and Japan to shape regional trade** to their advantage<br>▪ **Increase Chinese** and reduce the growth of U.S. **exports** to the region |

*Source: Association of Southeast Asian Nations*

# TRADE & INVESTMENT – USA/ CHINA/ INDIA

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## Increasing trade conflicts and restrictions between China and the US as well as China and India

**Trade Conflict**

High

### USA – CHINA TRADE
*Conflicts*

- **US and China hold several unresolved issues** surrounding the **bilateral trade** between the two countries
- **Trade deficit between China and U.S.** has swelled immensely as the volume of imports from China grew much more rapidly than US exports to China

### INDIA – CHINA TRADE
*Restriction*

- **India reducing trade dependency on China** especially for non-essential and low-quality goods
- **India has launched *Production Linked Incentives* scheme to promote domestic manufacturing,** mandated local content in public procurement, restricted and prohibited certain imports, put in place quality control orders and launched a series of anti-dumping probes

### USA – INDIA TRADE
*Agreements*

- US and India view one another as **important strategic partners** to advance common interests regionally and is the key aspect of strategic ties with potential for more growth
- India to soon revive talks on the **possible FTA with US**

Low

*Source: EAC*

# TRADE & INVESTMENT – USA-CHINA DECOUPLING?

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**Under Biden, the US' China policy will remain consistent in many areas: Pressure to decouple will vary substantially across industries and products – US will continue to drive supply chain restructuring**

**US drive to decouple its economy from China's** and secure production in strategically important fields has endured the change of government:

- The US will likely continue trying to **cut off Chinese companies** (e.g. SMIC) from key technologies; additional **Chinese companies might be blacklisted** by the US government (e.g. SenseTime)
- The US will utilize a variety of tools to **re-shore production** in specific sectors that are designated strategically important

**IMPLICATION FOR COMPANIES:**

- **Review your product portfolio and key customers** to determine where you are most likely to see disruption due to regulatory shifts
- In cases where the disruption may be significant, **consider how this dynamic could impact your addressable market** in China
- Ensure you have the processes in place required to **remain compliant in the face of rapidly changing regulations** and to pivot quickly as and when key customers/suppliers are targeted

**Industries possibly or likely to face pressure in the future:**

- Semiconductors (equipment, materials, end product)
- Medical devices & diagnostics
- Pharmaceuticals and pharmaceutical ingredients
- Aerospace and defense equipment
- Critical infrastructure, e.g. communication equipment or computer hardware
- Specialty chemicals and refined metals

*Source: EAC analysis*

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**Our EAC *Relocation Probability Index* shows that flexible supply chains close to consumers are becoming a crucial competitive advantage, with multiple locations across Southeast Asia and China benefitting**

## How are Asian supply chains changing in a post-pandemic world?

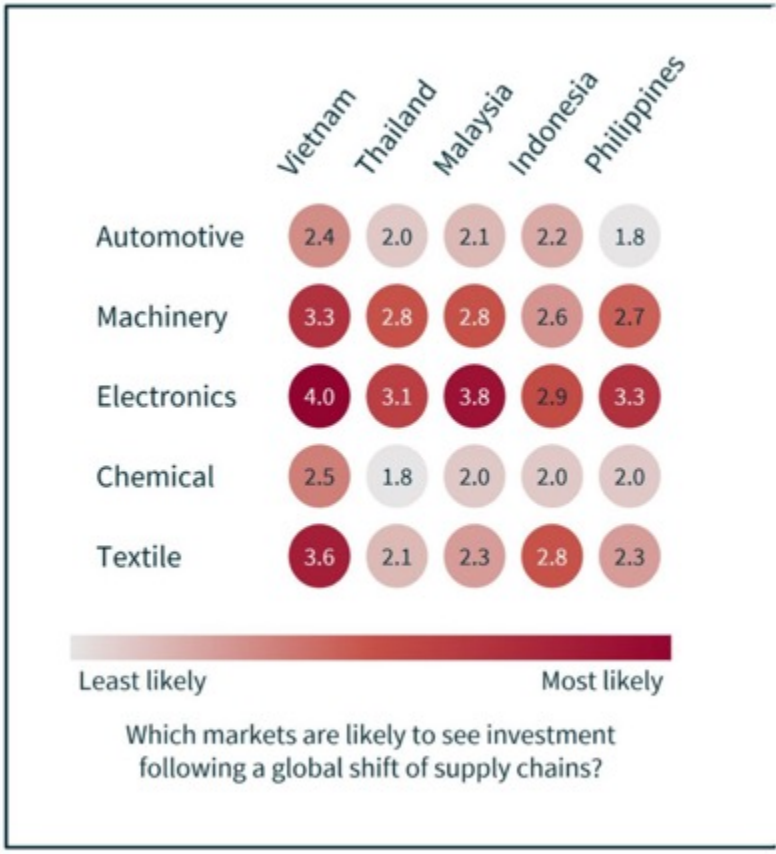
*A Review and Update of EAC's Asia Relocation Probability Index*

In 2019, EAC first published its Relocation Probability Index with a focus on Asia. The index looked at recent trends and indicators in international trade to analyze which industries are most likely to transform their supply chains and where companies are expected to go. At the time, the US-China trade war was accelerating an ongoing trend – the diversification of supply chains across the globe.

Since then, the world has changed in previously unimaginable ways. Although tariffs between China and the United States remain firmly in place, the trade war faded into the background as a global pandemic disrupted supply chains and devastated economies.

With business starting to normalize, we took a lock back at how supply chains have developed under this influence and what can be expected in the future.

▶ Read the full article **HERE**



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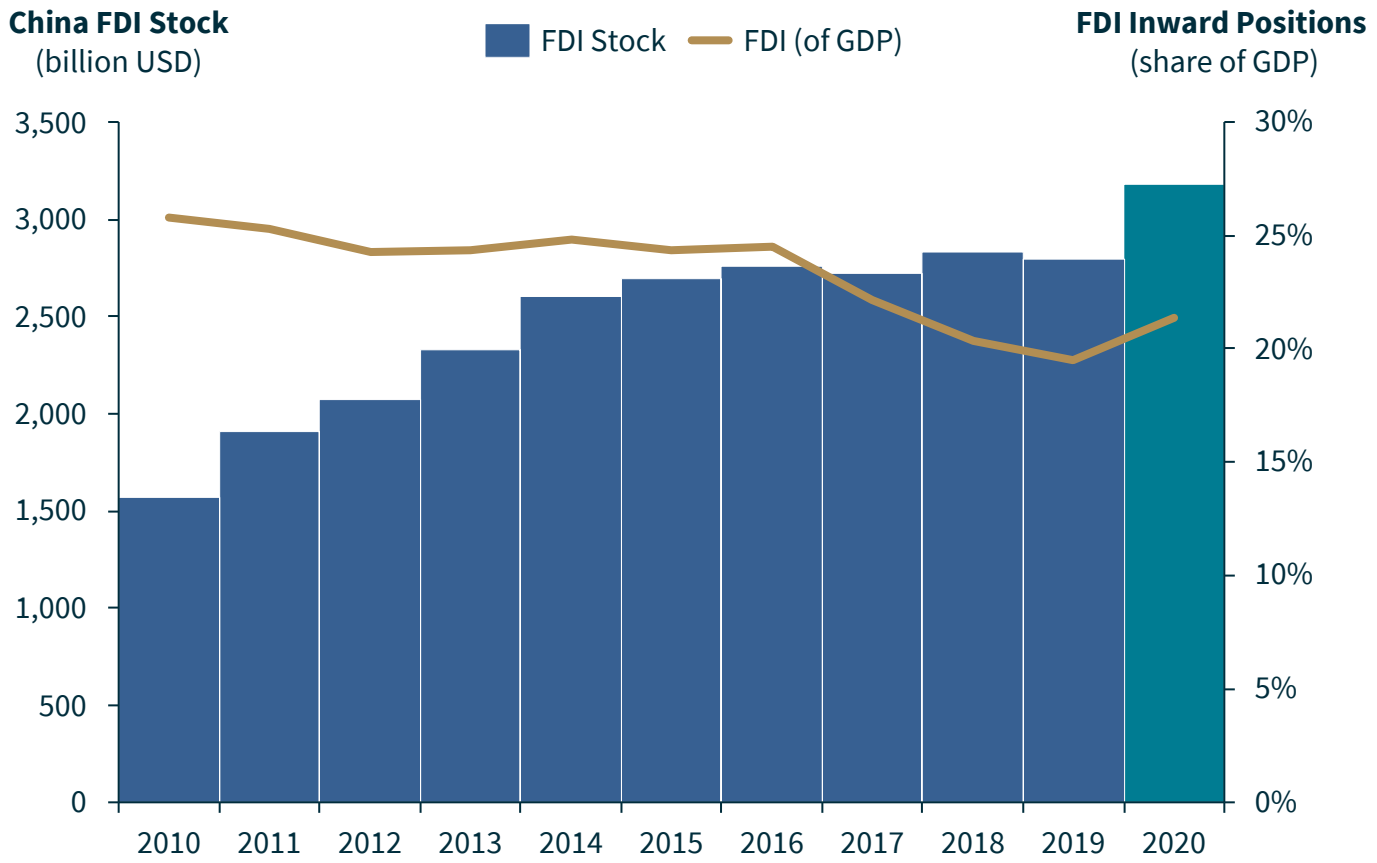
## Foreign direct investment into China has reached new heights in 2020 and 2021, as the country quickly recovered from COVID-19 and remains an attractive market for global enterprises

### CHINA FOREIGN DIRECT INVESTMENT




In 2020, as global foreign direct investment flows decreased by almost 40%, **China's inbound direct investment expanded by more than 10%**.

As a result, in 2020 **China's share of global foreign direct investment** reached an all-time high: ~25% and thus almost doubling its share in 2019.

For the first 8 months of 2021 this trend has continued so far: the Ministry of Commerce stated that FDI **further rose +22.3% year on year**.

*Source: OECD, Ministry of Commerce*

# TRADE & INVESTMENT – EU-CHINA AGREEMENT ON INVESTMENT

EAC INTERNATIONAL CONSULTING

## EU and China agreed on Comprehensive Agreement on Investment, aiming improved market access and a level playing field – Due to political sanctions, ratification of the agreement currently seems unlikely

### WHAT IS THE COMPREHENSIVE AGREEMENT ON INVESTMENT (CAI)?

- On Dec. 30th 2020, the EU and China agreed on the **Comprehensive Agreement on Investment**
- **Targets:** Ensure that **EU investors achieve better access** to China's market and that foreign companies **compete on a level playing field**:
  - **Removing restrictions** for EU firms
  - Forcing state-owned services enterprises to **declare subsidies** from the Chinese government
  - **Prevent forced transfer of technology** for EU firms in China

**The Optimistic Take**

- Agreement considered a step in the right direction and addressing the right issues concerning European MNEs
- China has made clear concessions in areas like market access and level playing field
- Negotiating with China is better than isolating the country, even if the outcome is not perfect

**The Critical Take**

- Agreement mostly contains only declarations of intent to "move in a certain direction"
- "Paper is patient": actual implementation and measuring of effectiveness will be difficult
- The CAI only reflects economic interests and does not openly address many other political issues

**Recent Developments:**

- In **March 2021**, the EU (along with the US, UK and Canada) decided to sanction Chinese officials over human rights abuses in Xinjiang
- The sanctions **target local Chinese officials** and one entity in Xinjiang with consequences such as travel bans and the freezing of assets
- In return, **China quickly announced their own counter-sanctions,** which target **more high-level** individuals and entities, including members of the EU parliament and Germany's Mercator Institute for China Studies
- Sanctions straining EU-China relations and could **put the ratification process of Comprehensive Agreement on Investment in jeopardy**

*Source: EAC research*

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# BUSINESS ENVIRONMENT – EUROPEAN COMPANY VIEW

EAC INTERNATIONAL CONSULTING

**EAC client feedback and European Chamber survey highlight growing divergence between economic reality vs. political tensions**

## POSITIVE MARKET DEVELOPMENT & FINANCIAL PERFORMANCE

Firms indicated **strong performance and future commitment** to business in the country:

- + 3/4 respondents turned a profit in 2020
- + 68% are optimistic about future growth
- + Only 9% are considering shifting current or planned investments out of China
- + 27% of European companies are increasing their shares in local JVs

**Most Clients see strong growth in China in 2021 …**

**VS.**

## CHALLENGING GEOPOLITICAL RISKS/ BUSINESS ENVIRONMENT

Yet, surveyed companies are worried about an **increasingly challenging business environment** and are looking for ways to decrease their risk:

- – >25% of manufacturers are onshoring at least some of their supply chains
- – Market access barriers are reported by 45% of surveyed companies
- – COVID-19 travel restrictions limit global interaction and slow down investments

**…But also witness increasing challenges**

*Source: EAC, European Chamber of Commerce in China Survey (n=585)*

# BUSINESS ENVIRONMENT – GERMAN BUSINESS CONFIDENCE

EAC INTERNATIONAL CONSULTING

**AHK survey results from early 2021 show that German companies in China are optimistic and have strong commitment to the market, despite remaining regulatory challenges & increasing local competition**


Survey finds 96% of German firms have no plans to leave China, many see rising sales

Companies see easier market access, more transparency, equal treatment under China-EU CAI

**Business Confidence Survey: Positive Development for German Businesses in China and High Expectations for EU-China Investment Agreement**

German firms upbeat about outlook for China despite US decoupling fears, survey finds

Poll finds Germans diverge from US' anti-China campaign

*Source: German Chamber in China, Online media websites*

# BUSINESS ENVIRONMENT – KEY CONCERNS

EAC INTERNATIONAL CONSULTING

**Despite confidence in the local market, there is a growing list of concerns that foreign companies have regarding the future of the business operations in China**

**KEY ISSUES WORRYING FOREIGN COMPANIES OPERATING IN CHINA**

**Long-term growth trajectory** might be endangered without additional commitments for further institutional reforms, increasing productivity, efficient resource allocation and market opening

Due to its increasingly aggressive diplomatic behavior, **China's image in many Western countries** has been deteriorating

As China's definition of **'national security' and self-sufficiency** expands (s. 14th FYP), European companies experience an exponential increase in challenges and a loss of business opportunities

Foreign companies increasingly have to respond to issues that result directly from the **business environment becoming more politicized**

**Business regulation push** by government is worrying foreign enterprises regarding sudden market changes and government interference

**COVID-19 travel restrictions** make it difficult for foreign companies to bring technical experts to China and take significant investment decisions

**New cybersecurity and data protection laws** make it increasingly difficult to handle datasets generated in China

**MNEs are increasingly forced to audit their supply chains in detail** (e.g German Supply Chain Due Diligence Act)

**Power outages** in late 2021 have impacted production lines also of foreign firms across the country

**Expat exodus** due to COVID-19 travel restrictions and cut of tax benefits

*Source: EAC compilation*

# BUSINESS ENVIRONMENT – REGULATORY CLAMPDOWN

EAC INTERNATIONAL CONSULTING

**More than a dozen industries have been put under stronger regulatory spotlight over the past month**


- Fintech companies
- Ecommerce and social media companies
- Celebrity and fan club culture
- High-income individuals who avoid taxes, or make "excessively high incomes"
- Tutoring and education companies, private schools
- Gaming companies
- Ride-sharing, car-hailing, bike-sharing, and power-bank-sharing companies
- Companies that want to IPO in the U.S.
- Companies that make heavy use of algorithms
- Cloud computing firms that sell services to state and Party organizations
- Cryptocurrency miners and exchanges
- Real estate developers and landlords
- Private investment funds
- Online insurance providers

*Source: SupChina*

# BUSINESS ENVIRONMENT – CYBER SECURITY

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## Legislations and regulations about cyber security in China are structured by national level, industry level, critical infrastructure, data security and specific industry applications

**National Framework**

- **Standard for Graded Cybersecurity Protection**

**Industry Framework**

- **Standard for Classified Cybersecurity Protection**

**Critical Infrastructure**

- **Critical Information Infrastructure Network Security Protection**

**Data Security**

- **Data Security Protection**
- **Password Application Requirement**

**Specific Industry Applications**

**e. g.** **Automotive Data Security Protections**

**Other Data Security Application Area**

### LAWS, REGULATIONS AND STANDARDS TARGETS

- Standardize IT security management, improve IT security assurance ability, **protect national security**, **social stability** and **public interests**, and promote informatization
- Extend scope to IT systems, communication network, **data resources**, network infrastructure, **Cloud computing platforms, Big data platforms, IoT, industrial control systems** and **mobile internet**, etc.
- Monitor, defend, and tackle with network security risks for critical information infrastructure, including telecommunications, **energy**, finance, **transportation**, **water** and **national defense** etc.
- Regulate data processing and protect legitimate rights and interests of individuals and organizations, including **data collection**, **storage**, **utilization**, **processing**, **transmission**, **provision** and **disclosure**, etc.
- Guarantee authenticity of IT system user identity, confidentiality and integrity of critical data, and the non-repudiation of operating behavior
- Encourage **rational and effective** use of automotive data in accordance with related law

*Source: Cyberspace Administration of China, EAC research*

# BUSINESS ENVIRONMENT – RECOMMENDATIONS

EAC INTERNATIONAL CONSULTING

## In its position paper, the European Chamber provides suggestions for foreign companies operating in China on how to adapt to existing challenges

### RECOMMENDATIONS FOR EUROPEAN COMPANIES

1. **Continue to integrate foreign staff into China operations**—as well as Chinese staff into global operations—in order to maintain diverse teams and avoid talent silos.
2. **Strengthen links between global and China teams**, in order to both increase understanding of China among headquarters and develop coherent China strategies.
3. **Establish 'decoupling teams'** to evaluate the costs associated with both localization in China and disconnection from certain global systems.
4. Develop a cost/benefit analysis of adopting either a '**flexible architecture**' model that can be localized for different markets or a '**dual system' model** that completely separates China production from production for the rest of the world.
5. **Audit all supply chains** to determine the current and future level of exposure to sanctions.
6. Adopt a realistic strategy for remaining abreast of, and reacting positively to, **changes in markets, public opinion and governments** that could have an impact on China operations.
7. **Avoid entering certain segments, or consider winding down certain business lines**, that are exposed to existing or potential sanctions, whenever the costs outweigh the benefits.
8. **Develop flexible global corporate de-carbonization strategies** that can be adjusted in the event that China operations are unable to access green sources of energy.
9. Invest and participate more in **government advocacy efforts** through chambers of commerce, industry associations and standards-setting bodies.

*Source: European Chamber of Commerce in China*

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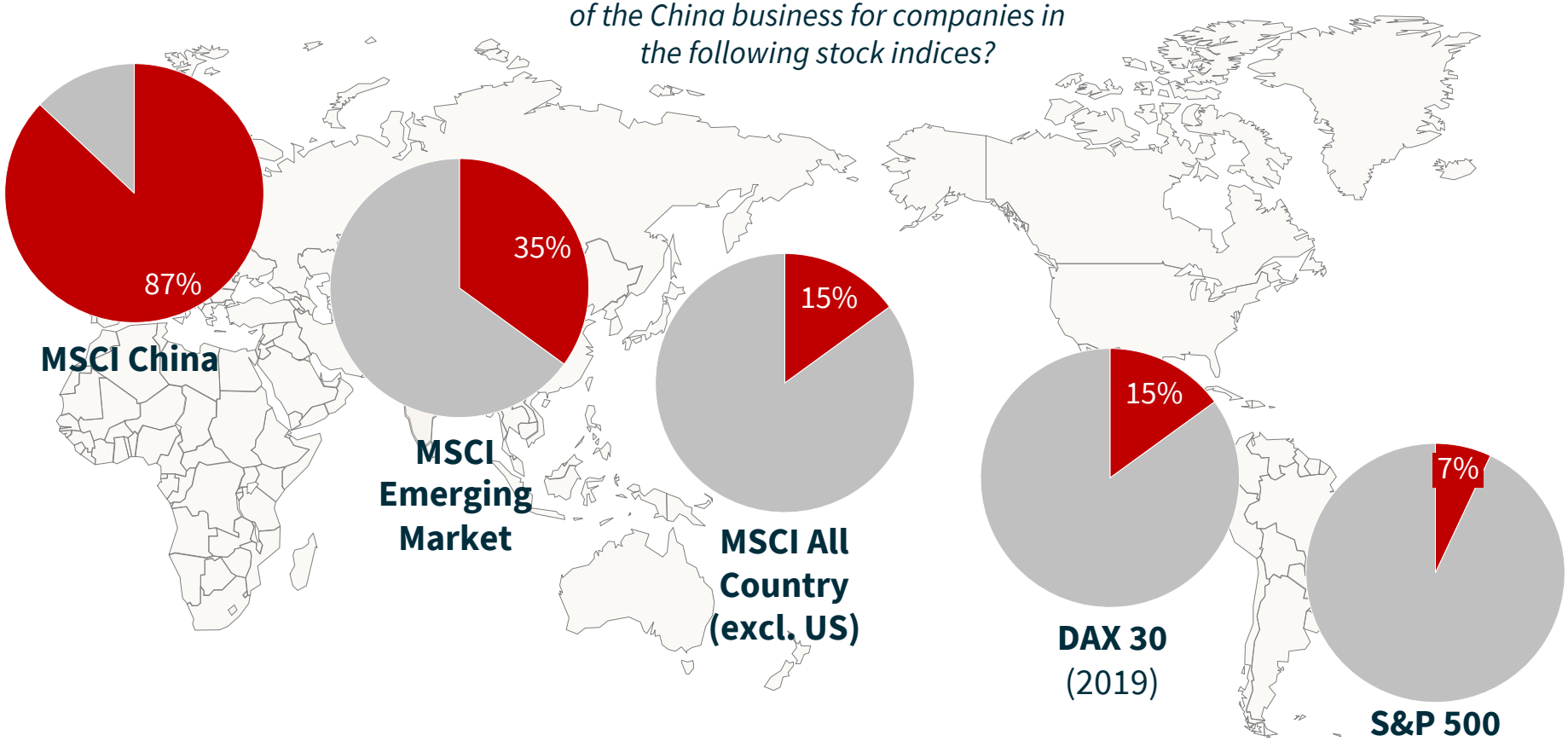
## Revenue exposure to China of publicly limited companies stands around 10-15% globally, with German MNEs having a higher exposure than American

### GLOBAL REVENUE EXPOSURE TO CHINA

*How high is the average revenue share of the China business for companies in the following stock indices?*




*Source: JP Morgan, EAC*

# MNCs IN CHINA – DEUTSCHLAND AG IN CHINA

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**In January 2021, The Economist published an article about how many German companies are bullish on China and keep investing, while also becoming more and more dependent on the Chinese market**

**BMW Group** President and CEO of Region China Jochen Goller: "*All of our investments we committed will continue, and we are actually discussing investing more in China in the future.*"

**Siemens** CEO Joe Kaeser: "*As a long-term and well-established partner of China and its industries, we support the call of the Belt and Road initiative and take another solid step forward on a larger scale and a wider scope.*"

**Adidas** CEO Kasper Rørsted: "*Adidas will 'invest heavily' in China, where he saw huge long-term potential. The firm is on track to add 2,000 stores in China and hit 12,000 by 2020.*"

**BASF** CEO Martin Brudermüller: "*We are pleased to see our mega-investment project in China is progressing.*"

**Volkswagen** CEO Herbert Diess: "*Our company stands for a globalized world with over 650.000 employees, over 100.000 of them in China. Over one fourth of the Volkswagen Group's plants are located in China.*"

**Bayer** CEO Werner Baumann: "*We have been in China since 1882, and our future growth prospects are closely linked to the market.*"

The Economist

German business and China

**Deutschland AG continues to pour billions into China**

**Infineon** CEO Reinhard Ploss: "*We never considered to move away from China. We strengthened our China production, especially as an example for the modules for electromobility, and will continue to do so.*"

**Daimler** CEO Ola Källenius: "*China remains a large part of the potential pool for carmakers and certainly for Mercedes-Benz. It is a market that we will continue doubling down on and increasing our footprint in.*"

*Source: The Economist, Twitter*

# MNCs IN CHINA – (GERMAN) INVESTMENTS IN 2021

EAC INTERNATIONAL CONSULTING

## German companies have also in 2021 continued to further invest in their China footprint, with a focus on local production and research & technology

*Want a monthly update?*
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### SELECTED ANNOUNCEMENTS IN 2021 SO FAR

Selected

#### NEW INNOVATION CENTERS

**Röhm:** new technology center

**Henkel:** new adhesive technologies innovation center

**Clariant:** state-of-the-art catalyst China R&D center

**EOS:** new office and technology center — **Shanghai**

**Siemens Energy:** Innovation Center to focus on R&D — **Shenzhen**

**Rheinmetall:** new technology center for PCU development — **Nanjing**

**Continental:** a new development center for software and systems — **Chongqing**

#### NEW FACTORIES

**Volkswagen:** new EV battery factory (SOP 2023) — **Hefei**

**SIG:** second aseptic carton packaging plant — **Suzhou**

**Knorr-Bremse:** enlarging its Dalian plant

**GROB:** construction of phase V plant — **Dalian**

**Flender:** new production hall — **Tianjin**

**Covestro AG:** new production facility for polyurethane dispersions — **Shanghai**

**DMG Mori:** new automated production plant — **Pinghu**

**BSH:** new dryer factory — **Nanjing**

#### INVESTMENTS

**Porsche Ventures** invests in digital startup iMaker

**BASF** invests in biotechnology startup Bota Bio

#### COOPERATION

**Daimler + Beiqi Foton:** JV to produce heavy-duty trucks

**Bosch + Qingling Motors:** new JV to provide fuel cell systems

*Source: EAC research, Press Releases*

# MNCs IN CHINA – GERMAN AUTOMOTIVE OEMs

EAC INTERNATIONAL CONSULTING

## As China is the most important market for major German OEMs, they continue to heavily invest into local research and production capacity as well as partnerships with Chinese carmakers and tech companies

### VOLKSWAGEN GROUP

- **Takeover of majority stake in JAC Joint Venture:** VW now controls 75% of *Volkswagen (Anhui) Automotive* and plans to establish an e-mobility hub in Hefei.
- **Acquisition of 26.5% stake in EV battery maker Guoxuan:** An important aspect of VW's interest in Guoxuan is its expansion into high nickel cathode cells (13 GWh installed capacity and 16 GWh to be added with new mega-factory in Hefei). The firm also has ~5% of the LFP battery market in China.
- **Launch of ID.4 in China with drone spectacle:** VW presented two versions of the *ID.4* for the Chinese market. The *ID.4 X* is the version of the electric SUV developed for SAIC-VW, the *ID.4 Crozz* is the counterpart of FAW-VW.
- **Audi strengthens business in China:** Audi and FAW confirm a new cooperation company for the future production of PPE-based electric vehicles in Changchun.
- **Volkswagen explores flying cars in China**

### DAIMLER

- **Development of next-generation engines with China's Geely:** Daimler will cooperate with Geely to build next-generation modular combustion engines for use in hybrid vehicles to be used in cars under different marques at Geely and Daimler. Most of next-generation combustion engines will be made in China.
- **Mercedes-Benz and Geely: Global joint venture formally established** to transform *smart* into a leading player in premium-and intelligent electrified vehicles. In 2018, Geely had purchased a stake of 9.69% in Daimler.
- **Daimler, Beiqi Foton to Start Making Heavy-Duty Trucks in China:** Daimler Truck and China's Beiqi Foton Motor will build a factory near Beijing to produce Mercedez-Benz-branded heavy-duty vehicles.
- **AV startup Momenta raises USD 500 mio from Daimler, Toyota, Bosch, others:** The four-year-old company is testing autonomous cars in Beijing and Suzhou, and has a research center in Stuttgart.

### BMW

- **New Factory in Shenyang** BMW Group to invest 4.4 billion RMB in the construction of its new factory in Shenyang, Liaoning Province. The investment will be used to complete the main building of the new factory of BMW Brilliance Automotive.
- **Launch of iX3 Battery Production in China:** The new battery center is supposed to complement the High-Voltage Battery Center opened in 2017. Transport distances will be correspondingly short when BMW iX3 production starts at the neighboring BBA plant in Dadong, Shenyang.
- **Partnership with China's State Grid:** BMW and Chinese power company State Grid announced a massive charging network expansion that would roughly double the number of charging piles for the carmaker's vehicles in the country.
- **Brilliance Auto, BMW seek possibility of co-producing more BMW's models:** Brilliance Auto Group announced it intends to co-explore the possibility of producing more BMW's vehicle models in Shenyang.

*Source: EAC research and press articles*

# MNCs IN CHINA – CASE STUDY: dyson

EAC INTERNATIONAL CONSULTING

**Dyson is a success story in terms of how foreign brands can build and maintain a special image in China**

## DYSON IN CHINA – KEY FACTS

- China market entry in 2012, which became the **firm's fastest growing market in 2014** and ever since
- **High investment in Chinese market…**
  - Established network of ~600 Dyson stores in 90 cities (focus on tier-1 cities & pop-up store concept)
  - Built a technology center in Shanghai to better understand the Chinese consumers
- **…followed by commercial success**
  - Dyson vacuum cleaners now have ~60% market share in China
  - New *Airwrap* hair styler sold out within 3 minutes on Tmall, and in just 15 seconds on JD.com
  - Dyson was one of 84 brands with sales of 100 million yuan in one hour during 11/11
- **Moved headquarters to Singapore** in 2019 to reflect importance of Asia business (~50% of total revenue)

## SUCCESS FACTORS

- ✓ **Top quality** and focus on **fashionable design and exciting technology**, based on best-in-class **product innovation**
- ✓ **Consistent premium pricing** strategy (few promotions)
- ✓ **Clear target group** (mostly young women in the rising middle class)
- ✓ Successful **e-commerce and online marketing** strategy

*Source: EAC research*

# MNCs IN CHINA – EAC ENGAGEMENT TOPICS

EAC INTERNATIONAL CONSULTING

**In the past years, we have seen certain trends and client requirements frequently come up in China –**
**KEY TAKEAWAY: China stays attractive for foreign businesses, but requires attention and investments**

### China Subsidiary as Global Growth Driver

- **Organizational Transformation** to utilize growth opportunities
- Recognition of **growth potentials** via e-commerce/ new distributors
- **Ambitious investment strategies** China 2025

### Consumer Goods New Wave

- **High interest** in consumer goods growth opportunities in China (e.g. via CBEC)
- Development of **go-to-market/ distribution strategy**, esp. in F&B
- **Set-up of local organization**, incl. registration, office and staff

### Business Model Localization

- Rising local competition requires **adjustment of business model**
- Analysis of **product localization cost benefits** Discussion on special "**China Strategy**" to stay competitive (e.g. local innovation investments)

### Performance Improvement

- **Assessment of status quo** and improvement potential (e.g. factory optimization)
- Key stakeholder alignment and facilitation of **cross-regional communication**
- Structuring of **task force** and **on-site coaching**

### Asia Footprint Assessment

- Boom in certain industries often leads to **need for capacity expansion**
- Increasing environmental scrutiny forces **factory relocation**
- Focus of location search mostly on **East and South China**, as well as **SEA**

### Innovation & Digitization Benchmarking

- Rising interest in Chinese **local innovation and startup ecosystem**
- Need by European industry for China **innovation & competition benchmarking**

### Role of China as 2nd home market

- **Organizational assessment** to strengthen China organization
- Stronger need to consider China in all **HQ decisions** (across the value chain)
- **Autarky** of China organization to win in competitive market

### Sustainability

- Formulation of global or regional **ESG strategy**
- Market & Customer **Readiness Check**
- **Supply Chain Due Diligence** & Conformity
- **Carbon Footprint** Mapping & Target Setting

*Source: EAC*

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# CONSUMPTION – BIG PICTURE

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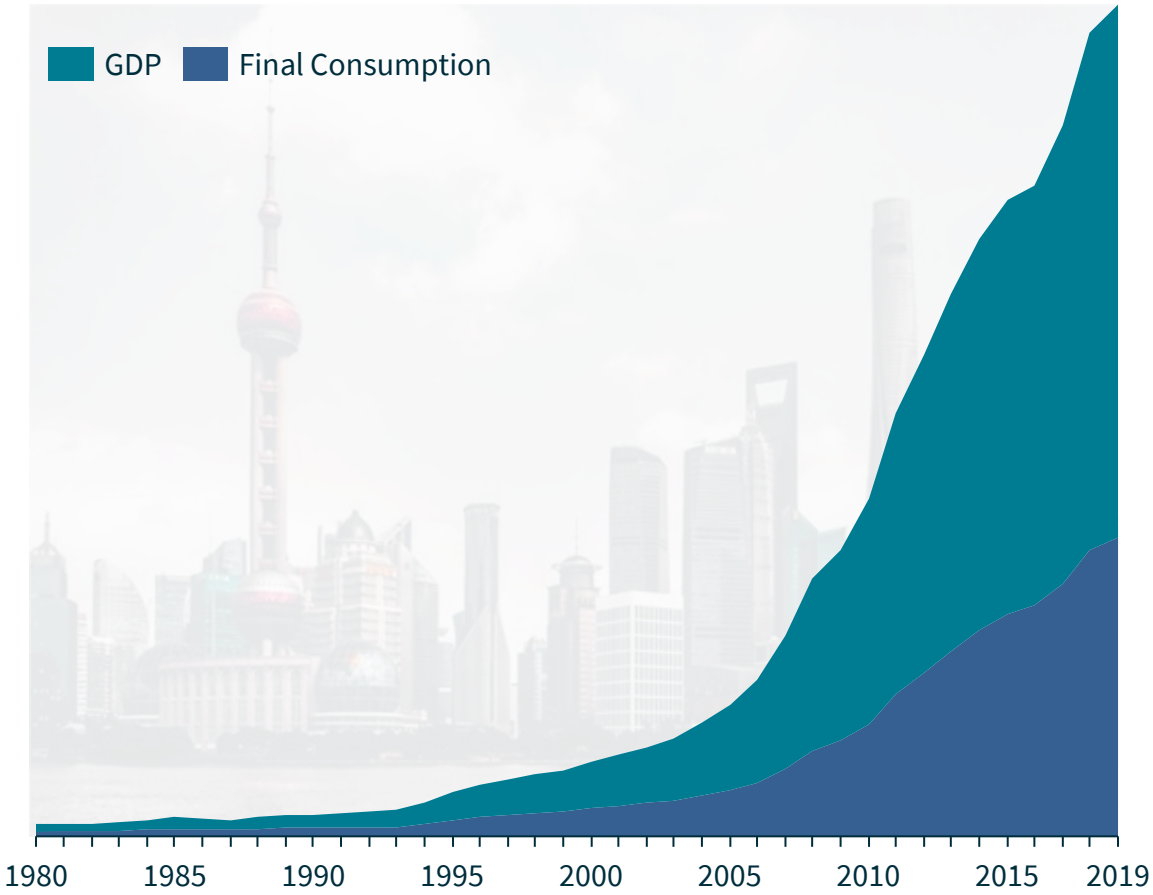
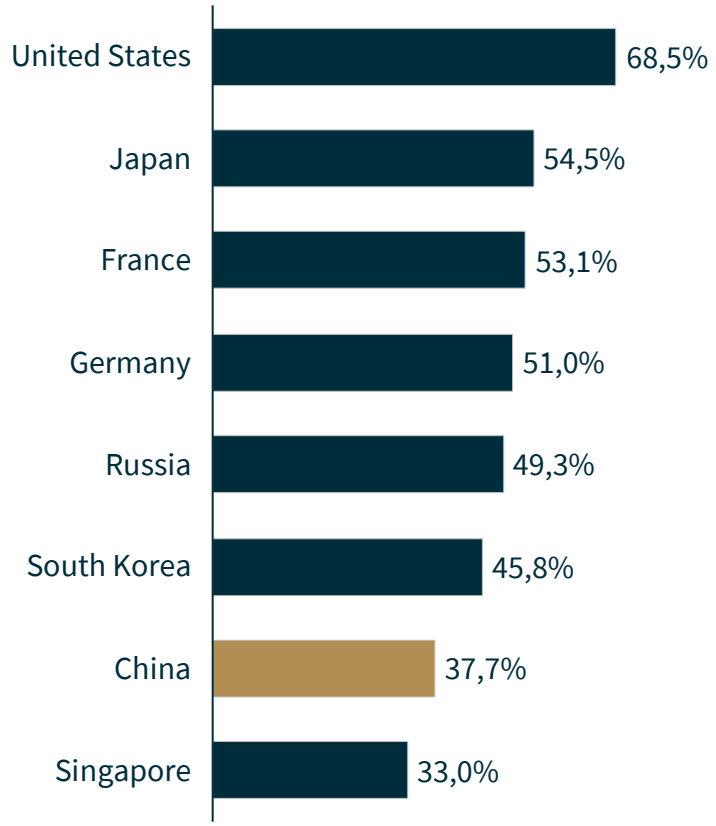
**Previously relying on an investment- and export-led growth mode, China consumption share of GDP is still lacking behind other countries and boosting private consumption will not be an easy task**

**CHINA GDP AND CONSUMPTION OVER TIME** (CURRENT USD)




**PRIVATE CONSUMPTION AS SHARE OF GDP**

*(Latest available data for each country)*




*Source: World Bank, CEIC*

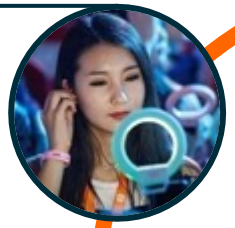
# CONSUMPTION – THE NEW CHINESE CONSUMER

EAC INTERNATIONAL CONSULTING

## The Chinese consumer is fundamentally different from 10 years ago – New (online) sales channels, rising domestic brands and an increasing desire for self-expression have changed purchasing habits

**Digital-first & Online-offline Integration:**

- >1 billion digital-savvy and mobile-first Chinese customers are increasingly defining how brands must operate their China business
- They research products online, shop on WeChat or DouYin, and expect a seamless O2O integration

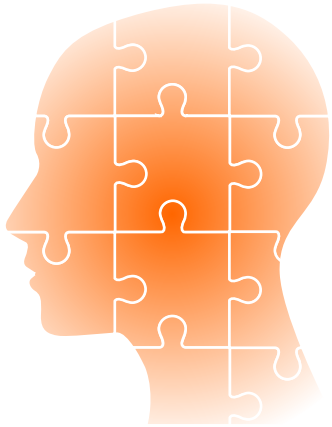


**Role of Influencers:**

- Faced with overwhelming product options, Chinese consumers turn to offline and online influencers (e.g. KOLs, live-streamers) to help make their purchase decisions

**Pre-purchasing Researcher:**

- Customers will actively investigate product parameters, understand the general rationale and performance expectation of the product, as well as diligent price comparisons



**THE NEW CHINESE CONSUMER**

**Individualization & Customization**

- Consumers desire to express themselves and their lifestyles in more unique ways
- Younger customers tend to pursue products that meet their own tastes, and expect more interactive products


**Proponent of Domestic Products:**

- Unlike older generations, post-90's customers are more willing to try Made-In-China products
- Buying Chinese brands is becoming a trend due to rising quality and increasing patriotic sentiments

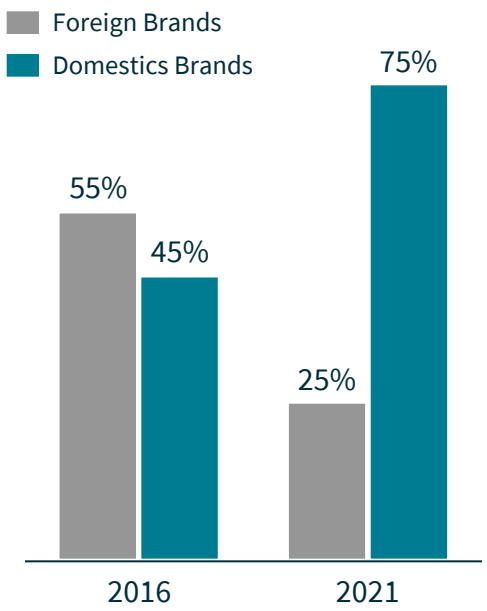
*Source: EAC*

# CONSUMPTION – THE RISE OF CHINESE BRANDS

EAC INTERNATIONAL CONSULTING

## Successfully emerging domestic brands highly focus on requirements of the young generation

**Seismic Shift:**
**Increasing interest, preference and trust in domestic brands**




*(Source: Baidu Attention Index)*

Market leader in **"Smart Home" products** and on track to become **largest smartphone manufacturer** globally

Established **White Goods brand** – increasingly attacking Premium segment

No.1 domestic brand in Chinese **sanitary industry**, starting **global expansion**

**Apparel brand** benefitting from increased **"national sentiment"** in China clothing industry

**KEY SUCCESS FACTORS**

- **Functionality & Quality**
- **China-for-China Design**
- **Online Channels**
- **Local Branding**

*Source: EAC*

# CONSUMPTION – NEW CHINESE BRANDS & MARKETING

EAC INTERNATIONAL CONSULTING

**Successful emerging brands highly focus on requirements of young generation of customers and design their products, select the channel and do marketing based on their preferences**

**CHICECREAM**

- Dedicated to become **premium ice cream brand** with strong Chinese characters
- Surpassed Haagen-Dazs and became No.1 frozen food brand on Tmall

**SATURN BIRD**

- The "**Boutique Instant Coffee**" drinkable in 3 seconds with same taste as hand grinding coffee

**GENKI FOREST**

- Aims to become the **sparkling water** with "0 sugar, 0 calorie and low fat" that young people like most

**FLORASIS**

- Provide healthy and nourishing **make-up products** with Chinese traditional craftsmanship and emphasizes on "Orient Cosmetics

**Livestream/ Celebrity Endorsement**

**Brand Cooperation**

**Pop-Up Store**


**AR/ VR Marketing**

*Source: EAC*

# CONSUMPTION – OFFLINE & ONLINE RETAIL TRENDS

EAC INTERNATIONAL CONSULTING

**For many consumer goods brand offline retailing has come under pressure, with focus of marketing shifting to digital channels – POS still highly relevant for O2O integration and brand positioning**

### Offline retailing under pressure

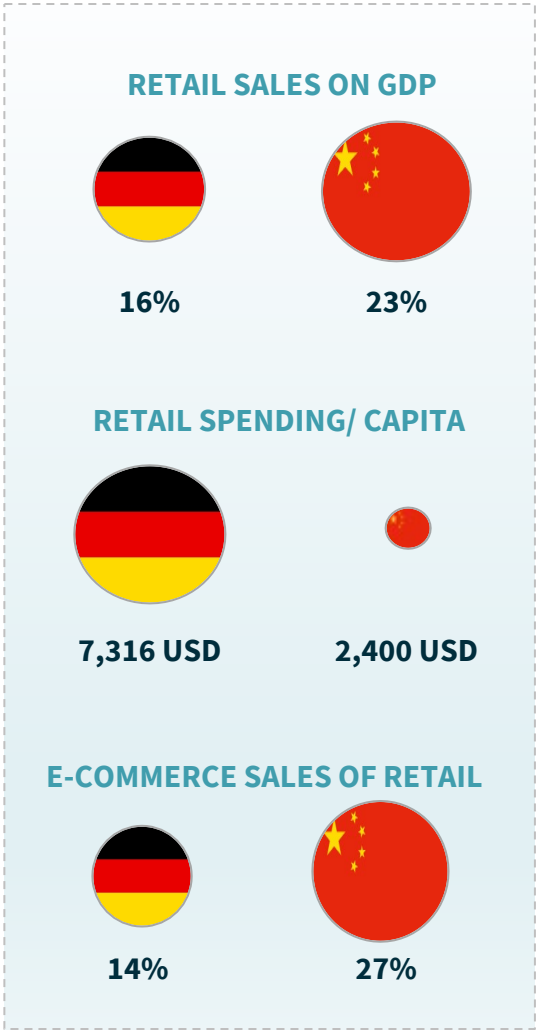
- Disrupted by e-commerce, POS struggle to create ROI and brands are carefully reconsidering their offline footprint
- For luxury products however, offline remains highly relevant
- Brands attention on e-commerce is very high: marketing and expansion budget allocated strongly to digital

### O2O integration is crucial

- Brands change the focus of their POS network to connect to e-commerce and social media
- Customer data is becoming increasingly important. In offline channels, POS are increasingly designed to collect data – own managed POS are most suitable

### Offline outlets used to boost brand positioning

- Offline presence in top malls is good for brand positioning – especially for luxury brands to increase exposure to affluent consumers who value offline experience
- The most important factor for many premium brands when choosing a mall is to see if the LVMH group is in there: this sets the tone of attracting affluent consumers
- Focus on quality, not quantity: Making offline shopping experience cool and exciting is key



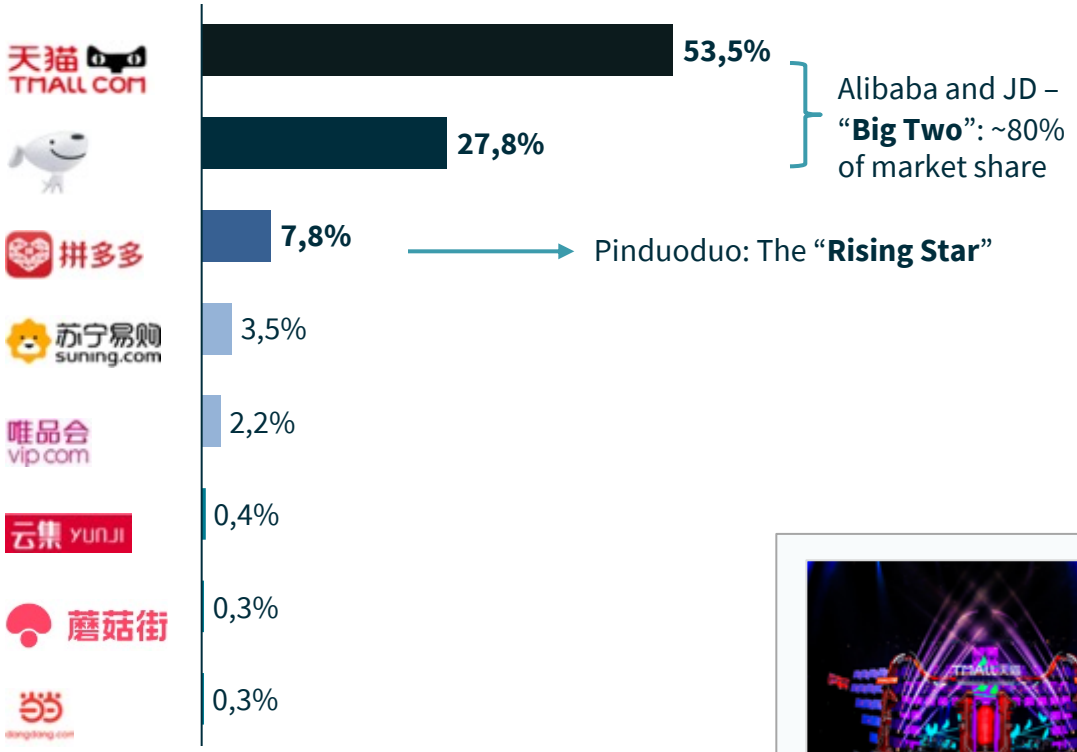

*Source: EAC primary*

# CONSUMPTION – TOP E-COMMERCE PLANFORMS

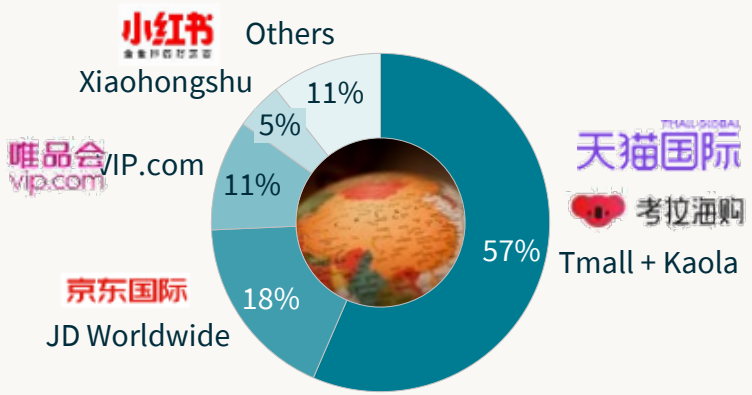
EAC INTERNATIONAL CONSULTING

**Despite increasing regulatory attention, Alibaba (Tmall) and JD remain the largest e-commerce platforms in China – But social commerce platforms such as Pinduoduo or Xiaohongshu are growing fast**

## E-COMMERCE PLATFORMS IN CHINA




## CROSS-BORDER PLATFORMS




**A Muted Double-11 in 2021**

China's annual online shopping festival on November 11th (Singles' Day) adopted a tone of sustainability this year. Instead of boasting about GMV numbers (+8.5% YoY), both Alibaba and JD focused much more on highlighting "green" vouchers, recycling, and eco-friendly logistics.

Note: Tmall incl. Taobao and Tmall Global, JD incl. JD Worldwide

*Source: Statista, EAC analysis*

# CONSUMPTION – CONSUMER GOODS NEWS IN 2021

EAC INTERNATIONAL CONSULTING

**The consumer goods industry was once again very dynamic in 2021, with both foreign and domestic companies rapidly expanding and adapting their market strategies**

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- **Suning** said to mull sale of Carrefour China majority stake. (October)
- **JD.com's** first brick-and-mortar mall set to open in Xi'an. (September)
- Anti-monopoly fine pushes **Alibaba** to first operating loss as public company. (May)

- ByteDance rival **Kuaishou** reports 37% sales growth. (May)

- **Xiaomi, Vivo and Oppo** sold one-third of the world's smartphones in first quarter. (June)

- **Oatly** opens its first China factory to double down on Asian market. (November)
- **Uniqlo** eyes 100 China stores a year, starts with Beijing flagship. (November)
- **Diageo** to build 75 mln USD distillery to make its first Chinese single-malt whisky. (November)
- **Sam's Club** expected to have 40-45 stores in China by the end of 2022. (April)
- **Lego** sales soared in 2020, and Lego is gaining fans in China. (March)

- **Unilever** angers Chinese consumers by using powdered milk for its ice-cream products. (August)
- **Adidas** hit by China boycott, Vietnam factory closures. (August)

- **Koolearn** to end tutoring for children amid education reforms. (October)

- Diary giant **Yili** files plan to buy one-third of rival Ausnutria. (November)

- New Brands: **BuffX** gears up for new product launches with ambitious USD 15m sales goal. (September)
- Chinese brand **Bosideng** becomes No.1 globally in down jacket sales. (August)
- Premium tea-maker **Nayuki** bubbles up toward Hong Kong listing. (June)

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# DOMESTIC INNOVATION – REGULATION & POLICIES

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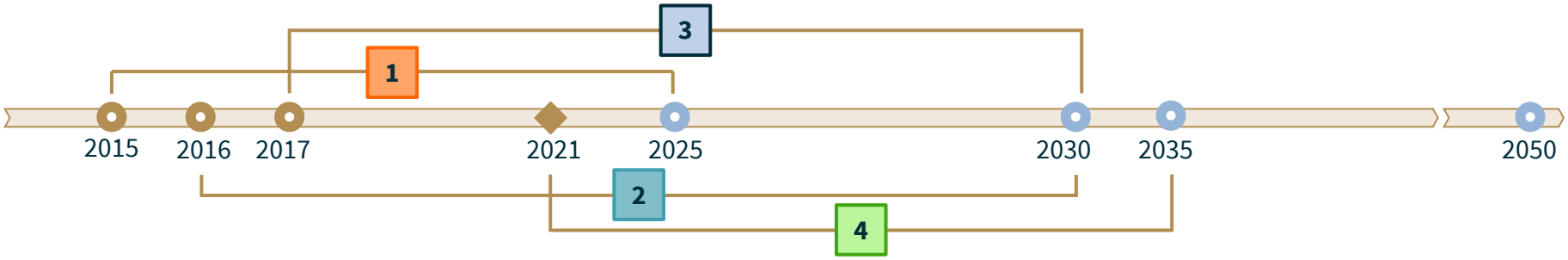
## In addition to current short- and mid-term government policies, China also develops several long-term plans related to innovation

**1 Made in China 2025 (2015-2025)**

**3 New Generation AI Development Plan (2017-2030)**

- **Overall objective:** Become a world innovation hub and technology lead of AI in 2030
- **Main contents:** 1) promote basic AI science research 2) develop generic technology for AI industry 3) supporting hardware/ software platform for AI technology 4) relevant infrastructure built-up




**2 Outline of National Strategy of Innovation-Driven Development (2016-2030)**

- **Overall objective:** Become a leading innovation-driven country in 2030 and an innovation superpower in 2050
- **Main contents:** 1) build competitive advantages in various industries 2) promote innovation in basic technologies 3) build regional innovation clusters 4) start megaprojects in some high-tech fields
- **Key technologies in-scope:** fuel cell, NEV, wind power, cyber security, automation and intelligent manufacturing

**4 14th Five-Year-Plan & Long-Term Plan 2035**

- A continuous version of 13th Five-Year-Plan (2016-2020)
- Focus less on quantitative GDP growth number and more on qualitative social fair and environment

*Source: Government sources, EAC Research*

# DOMESTIC INNOVATION – CHINA STANDARDS 2035

EAC INTERNATIONAL CONSULTING

## China Standards 2035 aims to more aggressively push Chinese technological standards – MNEs should actively participate in drafting standards and build up local technology and innovation competence

### CHINA STANDARDS 2035

- **Officially launched "China Standards 2035" strategy in 2018**
- Aim to **set global standards for emerging technologies**, such as 5G, Internet of Things (IoT), and Artificial Intelligence (AI)
- Stronger **control over system design and rulemaking**
- **Innovation is of great importance** as being pioneer in a new area opens opportunity to **take lead in formulation of industry standards**

### IMPORTANCE OF INDUSTRY STANDARDS

- Ensure products designed by different companies to **work together seamlessly**
- **Guaranteed compatibility**
- Big scale production
- **Drive innovation and efficiency**
- Profitable licensing fees to implement certain standards with patented technologies
- China has **gained an increasingly active role** in innovation recent years

### IMPLICATIONS FOR MNEs

- **Participate in drafting standards** for related sensors and components
- Keep dominance in **traditional technology sectors**
- Further **investment in technology and innovation** in China market
- Forge **new capability** in new related technology sectors
- **Keep pace with** Chinese dynamic market

*Source: EAC research*

# DOMESTIC INNOVATION – MANUFACTURING ADVANCEMENTS

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**Chinese technology companies like Alibaba and Xiaomi have recently introduced smart and automated manufacturing systems, that help to save cost, shorten lead times and increase flexibility**

## XIAOMI SMART FACTORY

- **Smart Mobile Phone Factory powered by 5G and Artificial Intelligence**, with size of 18,600 square meters
- Equipped with a **fully automated ("black light") production line** spanning processes from production management to machine processing, packaging and storage
- Capable of producing **>1 million smartphones a year** (focus on Xiaomi's high-end premium smartphones)
  - Factory will be also used for testing cutting edge materials, technologies, & manufacturing process, as well as, for pre-research projects, and automation equipment R&D
- Next expansion phase expected in around three years

## Alibaba RHINO SMART MANUFACTURING

- **Fully digitized facility leveraging intelligent manufacturing and automation** that gives micro garment merchants fast-fashion speed:
  - Raw materials are all coded and assigned with a unique ID, along with a QR code
  - Cutting, sewing, and printing machines are connected to digital systems, utilized to plan, manage and track the entire production process
  - Automated guided vehicles, pick-and-place robotic arms, and conveyor belts are used to transport materials to workers around the plant
- Allows merchants to order as few as **100 pieces**, with a **lead time of 10 days**
- **Tangible achievements**:
  - Reduced need to hold inventory by *30%*
  - Shortened the delivery time by *75%*
  - Cut water consumption by *50%*

*Source: Gizmo China, KrAsia*

# DOMESTIC INNOVATION – SHANGHAI AS R&D HUB

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**With >450 foreign R&D centers is China's main innovation hub (esp. for biomedicine), and has policies in place to continuously attract foreign companies to set up their research teams in the city**

## SHANGHAI'S CONTINUING R&D PUSH

- Currently, already 477 foreign R&D centers (1/3 by Fortune Global 500 companies) are located in Shanghai
  - Mostly in biomedicine, information technology, auto parts, and chemical industries
- End of 2020, "Regulations on Encouraging the Establishment and Development of Foreign-funded Research and Development Centers" was released by local government
- Eligible foreign-funded R&D centers will benefit from a numerous policy support measures, e.g.
  - Customs clearance facilitation for cross-border R&D
  - Cross-border financial services facilitation
  - Talent acquisition and development
  - Funding support and tax cuts
  - Participation in government projects
  - Facilitation of environmental assessment and hazardous waste management
  - Facilitation on land use for R&D purposes
  - Protection of intelligent property rights (IPRs)
- Regulations in effect from Dec 1, 2020 until Nov 30, 2025

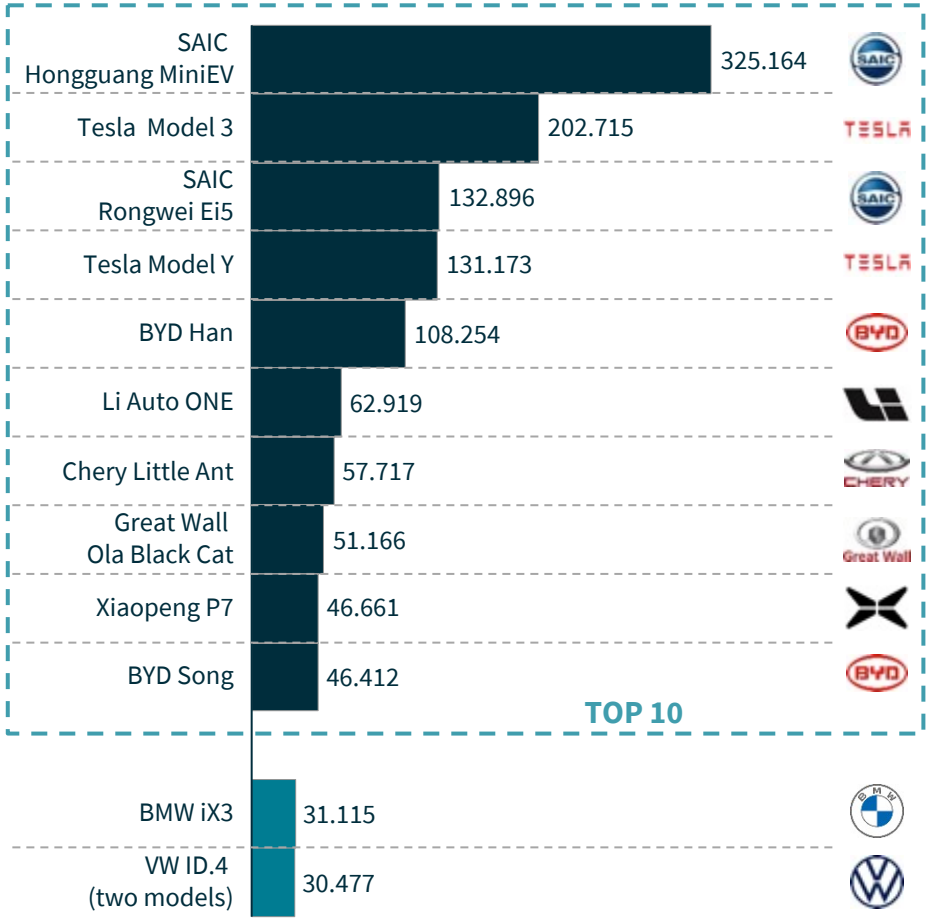

*Source: EAC research, Shanghai Municipal Government*

# DOMESTIC INNOVATION – E-MOBILITY

EAC INTERNATIONAL CONSULTING

## China remains one of the largest NEV globally with numerous local OEMs – In addition, almost all new production capacity recently opened or under construction in the country is focused on NEVs

### SALES OF EV MODELS IN CHINA (JAN-OCT 2021, UNITS)




### SELECTED OEM PLANTS WITH SOP IN 2021 AND BEYOND

| Company | Plant Name/ Type | SOP | City | Province |
|---|---|---|---|---|
| **Great Wall** | Plant for WEY | 2021 | Rizhao | Shandong |
| **Great Wall** | Pinghu Plant | 2021 | Jiaxing | Zhejiang |
| **Geely** | NEV Plant | 2022 | Shangrao | Jiangxi |
| **Geely** | NEV/ Lotus Plant | 2022 | Wuhan | Hubei |
| **Nissan** | Nissan-Dongfeng Plant | 2022 | Wuhan | Hubei |
| **BMW/ Brilliance** | Spotlight Automotive Factory | 2022 | Suzhou (Zhangjiagang) | Jiangsu |
| **BMW** | Expansion of Tiexi Plant | 2022 | Shenyang | Liaoning |
| **FAW Toyota** | New Energy Plant | 2022 | Tianjin | Tianjin |
| **Daimler/ Geely** | EV Plant | 2022 | Xi'an | Shaanxi |
| **Volkswagen** | NEV factory for MEB-platform | 2023 | Hefei | Anhui |
| **Volkswagen** | NEV factory for Audi | 2024 | Changchun | Jilin |

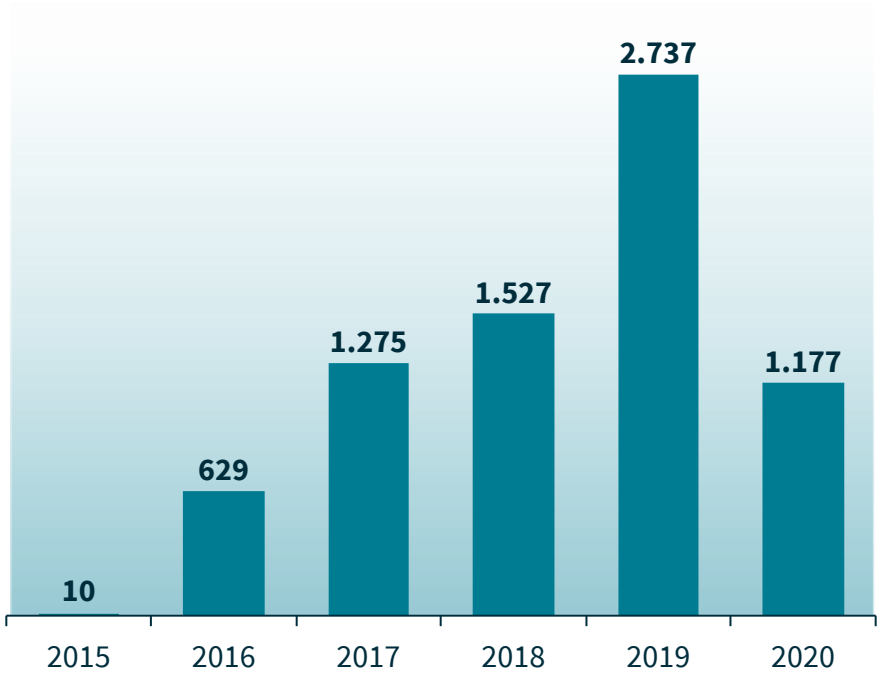
*Source: EAC research*

# DOMESTIC INNOVATION – FUEL CELL

EAC INTERNATIONAL CONSULTING

## FCEV deployment in China started comparatively late – FCEV are exclusively commercial vehicles, while Passenger segment focus is still on BEV commercialization

### CHINA FCEV ANNUAL SALES VOLUME (THSD UNITS)





0%


66%


34%

*Current stock:*

~5,800

### MARKET INSIGHTS

- China acted **comparatively late** in technology deployment, thus China's FCEV industry is still in the **nascent stage**
- However, the hydrogen industry has been lifted to China's **national strategic level**
  - Government aggressively pushes the development of fuel cell electric vehicles with an initial focus on **commercial vehicles**
- Strong development of BEV has provided good **industrial base** for FCEV in China as it has a **similar electrical** and **electronic architecture**

***FCEVs in China are mainly bus or truck***


Feichi FSQ6860FCEVG3


Foton Ouhui BJ6123

*Source: IEA, EAC Research*

# DOMESTIC INNOVATION – MAGLEV TRAINS

EAC INTERNATIONAL CONSULTING

**Apart from its growing bullet train network, China is also actively researching and investing into magnetic-levitation technology for both ultra high-speed and medium-speed commercial use**

## CURRENT MAGLEV LINES IN CHINA

- Apart from the well-known Maglev line to **Shanghai**'s Pudong Airport, there are some more active commercial train lines:
  - The **Changsha** Maglev Express, opened in 2016, connects Changsha Airport and Changsha South Railway Station with speeds of up to 100 km/h.
  - **In Beijing**, the S1 Maglev Train Mentougou Line, extending the capital's subway network in the West of the city (opened in 2017 and also medium-speed)
  - In 2021, one more low-to-medium speed Maglev line with speed of up to 100 km/h is scheduled to start operations in **Qingyuan**, Guangdong province.


## FUTURE MAGLEV PLANS IN CHINA

- Several Chinese institutions and companies are jointly developing a **super-high-speed magnetic-levitation train** that will be able to travel at up to **620 km/h**:
  - A futuristic **21-meter prototype was revealed in 2021**, featuring a full carbon fiber lightweight body and a low-resistance locomotive shape
  - One of its key elements is the use of **high-temperature superconductors** (-196 °C) instead of liquid helium superconductors (-269 °C), which are cheaper in both production and operation
  - A **commercially viable product** might only be 6 years away

- Also in early 2021, Guangdong revealed an ambitious long-term infrastructure plan, that includes concepts for a **proposed Maglev link** between the southern province, Shanghai on the east coast as well as the capital Beijing.
- In parallel, there is ongoing development for **medium-speed intra-regional maglev solutions** (e.g. in Chengdu)

*Source: EAC*

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# SUSTAINABILITY – POLICYMAKERS SETTING FRAME IN CHINA

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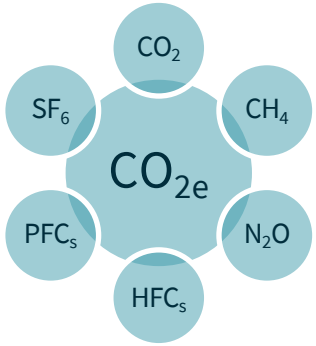
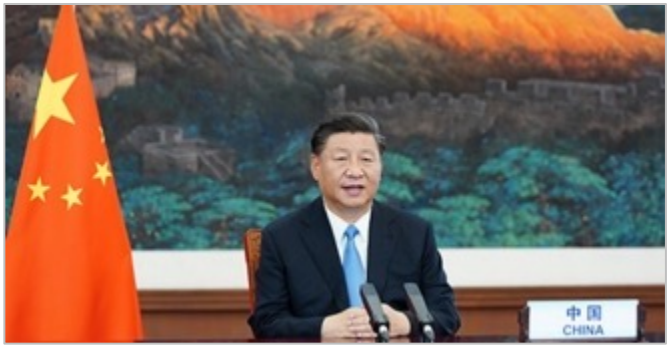
**Environmental protection and sustainability is taking increasingly shape in China's national policies, leading to emerging technologies and market expansion opportunities**

- **10 | 2021** — State Council of China ***issued national action plan*** for carbon peaking before 2030 and set policy system of ***1+N***
- **07 | 2021** — China's national ***carbon trading market*** launched in Shanghai
- **07 | 2021** — Circular economy development plan of 14th FYP issued, including ***life cycle assessment*** and management
- **03 | 2021** — China's 14th FYP released, focusing on economic and environmental improvements concerning ***quality***, ***innovation*** and ***sustainability***
- **02 | 2021** — Guidance on accelerating establishment & improvement of green & low-carbon ***circular economy*** system
- **09 | 2020** — President Xi announced China's '30·60' ***decarbonization goal*** at the United Nations General Assembly
- **03 | 2020** — Guidance on establishment of ***modern environmental governance system***
- **06 | 2013** — China's first ***carbon trading market launched*** in Shenzhen, followed by six others experimental markets and another regional market




**PLEDGE BY PRESIDENT XI** (SEP 22ND, 2020)

| Peak **$CO_2$ EMISSIONS** by **2030** | Become **CARBON NEUTRAL** by **2060** |
|---|---|




*Source: EAC research*

# SUSTAINABILITY – 14TH FIVE-YEAR PLAN

EAC INTERNATIONAL CONSULTING

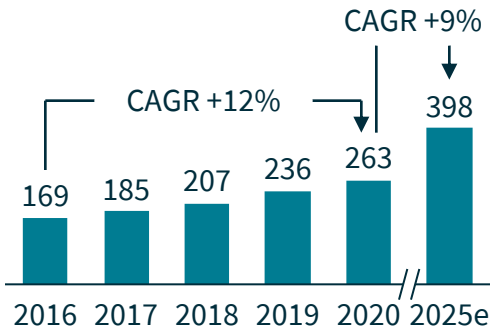
**To fulfil targets set for carbon emission, promising development of sustainable energy, including wind power, solar PV and biomasses etc. is expected with momentum to grow over proportionally**

**14TH FYP SUSTAINABILITY INITIATIVES**

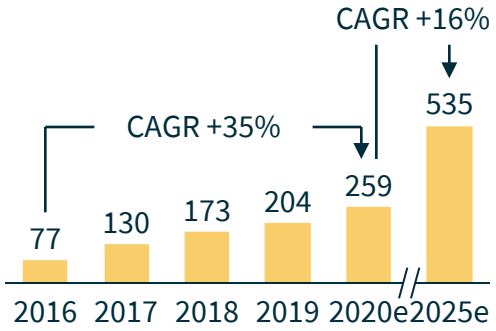
- Continue to reduce environmental pollution
- Accelerate the promotion of green economy and low-carbon emission development
- Enhance the quality and sustainability of the ecosystem
- Increase resource utilization efficiency

***IMPLICATIONS ON INDUSTRIES***

***Wind power installation (acc., GW)***




***Solar power installation (acc., GW)***




- **Target: Carbon Neutral by 2060**
- Newly installed energy facilities must be **non-fossil energy**
- Beneficial industries are wind power, solar PV, biomasses and waterpower
- The **phase-out of subsidy in 2021** will push wind & solar power to reach lower cost competitive against fossil generated electricity
- **Future over-proportional growth** is estimated pushed by **continuous cost down** and **gov. push**

*Source: Emission Gap Report 2019, EAC research*

# SUSTAINABILITY – WHO IS DRIVING THE SUSTAINABILITY PUSH?

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**Sustainability in China is currently still largely pushed by the government, while large majority of consumers is still in "catch-up" mode – Large enterprises pay more and more attention to ESG**

## GOVERNMENT

- + **Top-down introduction and push** of sustainability policies across all government levels
- + Strategic interest in **energy security and self-reliance**
- + **Ongoing regulation campaign** on "dirty" industries
- + Sustainability as part of **education program**
- – **Economic growth and rising prosperity** still rule over environmental concerns

## (PRIVATE) COMPANIES

- + **86%** of CSI300 A-Share companies issue **ESG reports** (investor relations)
- + ***New Economy* companies** like Meituan, Xiaomi or Pingan have sustainability/ ESG on their agenda
- + **Foreign-invested companies** need to fulfil global ESG commitments
- – ESG not yet a big topic among Chinese **medium-sized firms**

## CONSUMERS

- + **Rising sustainability awareness** in major tier-1 cities like Shanghai
- + "**Digital society**" inherently resource-light (paper, etc.)
- – But for most people still **convenience > sustainability** (e.g. food delivery, packaging)
- – Still in "consumption catch-up mode": Limited pro-active demand for **sustainable/ "fair" products** like in some European countries

*Source: EAC*

EAC INTERNATIONAL CONSULTING

## The Chinese government has forced entities in eight industries into national mandatory carbon trading market – These industries account for ~70% of the country's total carbon emissions

**Carbon Trading System in China**

- **Mandatory market** (CEA - China Emission Allowance)
- **Voluntary market** (CCER - China Carbon Emission Reduction)

| | |
|---|---|
| **Power** | 2162 power suppliers emitting 4.5 bln $tCO_{2e}$ in total have entered the national market on Jul 16th 2021 |
| **Iron & Steel** | Entered regional markets of Tianjin, Shanghai, Chongqing, Hubei, Guangdong and Fujian |
| **Non-Ferrous Metal** | Entered regional markets of Shanghai and Fujian |
| **Chemical** | Entered regional markets of Tianjin, Shanghai, Hubei and Fujian |
| **Petrochemical** | Entered regional markets of Beijing, Tianjin, Shanghai, Guangdong and Fujian |
| **Building Materials** | Entered regional markets of Shanghai, Shenzhen and Fujian |
| **Papermaking** | Entered regional markets of Shanghai and Fujian |
| **Aviation** | Entered regional markets of Shanghai and Fujian |

*Chinese Ministry of Ecological Environment issued allowance setting and allocation plan for power sector in Dec 2020*

*To peak before 2025*

*Issued discussion draft for allowance setting and allocation plan for electrolytic aluminum*

*Generally to peak before 2025; Cement to peak before 2023; Issued discussion draft for allowance setting and allocation plan for cement*

*Source: EAC Research*

# SUSTAINABILITY – IMPLICATIONS FOR ENTERPRISES IN CHINA

EAC INTERNATIONAL CONSULTING

**Companies operating in China should put sustainability on their strategic agenda, both to support global efforts but also to be prepared for a further regulative push in the country**

## 3 KEY TAKEAWAYS

- International regulators, customers and shareholders increasingly expect **implementation of defined corporate ESG targets across all global regions**
- Pro-active support of China in its own sustainability initiatives can benefit a company's **government relations**
- But **sustainability/ ESG still no major differentiation point in Chinese B2B/ B2C market** like in other regions (yet)

## SUCCESSFUL CORPORATE SUSTAINABILITY EFFORTS IN CHINA

1. **China Board-level commitment**
2. Shift from focus on near-term revenue to a **purpose-driven strategy**
3. Integration of sustainability factors into China **business strategy formulation**
4. **Focus of sustainability efforts** on issues most relevant to the China business
5. Availability of in-house **sustainability professionals** and sufficient knowledge across business units and supply chains

*Source: EAC*

# SUSTAINABILITY – EAC SERVICE OFFERINGS

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**EAC is addressing the importance of sustainability with tailor-made solutions to support multinational corporations to embrace both growth opportunities and challenges with focus on Asian markets**

## ESG STRATEGY FORMULATION

***We help our clients to set and implement a clear and actionable strategy for ESG leadership***

**Our Approach**

- Global ESG Regulation & Subsidy Management
- ESG Certifications, Reporting and Audit
- Sustainability Commitment Targets Setting
- Integration into Corporate Strategy
- Roadmap for Sustainable Transformation

## SUSTAINABLE PRODUCTS INNOVATION

***We help our clients to transform to a sustainable product & service portfolio***

**Our Approach**

- Market & Customer Readiness Check
- Eco-Products Value Creation
- Product Life Cycle Assessment
- Circular Product Mapping & Packaging
- Actionable Go-to-Market Concepts

## RESPONSIBLE SUPPLY CHAIN

***We help our clients optimize their supply chains beyond regulatory requirements***

**Our Approach**

- Supply Chain Due Diligence & Conformity
- Supply Chain Redesign
- Evaluation of Nearshoring Concepts
- Circular Supply Chain Feasibility
- Logistics Sustainability Optimization

## GREEN MANUFACTURING

***We help our clients to reduce greenhouse gas emissions in their Asian operations***

**Our Approach**

- Carbon Footprint Mapping & Target Setting
- Resource Efficiency Improvement Initiatives
- Business Case for Green Powering Options
- Waste Reduction & Recycling Concept
- Carbon Neutrality & Trading Opportunities

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# DEMOGRAPHICS – WHAT HAS CHANGED?

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**A mix of social and economic developments had a profound impact on China's population in last decades**

**FROM... 1960s**

- **Traditional family model** with early marriages, stay-at-home mothers and large families
- Agricultural society, where **children act as "social safety net"**
- Lower **life expectancy** and higher **child mortality** due to often lacking medical treatment

**...TO 2020s**

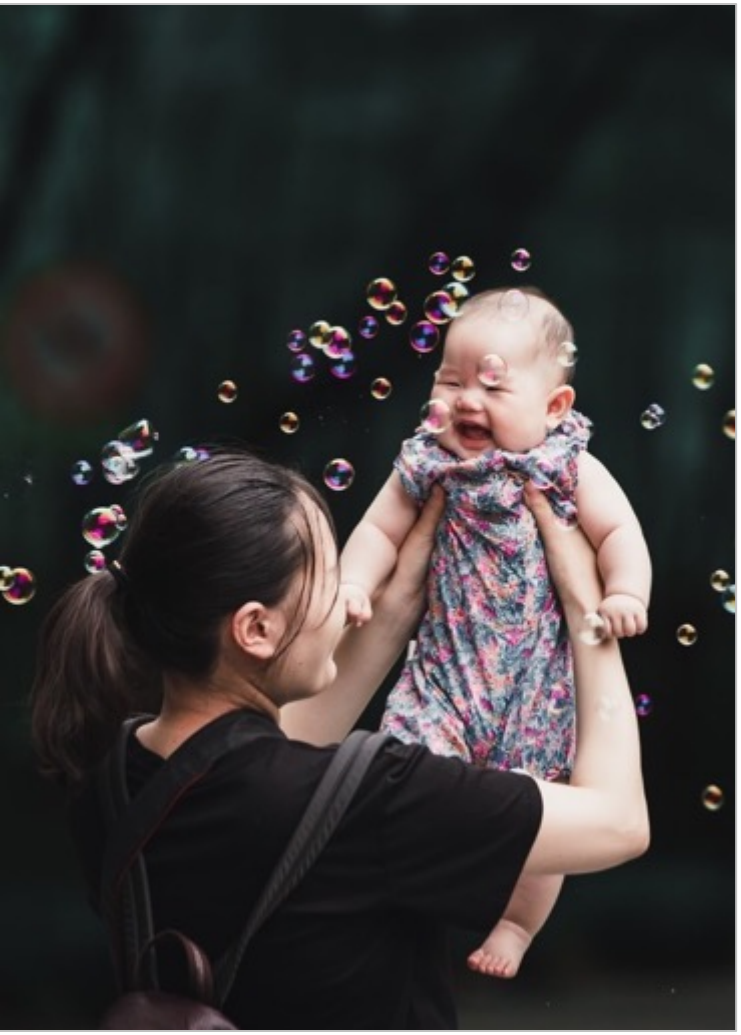
- **Increasing living expenses** (esp. high housing prices)
- High cost of childcare (鸡娃, "tiger mom" phenomenon)
- Missing time to take care of children (working parents), but **lack of systematic (financial) support** from government & businesses for raising kids
- Changing lifestyle: **marriage rate** in 2020 was the lowest in two decades (+ increasing divorce rate)
- **Improvement of general women education level** causes delay of average maternity age
- **Hukou policy** provides barriers for raising children
- **"Only child" generation** needs to take care of parents
- **Imbalance of men and women** (especially rural areas)
- **Pregnancy prevention methods** more common

*Source: EAC*

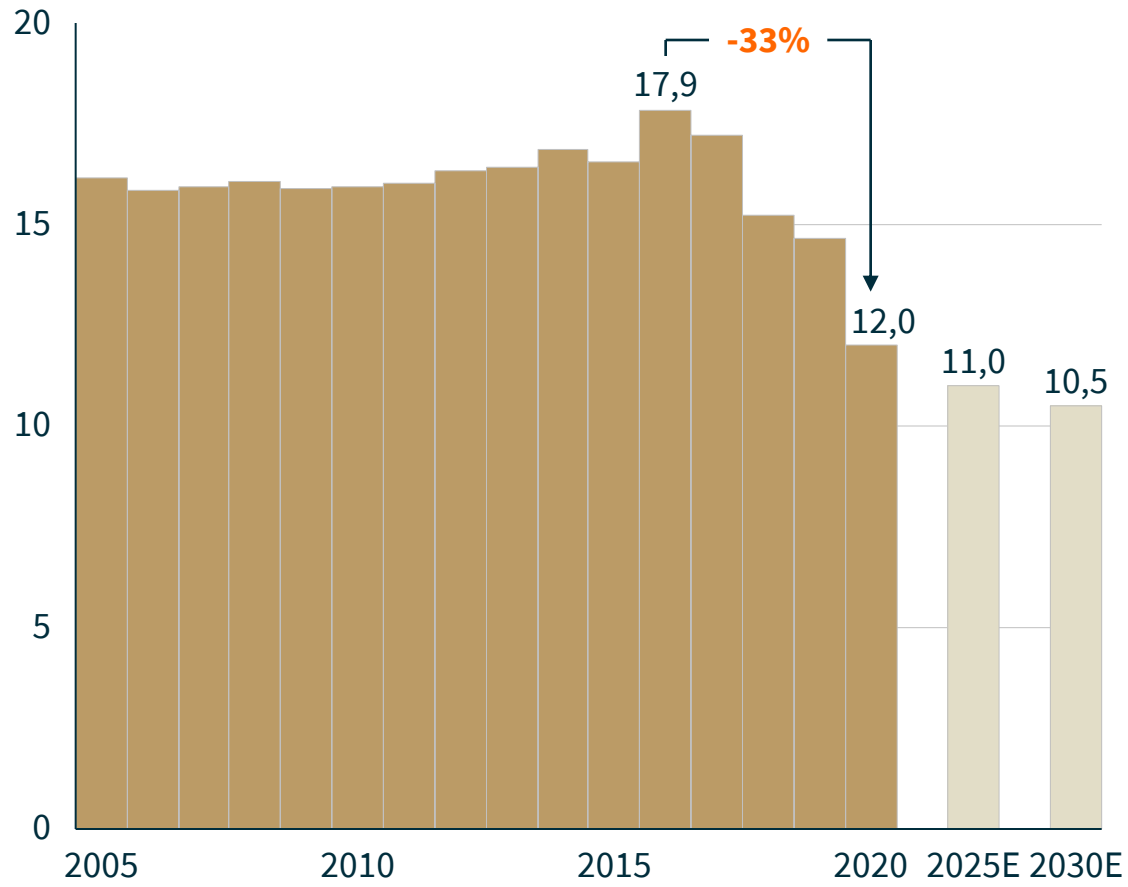
# DEMOGRAPHICS – NEW-BORN BABIES

EAC INTERNATIONAL CONSULTING

**After reaching a high in 2016, number of new-born babies in China has been declining sharp and reached a new low with only 12 mio children being born in 2020 – despite reversal of one-child policy**



**CHINA NEW-BORN BABIES PER YEAR** (MIO)



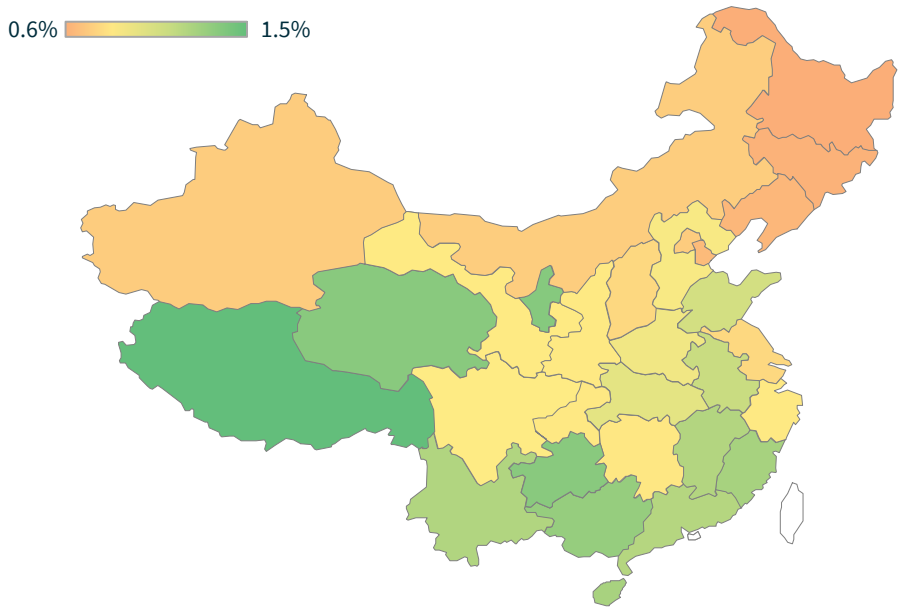

*Source: National Bureau of Statistics, EAC analysis*

# DEMOGRAPHICS – BIRTH RATE

EAC INTERNATIONAL CONSULTING

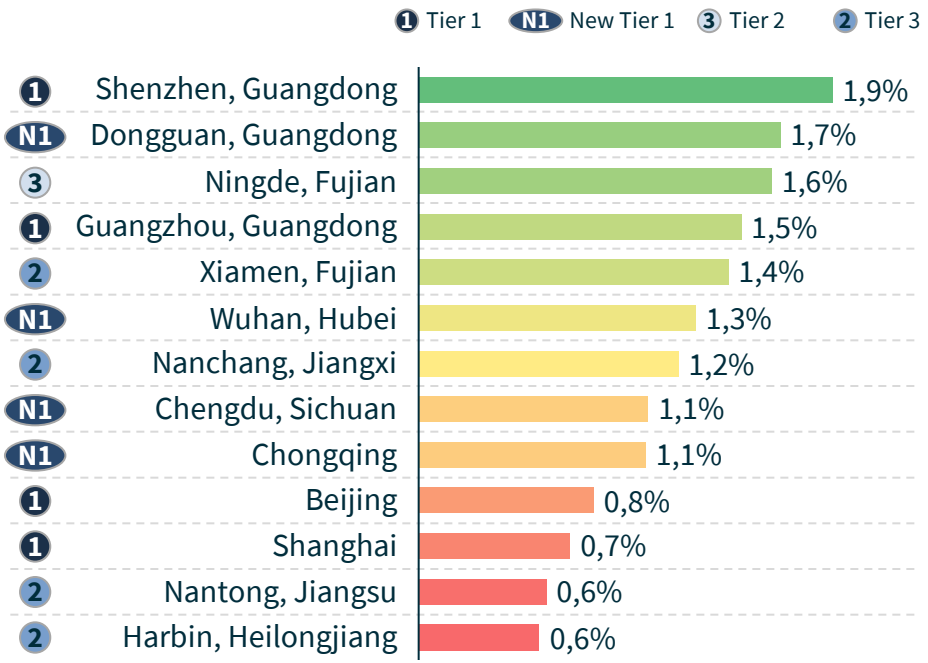
## Regarding fertility and birth rates in China not only the national average should be considered: There are tremendous regional differences due to economic and cultural factors

### PROVINCE-LEVEL BIRTH-RATE (2019)




- Inner provinces with **weaker, more rural economies** and larger shares of **ethic minorities** tend to have more children
- **Stark contrast between North and South**, which reflects economic development and corresponding migrations
- **Shandong** with relatively high birth rate due to cultural factors and significant (but short-term) increase in 2016/17

### CITY-LEVEL BIRTH RATE (2019, EXCERPT)




- Regional birth rate differences also reflected in city data, with **southern cities performing generally better**
- **Shanghai and Beijing** wealthy and highly developed
- **Shenzhen and surrounding Pearl River Delta** as positive outlier, due to **migration of young workforce**

*Source: National Statistics Yearbook*

# DEMOGRAPHICS – 2020 CENSUS RESULTS

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**While China's 2020 Census results need to be taken with a grain of salt, they still offer interesting insights that hint at the ongoing demographic shift**

| | |
|---|---|
| **1,411 billion** | **National Population** (+5.4% compared with 2010) |
| **2.62 persons** | **Average Size of a Family Household** (0.48 person less than in 2010) |
| **+2.15pp** | **Change in Proportion of Population in "Eastern Region"**[1)] |
| **105.07** | **Male-female Sex Ratio** (slight decline compared with 2010) |
| **18.7%** | **Share of 60+ Age Group** (264.02 million persons, +5.44 percentage points compared with 2010) |
| **64%** | **Urbanization Rate** (902 million persons living in urban areas, +14.2 percentage points) |
| **493 million** | **Floating Population** (number of population living in places other than their household registration areas) |

1) Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Hainan

*Source: National Bureau of Statistics*

# DEMOGRAPHICS – KEY TAKEAWAYS

EAC INTERNATIONAL CONSULTING

**We see four main areas where demographic changes will impact businesses in China**

**OPPORTUNITIES IN HEALTHCARE INDUSTRY**

- Rising number of elderlies with less children will mean **higher demand for medical treatment and elderly care**
- **"Only child" generation** needs to take care of parents
- Industry is already a **key focus in government policies**

**WAR FOR TALENT & RISING WAGES**

- Ageing population will make it increasingly difficult to find young skilled labor, forcing companies to **heavily invest into HR efforts**
- Wages for both white-collar and blue-collar workers **will continue to rise**

**AUTOMATION PUSH**

- **Shrinking workforce and rising wages**: The era of endless cheap labor is coming to a close in China (end of population dividend)
- Companies will have to heavily invest into **digitization, robotics and smart manufacturing technologies** to stay competitive

**STRONGER FOCUS ON REGIONAL CLUSTERS**

- In the future, China will become even more a **country of "different speeds"**
- Especially B2C companies need to regionalize their strategies and possibly **prioritize young and dynamic growth clusters** such as the *Greater Bay Area*

*Source: EAC*

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# HEALTHCARE – A MAJOR MARKET OPPORTUNITY

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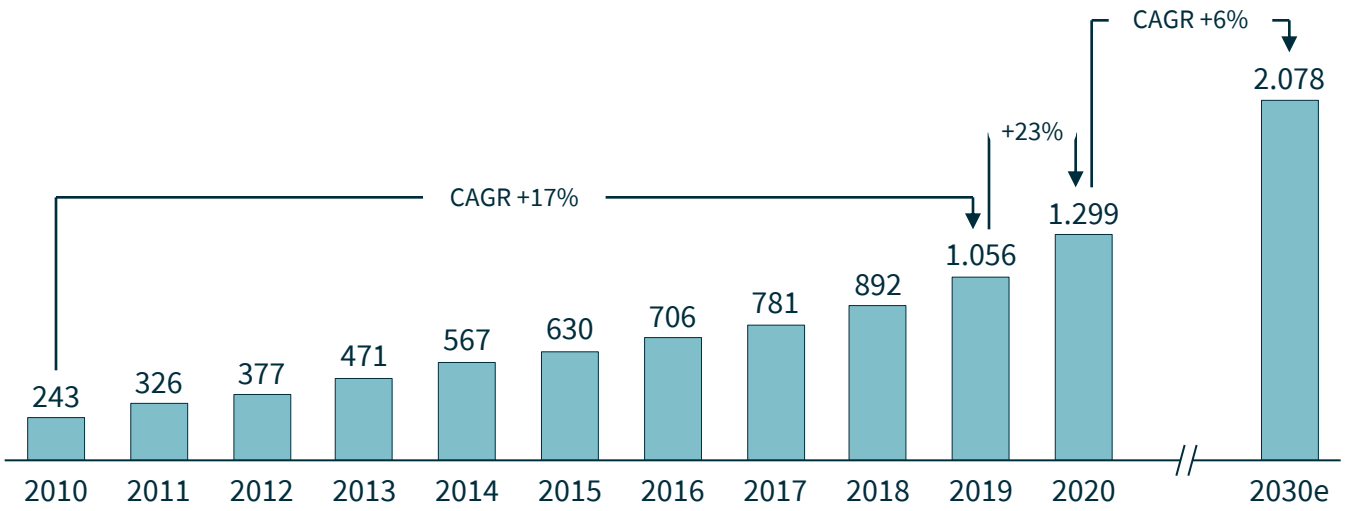
**China's healthcare industry is currently the second biggest in the world behind the US with a total market size of ~1,299 bln EUR in 2020 and expected to keep a steady growth in the coming years**

**CHINA HEALTHCARE MARKET DEVELOPMENT: 2010-2030** (BLN EUR)




**>90%**

Medtech MNCs expect **greater localization in the industry after the COVID-19 outbreak**

**~60%**

Medtech MNCs mention that **localization of manufacturing will be a key success factor**

**~60%**

Medtech MNCs think **localized R&D or collaborating with local partners** on supply chain will present new opportunities

*Source: Market Survey on Medical Localization 2020*

**EAC INSIGHTS**

- China market presents **considerable growth opportunities**, particularly as the Chinese government has laid out **multiple initiatives** to support long-term growth and innovation
- In terms of foreign investment, the healthcare industry has been steadily **opening to foreign participation** – medicals or pharmaceuticals are on the "*Encouraged Industry*" list

*Source: EAC Research*

# HEALTHCARE – IMPORTANT DEVELOPMENTS

EAC INTERNATIONAL CONSULTING

## Seven factors contribute to strong localization need for medical device companies – If you want to be able to participate in the competitive Chinese market, you need to check which one impacts your business

### Government Push

- National healthcare and domestic healthcare industry strongly supported by various high-level government policies (Healthy China 2030, Made in China 2025, 14th FYP)

### Two-Sided Increasing Competition

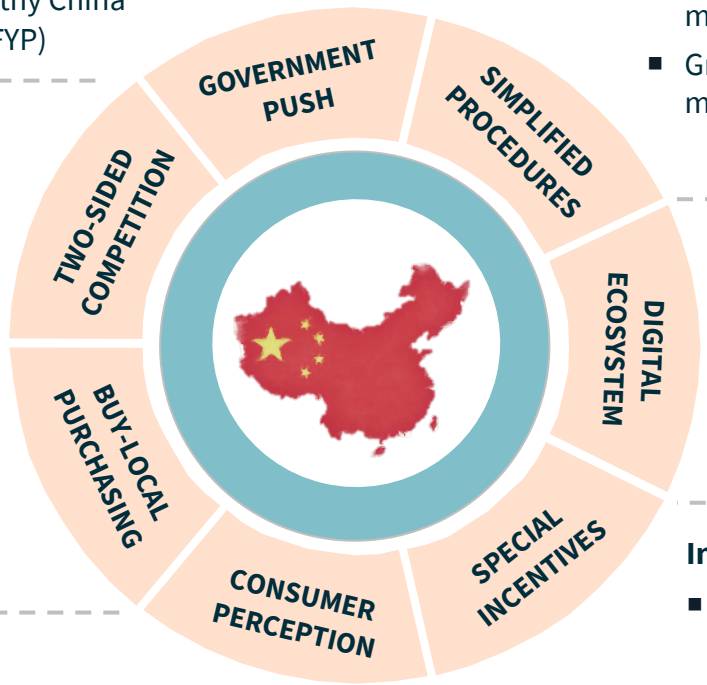
- Domestic players become increasingly advanced and innovative
- Major foreign players heavily invest into local market and their footprint

### "Buy-local" Purchasing

- Centralized Volume-Based Procurement to reduce health care cost and unwritten "*buy-local*" practices create price pressure as well as need for localization

### Changing Consumer Perception

- Foreign products not always perceived as superior anymore (esp. by generation X)
- Growing trust in domestic companies & products (also fueled by nationalism)




### Simplified Procedures

- NMPA released new guidance simplifying the process for registering new manufacturing sites in China
- Green path on product registration and market access for local products

### Participation in Chinese Ecosystem

- Increasing digitization and connectivity of medical devices within China's unique ecosystem
- Foreign brands might miss out without localization

### Incentives for Foreign Companies

- Several healthcare-related industries are on China's Encouraged Investment List, and thus eligible for preferential treatment (e.g. tax deductions)
- Cities like Shanghai actively promote and support set-up of local R&D

*Source: EAC*

# HEALTHCARE – GOVERNMENT PUSH

EAC INTERNATIONAL CONSULTING

## National industry are supported by various high-level government policies – High interest of EAC clients in executive dialogues to understand details especially of the new 14th Five-Year Plan

### MAJOR HIGH-LEVEL GOVERNMENT POLICIES BOOSTING THE HEALTHCARE INDUSTRY


#### HEALTHY CHINA 2030

- First **mid- to long-term strategic plan** in health sector developed at national level (overall blueprint guide incl. two **sub-plans**)
- Greater focus on **prevention**, **DRG** payment model, diversification of **healthcare providers**, **innovation** orientation
- Selected objectives:
  - ↑ Health service sector gross value
  - ↑ Avg. life expectancy to 79
  - ↓ Infant mortality rate to 0.5%
  - ↓ Premature mortality from chronic disease by 30%

#### 14TH FIVE-YEAR PLAN

- Focus on development of **diagnostic imaging equipment**, medical robots, new implantation devices, biomedical materials, wearable equipment, etc.
- Cooperation with medical institutions for **upgrading medical device production in volume & quality**
  - Strengthen standardized application of medical devices in different levels of medical institutions
    - Promotion of **DRG implementation** for general surgery & treatment

**CHINA'S HEALTHCARE PUSH**

#### MADE IN CHINA 2025

- "Medical" identified as **one of 10 key priority industries** for innovation
- Focus on improving and internationalizing manufacturing as well as innovation

*Source: EAC*

# HEALTHCARE – IMPLICATIONS

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INTERNATIONAL CONSULTING

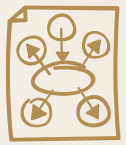
**Foreign companies selling in China need to consider the market environment in their respective industry, be aware of registration needs, fragmented channels and carefully plan their sales setup**

The Chinese market is highly competitive, under increasing price pressure, and facing a rapid localization trend – However, there is still a lot of potential in the high-end segment

▶ **Check the local competition and be sure about your unique selling point before entering the Chinese market; consider localizing your product or your manufacturing process if possible**

A *Product Registration Certificate* and *Import License* are required to sell products directly to the Chinese market, requiring significant paperwork and preparation time

▶ **Be aware of the registration certificates needed for your industry/ product and start the process early enough; find an experienced agency to support you**



Distribution channels and medical institutions are relatively fragmented and often have to follow different policies and purchasing regulations (VBP, DRG) based on type and region

▶ **Identify the channels and purchasers that are most relevant to you and where foreign manufacturers have a higher chance of success (e.g. private hospitals)**

Chinese sales and distribution landscape for medical devices is fragmented and undergoing significant changes, requiring a combination of direct & indirect selling

▶ **Ideally utilize your own "boots on the ground" as well as a strong distribution partners (due diligence!) for an effective omni-channel approach**

*Source: EAC*

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# INDEX

# 2ND HOME MARKET – REASONS FOR A NEW APPROACH

EAC INTERNATIONAL CONSULTING

**The unique Chinese market requires a dedicated strategy & organizational readiness to stay competitive**

### China Growth Momentum

- Dynamic economic growth and rebound from COVID-19 in most industries
- Rising revenue contribution of China for most MNEs
- Ongoing investments into local footprints indicating confidence

### Strategic Considerations

- Risk of not participating often higher than risk of failure/ over-extension
- Close observation of Chinese competitors who will eventually go global
- Closeness to major B2B customers who are growing in China

**FULL-ON CHINA PUSH:**

Need for upgraded local value proposition and organizational setup to be able to quickly adapt to market changes and be prepared for future developments

### Increasingly Challenging Business Environment

- Tighter market access and regulation
- Self-Sufficiency & Dual Circulation
- Increasing domestic competition
- “Buy local” policies

*Source: EAC*

# 2ND HOME MARKET – VISION

EAC INTERNATIONAL CONSULTING

**Transforming into a true 2nd-home-market organization has to be based on a clear vision**

## FROM…

### Typical China Organization

- China one of the **largest and fastest growing global markets** with rising revenue share
- But **low level of local value creation, empowerment and decision-making** limiting further growth potential
- **Limited local execution power** and slow reaction time to Chinese trends – **missing "China Speed"**
- Increasing **demand for localization** due to policy changes and decoupling
- Potentially **insufficient HR capabilities**

## TO…

### Vision for Future China Organization

- China with fully capable **"second home market" organization**
- **Agile:** able to compete in fast China market due to local decision-making (within global governance framework)
- **Clear value proposition**: local value creation and product portfolio with fit-to-market (local branding)
- **Localized "China for China" products**: R&D and design capabilities within Chinese organization
- **Digital Champion and Innovation Leader** within the Group
- **Informed representation** in HQ

*Source: EAC*

# 2ND HOME MARKET – IMPLICATIONS FOR INVESTORS

EAC INTERNATIONAL CONSULTING

***"Success in China requires to play the Chinese game":*** **understanding the changing market environment and learning from the Chinese counterparts is crucial to remain competitive and to survive in China**

## CENTRAL ELEMENTS OF A CHINA STRATEGY …

- UNDERSTAND CHINA
- NEW BUSINESS OPPORTUNITIES
- NEW BUSINESS MODELS
- CLOSE-TO-MARKET APPROACH
- LOCAL FOR LOCAL MANAGEMENT
- LOCALIZED COMPANY CULTURE
- INNOVATION IMPROVEMENT
- STRATEGIC CO-OPERATIONS
- COST CONTROL
- IPR PROTECTION

*"Foreign operations in China are de facto on a **pathway to becoming more like a local Chinese entity** rather than integrated in global network. They are not decoupling from China, but rather decoupling their China operations from their global ones."*

merics

– **Mercator Institute for China Studies** (Merics)

## … AND HOW TO PLAY THE CHINESE GAME?


*Source: EAC*

# 2ND HOME MARKET – CASE STUDY: KONE

EAC INTERNATIONAL CONSULTING

**Since its market entry in 1996, the Finnish company KONE has become the market leader in elevator and escalator solutions in China, which accounts for 60% of the global demand**

**Kone in China – Key Facts**

- Finland's largest company in China, with rapid growth since 2004/ 2005
- China accounts for **30%** of KONE's global business: **3 billion EUR** in 2020
- China revenue still highly driven by **new equipment sales**; service share only at 15% compared to 60% in Europe

*"The old mentality of many international companies has traditionally been: what we know in Europe or North America we will bring to China. But I think it has actually **become the opposite** now."*

– **Henrik Ehrnrooth**, CEO Kone

## KONE KEY SUCCESS FACTOR: FULL-ON IN CHINA

1. Development of products **'in' China 'for' China:** Mostly local production with adoption to local needs
2. High level of **localized management teams:** focus on local talent development & close cross-regional collaboration
3. **Nationwide footprint:** Coverage across tier-1 to tier-4 cities
4. Expansion of **"connected" service network:** Forerunner in China of selling service together with equipment
5. Implementation of a **DUAL BRAND strategy** with unique market approach for different segments
6. **Aligned with governmental goal** to cut carbon emission and **close partnerships with real estate developers**

*Source: Week in China Interview with CEO Henrik Ehrnrooth, EAC summary*

# 2ND HOME MARKET – CHALLENGES & LESSONS LEARNED

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**When conducting a 2nd home market project, several key learnings should be kept in mind**

**Create Strategic Clarity**: often employees and management have different understanding or perspectives on a company's goals (maybe because they are too loosely defined) – ensure a joint vision first!

**Alignment, Alignment, Alignment**: key strategic messages need to be communicated over and over (especially between China and the HQ) – use both 1:1 sessions as well as workshops to guarantee understanding and buy-in throughout the organization!

**Manage Capacity Constraints**: taking a step back to think about overall strategy and larger scale changes while managing day-to-day business can be challenging for the entire organization

**Enabler Prioritization**: you and your team will not be able to implement all desired actions at once – so jointly prioritizing the most impactful focus topics is crucial!

**Implementation Feasibility**: define action steps clearly and assign responsibilities both on working and management level – a defined roadmap has value in itself, but proper execution determines the initiative's future!

*Source: EAC*

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# OUTLOOK – MAJOR EVENTS & ACTIVITIES 2022

EAC INTERNATIONAL CONSULTING

**In 2022, all eyes will be on the Winter Olympics in February/ March, as well as on important political meetings in April as well as the second half of the year**

**MAJOR EVETS AND ACTIVITIES IN CHINA 2022**

Holiday | Political | Economic | Other

**January**

**February**

**March**

**April**

**May**

**June**

**Beijing Winter Olympic Games and Winter Paralympics**

Chinese New Year Holidays

Release of 2021 GDP Data

**National People's Congress and Chinese Political Consultative Conference**

China International Consumer Goods Expo (CICGE)

**July**

**August**

**September**

**October**

**November**

**December**

BRICS 2022 Summit held by China (Time TBD)

China International Fair for Investment and Trade (CIFIT)

China Import and Export Fair (CIEF)

China International Import Expo (CIIE)

China International Industry Fair (CIIF)

National Day Holiday

**20th National Congress (date tbd)**

*Source: Public Information, EAC Research*

# OUTLOOK – PREDICTIONS & ATTENTION POINTS 2022

EAC INTERNATIONAL CONSULTING

**For 2022, we predict a continuation of trends started this year – Foreign companies will still struggle with political tensions and COVID-19 travel restrictions**

## PREDICTIONS

- No sudden ending of **COVID-19 travel restrictions**, even after major events in Q1 are completed
- Further emphasis on **"buy-Chinese" polices** in several industries, coupled with even more **rising Chinese B2C and B2B brands** directly competing with foreign players
- More **foreign companies affected by "geopolitical fallout"** and forced to take a stance regarding their China business
- More than 1/3 of cars sold in China 2022 could be **NEVs** (penetration rate already up to 20% in 2021)
- Further political discussions on China **pension scheme reform and real estate tax** introduction
- Further push of **sustainability agenda and initiatives** with strong political backing

## Attention Points

- Will **GDP growth** drop below 5%? (most experts estimate a 2022 GDP growth between 5-6%, but…)
- Which other industries will be hit by China's **regulation and "common prosperity"** push?
- What will the new **German government's** stance on China be, and how will this manifest in possible political actions?
- How long will **power shortages** continue to affect businesses?
- Will the government let the **real estate woes** affect the economy for the sake of a more sustainable growth model?

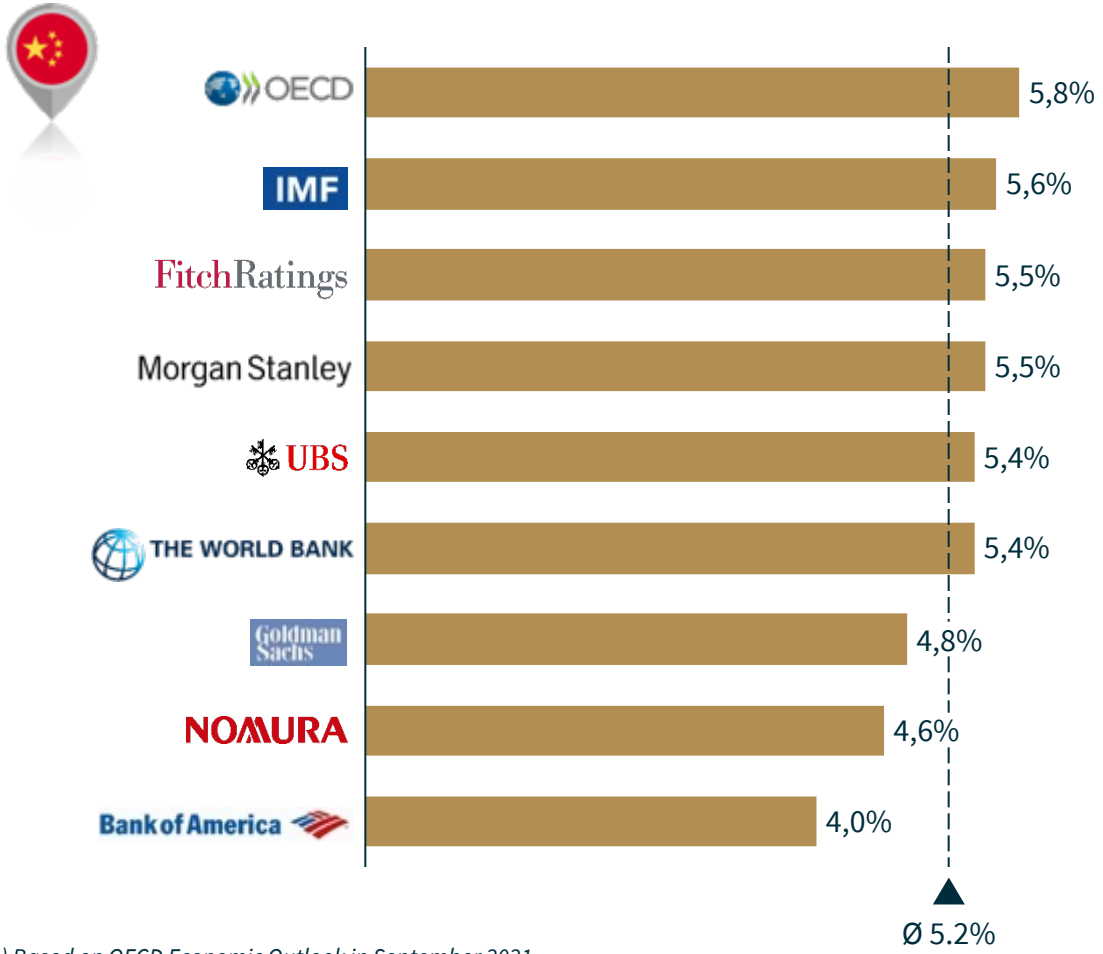
*Source: EAC*

EAC INTERNATIONAL CONSULTING

## Global major institutions forecast the China's GDP growth in 2022 will reduce back to around 5.2%, along with the high GDP growth expectation of India and United Kingdom

### 2022 CHINA GDP GROWTH FORECASTS (% YOY)

Selected




**2022 GDP Growth Forecast for Major Economies** [1] (OECD)

| | |
|---|---|
| India | 7.9% |
| China | 5.8% |
| UK | 5.2% |
| Germany | 4.6% |
| France | 4.0% |
| USA | 3.9% |
| Russia | 3.4% |
| Japan | 2.1% |
| World | 4.5% |
| G20 | 4.8% |
| Euro Area | 4.6% |

*1) Based on OECD Economic Outlook in September 2021*

*Source: OECD, Research Institutes, EAC Research*

# OUTLOOK – LONG-TERM GROWTH PROSPECTS

EAC INTERNATIONAL CONSULTING

## China is likely to maintain a steady growth path and eventually overtake the US as the biggest economy, but growth rates will continue to decrease due to several challenges

### WHAT IS IMPORTANT WHEN LOOKING AT CHINA'S FUTURE GROWTH?

According to some research and comparisons of GDP per capita development, **China's current growth is already lagging behind** the past development path of other Asian countries, such as Japan or South Korea.

▶ Obviously China is much larger, but this makes the danger of being caught in the "*middle income trap*" even more eminent

Due to its **aging population and low birthrates**, labor supply is already starting to become a major problem for China.

▶ China has extremely benefitted from its "*population dividend*" over the past decades. In the next year labor will actually turn into a growth barrier.

When labor and capital cannot contribute enough to economic growth anymore, **becoming more productive is key** (measured in TFP, Total Factor Productivity)

▶ That is the reason why China is investing so much into automation and trying to improve the efficiency of its economy. But experts wonder if it will be enough...

| Growth Contribution | Labor Input | Capital Input | Total Factor Productivity |
|---|---|---|---|
| Past | ↑ | ↑ | ↑ |
| Future | ↘ | ↗ | ↑ |

### WHEN WILL CHINA BE THE LARGEST ECONOMY?

- Due to its outperformance in 2020, the **Centre for Economics and Business Research** forecasts China to overtake the US and become the world's largest economy by around **2028**, five years earlier than previously forecasted
- However, the **Economist Intelligence Unit** only sees China becoming the No. 1 global economy in nominal GDP terms by **2032**

***Studies on China's long-term GDP growth potential***

| Source/ Study | Estimate | Period |
|---|---|---|
| World Bank (2020) | 6.0% | 2020-2030 |
| People's Bank of China (2021) | 5.4% | 2021-2025 |
| Bank of Japan Research (2021) | 5.7%<br>5.2% | 2021-2025<br>2020-2030 |

*Source: EAC, Centre for Economics and Business Research, EIU, Morgan Stanley, Sasaki et al.*

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# EAC HIGHLIGHTS – BEST MANAGEMENT CONSULTANTS AWARDS

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## EAC International Consulting has once again been honored by German magazine *brand eins* and Statista

As part of the renowned industry report "**Best Management Consultants 2021**" by German magazine brand eins and Statista, EAC International Consulting has once again been honored - this year in the Mergers & Acquisitions category!

What do clients and companies appreciate about us? Tailor-made solutions in the areas of strategy, operational excellence and M&A, as well as our Asia expertise, which has been continuously developed over more than 25 years.



In addition, an in-depth interview with my Partner colleague Daniel Berger was published in the current issue. Under the title "*We need to think more Chinese*", he advises German companies to act faster and more agile if they want to continue to be successful in China. Business models need to be adapted and companies need to act in a more systemically relevant way so that they are not interchangeable in the long term.

The full interview (in German) can be found at the following link: https://lnkd.in/d6t7eej

# EAC HIGHLIGHTS – EVENTS & WEBINARS

EAC
INTERNATIONAL CONSULTING

**In the past months, representatives of EAC gave both offline and online presentations on topics ranging from macro-economy and sustainability to medical technology and e-commerce**








# EAC HIGHLIGHTS – CLIENT BRIEFINGS

EAC INTERNATIONAL CONSULTING

## We regularly publish in-depth industry reports and client briefings:


### How to Win in China's E-Commerce Market?

China's e-commerce landscape is highly innovative and dynamic – but fast changing business models bear risks that need to be addressed. EAC offers an innovative opportunity assessment and holistic online strategies.

READ ONLINE


### Manufacturing Footprint Sustainability in China

China is committed to improve industry value-add: Regulatory changes and supply chain risks have posted challenges to stable production. Thus, location sustainability becomes a key strategy decision for manufacturing companies in China.

READ ONLINE


### Embracing a Sustainable Future in China

Globally, countries start to put sustainability as a key indicator in their MNCs supply chain assessment. In China, sustainability is taking a core place in current and future policies. Players in various industry should be well-prepared for upcoming changes.

READ ONLINE


### 2nd Home Market China

For China to truly become a "second home", MNCs need to build an organization that is supported by the headquarters and involved in global processes, while at the same time also being agile and empowered enough for quick decision-making and local execution.

READ ONLINE


### Opportunities to Leverage Wind Supply Chain Shifts to China And India

Asia is the key driver of growth for the wind energy sector. Driven by the strong market, local supply chains in China and India have been developing and now offer increasingly mature & cost-effective sourcing opportunities.

READ ONLINE

# EAC HIGHLIGHTS – WECHAT ACCOUNT

EAC
INTERNATIONAL CONSULTING

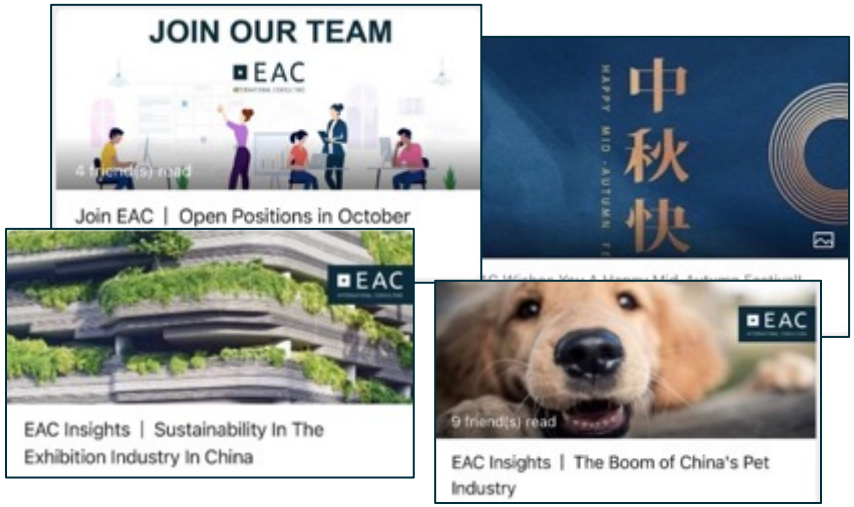
## EAC further developed its official WeChat account this year with regular content posting – Follow us!


**We launched the EAC Official WeChat Account this year!**

In the account, you can find our insights for different industries, our opinions on the latest trends in China, our news and activities, or even the opportunities to join us.

Search "EAC International Consulting" on WeChat or scan the QR code to follow us.

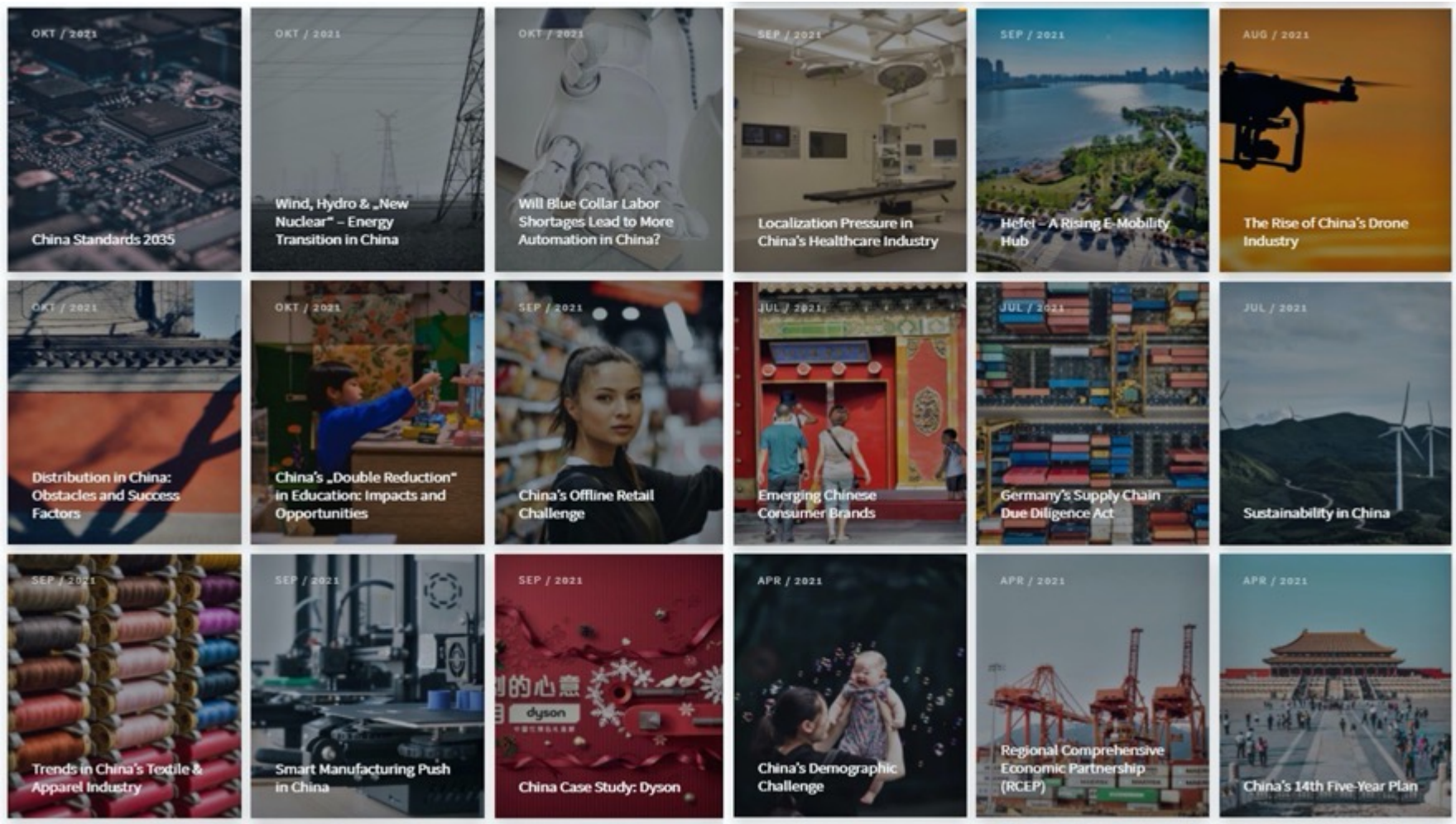
***Scan the QR code to follow the EAC official WeChat account!***



# EAC HIGHLIGHTS – EXECUTIVE BRIEFINGS

EAC INTERNATIONAL CONSULTING

**EAC also developed regular one-page Executive Briefings for Professionals, summarizing current development in China on-point: https://eac-consulting.de/en/eac-insights/executive-briefings/**



# EAC HIGHLIGHTS – MONTHLY NEWSLETTER

EAC
INTERNATIONAL CONSULTING

***"The curated China business news digest for executives and professionals, sent to your inbox directly from the heart of Shanghai"***


Receive into your inbox a brief monthly summary of…

- ❑ Macro-economic developments (incl. *EAC insights*)
- ❑ "Chart of the Month"
- ❑ Business landscape
- ❑ Key industry insights (consumer goods, automotive, etc.)
- ❑ Activities of foreign companies (investments, cooperations, etc.)

**SUBSCRIBE HERE**

# EAC HIGHLIGHTS – TEAMBUILDING & STRATEGY DAY

EAC
INTERNATIONAL CONSULTING

## Fun times! In October, EAC Shanghai went on a one-day excursion for the annual EAC team event


On October 18th, EAC went on a one-day excursion to Changxing Island nearby Shanghai for the annual EAC team event.

First, company strategy and recent projects in our various functional/ industrial competence teams were discussed.

The afternoon was then reserved for joint barbecue as well as some team building activities.

Luckily the weather was on our side throughout the day.

Now we are ready to jointly tackle the next months!
加油！

# WHO IS EAC? – PROFOUND EXPERTISE IN KEY REGIONS

EAC
INTERNATIONAL CONSULTING

**With a clear vison we provide first-hand know-how and experience with the highest standard – we work with culturally mixed teams to achieve maximum results in our offices around the globe**

**> 100 EXPERTS IN OUR OFFICES IN...**

- Munich
- Shanghai
- Mumbai
- Moscow

**EXPERTISE IN EMERGING MARKETS**

- China
- India
- Southeast Asia
- Northeast Asia
- Russia
- CEE

**FUNCTIONAL COMPETENCIES**

- Strategy
- M&A
- Operational Excellence
- Digitalization
- Sustainability

**LONG-TERM MANAGEMENT EXPERTISE IN ASIA**

- With >25 years of local presence EAC is a pioneer in the emerging core markets China and India
- Strong project track record stems from long-standing relationships with global & regional industry stakeholders

**IN-DEPTH INDUSTRY KNOWHOW**

- No “off the shelve”-projects: tailor-made project solutions for the individual requests of our clients
- EAC is supported by a high-caliber advisory board of former, internationally active CEOs in China and Europe

**WE CREATE VALUE**

- “Single-Shop-Services guaranteed through high cross-regional flexibility – no risk of “profit center fences”
- Strong global network of independent experts in all relevant growth markets through EAC regional hubs

**MORE THAN A VISION – A PROMISE**

- We are overachieving the expectations of our customers with individual consulting approaches and innovative strategies
- We are a strong strategy partner – also during execution stage. Our project philosophy: “Walking the last mile”

# WHO IS EAC? – SUPPORTING YOUR LOCALIZATION IN CHINA

EAC
INTERNATIONAL CONSULTING

**All four Partners in China contribute to helping foreign companies localize in China with their respective functional focus**

Daniel Berger
*Partner EAC Shanghai*

**Strategy:** *"Foreign businesses need to think in a more Chinese way"*

**M&A:** *"Grow and localize in China via acquisitions"*

Eric Luo
*Partner EAC Shanghai*

**FOREIGN COMPANIES NEED TO FURTHER PUSH LOCALIZATION IN CHINA**

John Deng
*Partner EAC Shanghai*

**Strategy (Product):** *"Localizing & adapting products to China market demand"*

**Operation:** *"Finding the right location and optimizing your local organization"*

Uwe Haizmann
*Partner EAC Shanghai*

# REACH OUT TO US!

EAC
INTERNATIONAL CONSULTING

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