Altios China

/China

How to accelerate in a more complex but growing environment

/FOREWORD

Since 2020 and the beginning of the COVID-19 pandemic, **China has still not fully opened its border to foreign visitors and investors yet** which has pushed them to consider other destinations.

While remaining of **the biggest and most dynamic market in the world**, the local regulations and business practices make it also one of the hardest markets to be conquered. This situation, combined with the new political situation, has convinced many investors to re-think their investments in China to reduce their risk exposure. Still, **key dynamic sectors still exist in China with important opportunities** for growth in the coming decade that can be captured. It is however important for foreign companies to **acculturate themselves to face the non-stopping growing Chinese competition and grow agile in a more complex environment**.

So, what actions can foreign companies implement to succeed locally? And what are the most dynamic segments of the Chinese economy? In this white paper, we explore the ever-transforming Chinese economy to identify the right opportunities and define the right approach to secure your expansion strategy in China. We also focus on recommending the right road-to-market for SMEs that are interested in exploring the market while limiting their investments and risk exposure.

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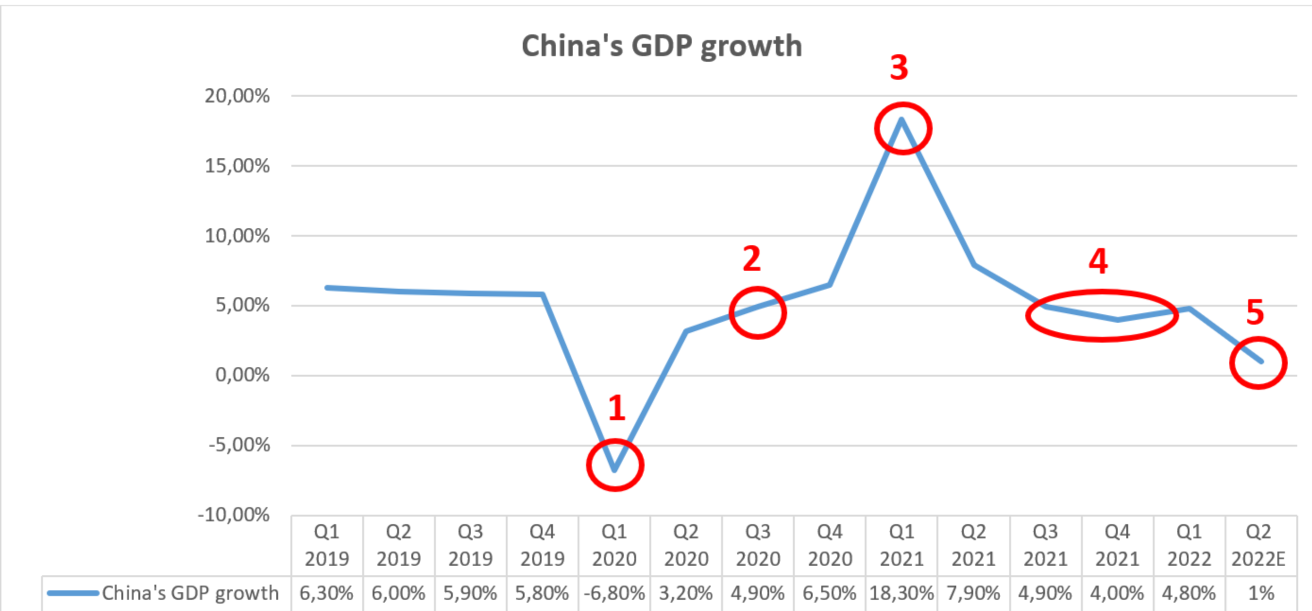
/Situation of the Chinese economy

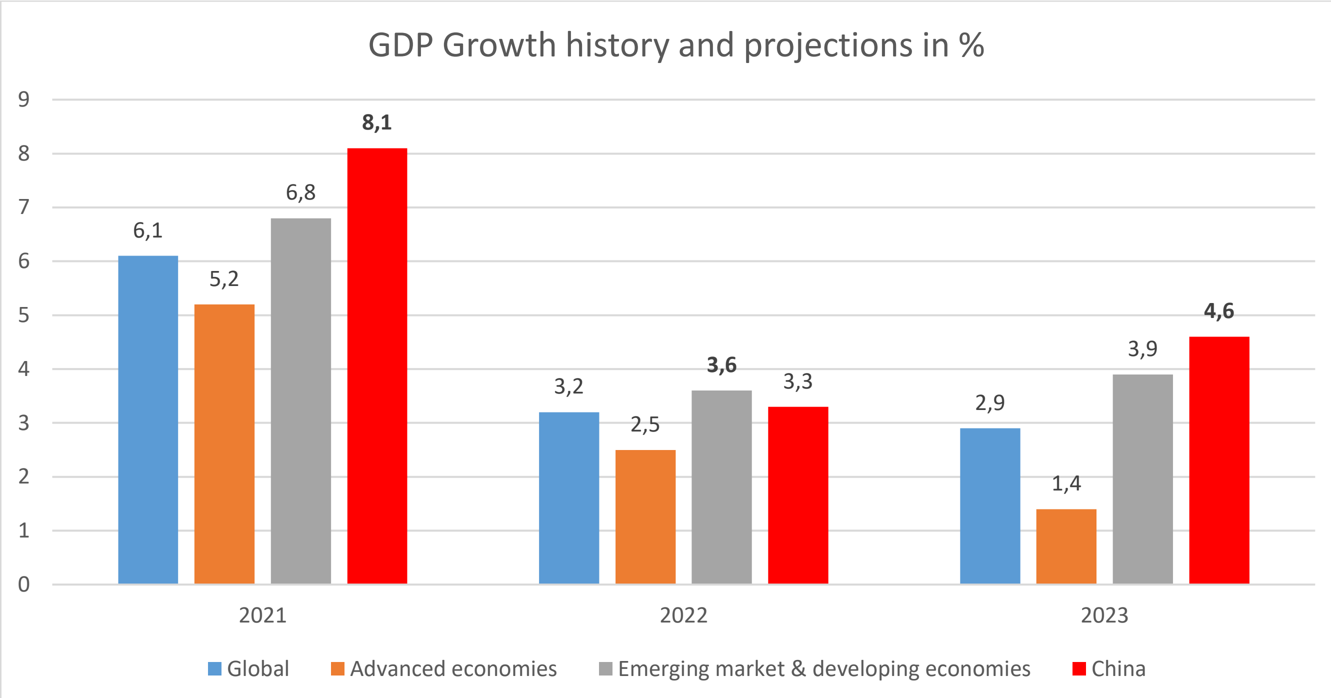
The outburst of the COVID-19 pandemic has highly impacted the local economy and the whole value chain. **The Chinese economy turned inwards** to face the decrease of foreign markets consumption and sustain its local demand but proved to be one of **the most resilient worldwide**. With an average GDP growth rate of 5.95% in 2019, 2.24% in 2020, and 8.11% in 2021, the decisions made have brought **a diminished but stable growth to the country**. However, since the outburst of the new Omicron variant in Shanghai early March 2022, the local economy faced unprecedent challenges.



	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022E
China's GDP growth	6,30%	6,00%	5,90%	5,80%	-6,80%	3,20%	4,90%	6,50%	18,30%	7,90%	4,90%	4,00%	4,80%	1%

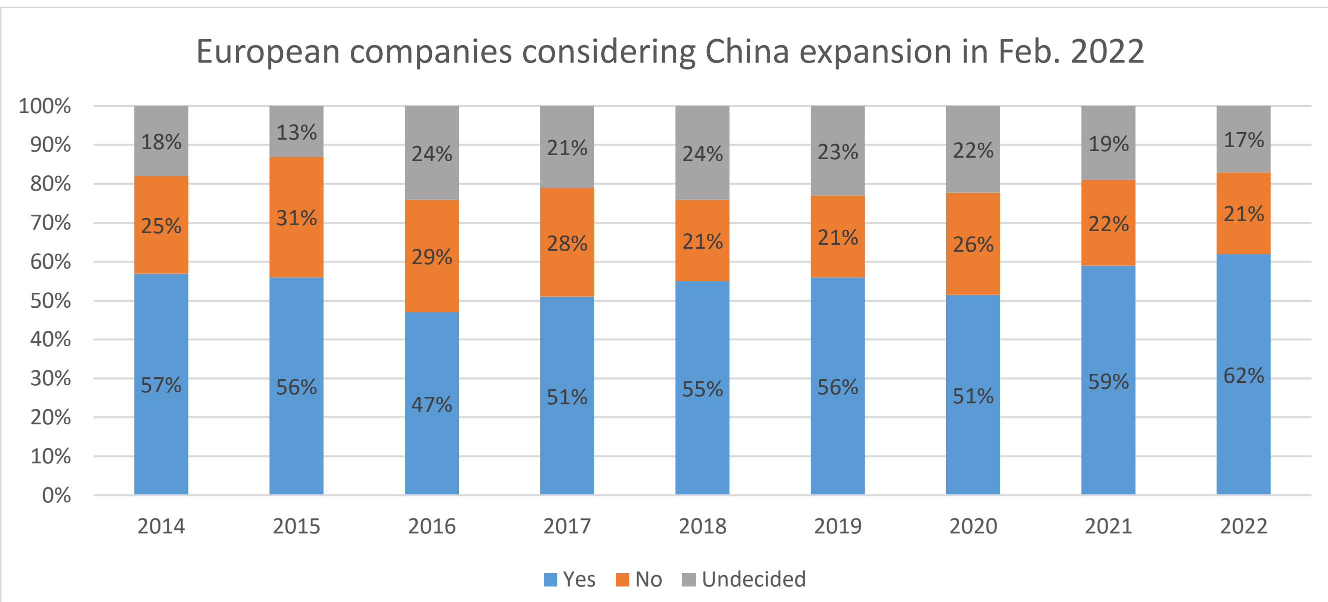
Source: Chinese National Bureau of Statistics

The new OMICRON outbreak in Shanghai and Beijing with strict restrictions imposed by the government saw **the GDP growth rate to fell dramatically to 1%** in Q1 2022. Overall, experts from IMF predict in July 2022 a positive but diminished growth in 2022 for the Chinese economy with **+3.3%** and **+4.6%** for 2023. Nevertheless, the experts from IMF also predict that the Chinese economy will remain one of the **most dynamic compared to advanced economies**.



Source: IMF

This situation is confirmed by the 2022 Business Confidence Survey organized from the European Chamber of Commerce in China which confirms that despite the recent challenges, foreign companies in China are **still optimistic regarding the long-term potential of the Chinese market** with less cutting plans compared to 2021.

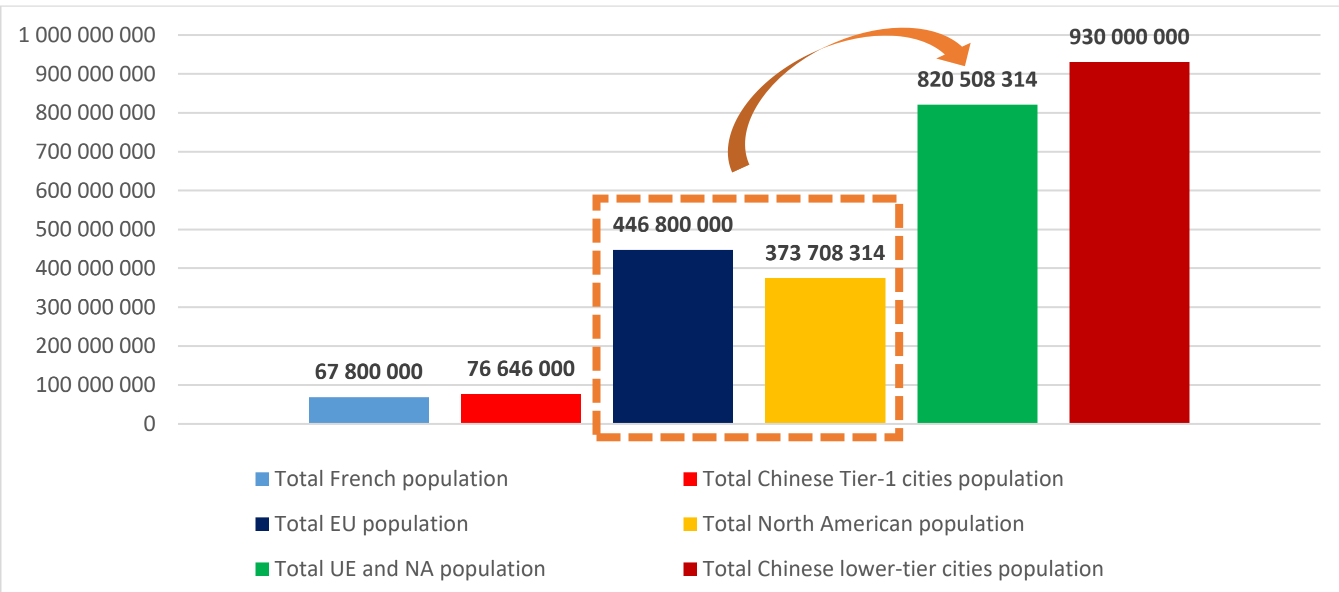


Source: Business Confidence Survey 2022 by the European Chamber of Commerce in China

However, it is important to understand that despite a total population of **1.4 billion inhabitants** and an **average GDP per capita of USD 12,556 in 2021,** the Chinese market is extremely segmented in multiple regional sub-markets. With an increasing urbanization rate of **64.7%** in 2021, cities are a key referral to assess the potential of those sub-segments as they highly influence local development.

Chinese cities are traditionally classified in tiers, the Chinese cities tier-list system is an **unofficial classification system** created to better compare Chinese cities level of development and market size. Different criteria such as GDP, GDP per capita, size of the population, administrative status, etc. were used. The traditional method, used by most companies, classified cities in 4 categories: Tier-1, Tier-2, Tier-3, and Tier-4 cities.

While being a bit outdated, this traditional classification system still allows to identify Chinese most developed cities that concentrate the richest and most sophisticated markets. Put all together, **Chinese tier-1 cities gather a total population of 76,646,000 inhabitants, while lower-tier cities gather a total population of more than 930 million inhabitants**.



Overall, the Chinese market still provides important **growth opportunities and rooms for development**. The current political and economic context is in not impacting China the same it is impacting other economies. Foreign investors and companies can remain optimistic about the Chinese market and its potential while limiting their risk exposure. The Chinese market represents an important alternative to advanced companies and other unstable developing countries.

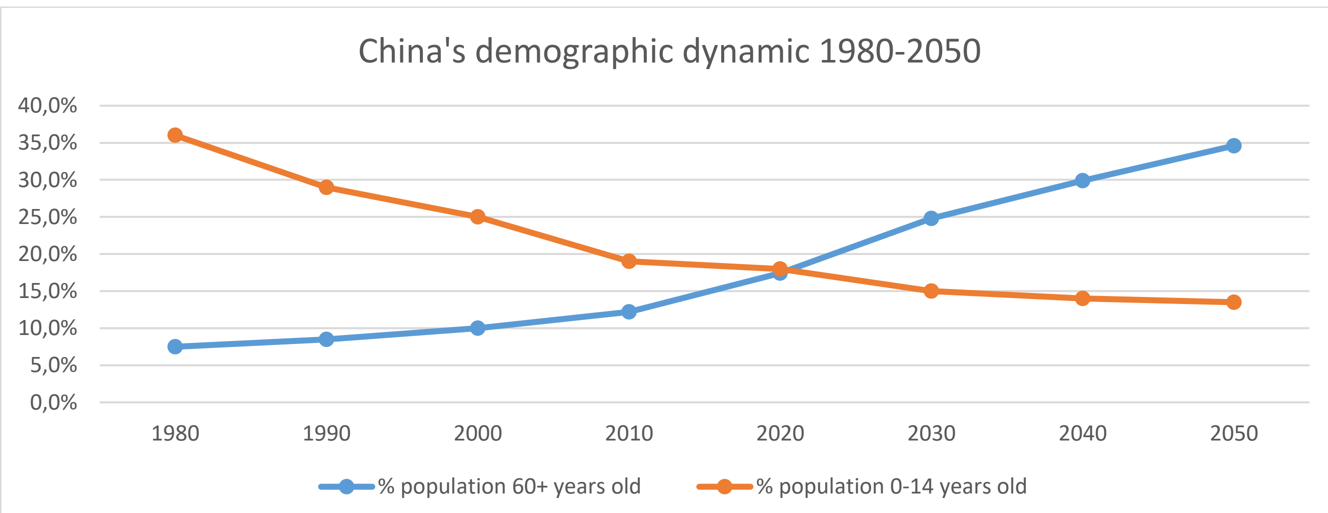
[1] https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=CN

/Fast growing segments in China

Traditional segments of the Chinese market start to become saturated with a highly competitive pressure: Food & Beverages, Wine, Home appliance, Furniture, etc. Nevertheless, as the market is becoming more mature, new segments are recording rapid growth.

/Healthcare & Life science

Through urbanization and due to population aging, the Chinese healthcare market has maintained continuous growth that kept accelerating since 2020. As China's death and fertility rate is decreasing rapidly, new market segments are developing. By 2050, **330 million Chinese citizens are expected to be over 65 years old**, while the current fertility rate is below 1.7[2]. Population aging brought the launching of new products (*elderly formula and milk, food supplements, senior activities, etc.*) and new services (*Retirement home, Clinical residential care, etc.*).



Source: World Bank

With **less than 2 medical doctors per 1,000 inhabitants**, China is way behind Germany (4.3 medical doctors per 1,000 inhabitants) or even Australia (3.7 medical doctors per 1,000 inhabitants). As of today, the **Chinese medical system is not ready to face the population aging issue** and important investments will be made by Chinese authorities to upgrade its system.

[2] World Bank Group

In 2020, the Chinese pharmaceutical market volume reached **USD 220 billion to become the world's #2 after the American market**, while the China's medical device market revenue reached **USD 118 billion**. The market volume and value are also expected to increase in the coming years due to the implementation of new policies.

Chinese authorities tend to favor locally manufactured products to decrease their cost of procurements for public and private hospitals. According to the latest "Made in China 2025" plan, **95% mid-to-high-end medical devices must be produced locally by 2030**. This situation is key for foreign companies that need to consider investing in China to secure their presence on the long-term.

/Automotive & NEV

China remains the #1 Automotive market by both annual sales and production outputs. **35 million vehicles are expected to be produced by 2025**. The Chinese automotive market remains dynamic despite COVID-19 with a strong segment related to NEV.

	June 202			January -June 2022		
	Units (10k)	Share (%)	Y-o-Y (%)	Units (10k)	Share (%)	Y-o-Y (%)
Sedan/Hatchback	108.6	43.5	47.7	492.8	40.7	8.2
MPV	7.7	3.1	13.3	38.2	3.2	-18.3
SUV	105.,5	42.2	45.8	496.8	41	7.1
Mini Van	2.1	0.8	-35.5	15.6	1.3	-16.5
Passenger cars total	**223.9**	**89.6**	**43.6**	**1,043.4**	**86.1**	**6**
Commercial vehicles total	**26.1**	**10.4**	**-33.2**	**168.3**	**13.9**	**-38.5**
Grand total	**249.9**	**100**	**28.2**	**1,211.7**	**100**	**-3.7**

Source: CAAM

The Chinese New Energy Vehicle (NEV) is booming for the last 7 years. In 2021, **3.3 million NEV (PHEV & BEV) were sold in Mainland China**, which made China the #1 NEV market worldwide. In 2022, 5.22 million units are expected to be sold **(+47.2% of YoY growth compared to 2021**), for an average of **38% growth rate from 2021 to 2025**.

Beyond the local market, China is also a leader for the exportation of NEV making **60% of global exports of BEV in 2021**. Despite the heavy impact of OMICRON outburst in March/April/May 2022, the exports of BEV kept increasing with **USD 1.2 billion worth of vehicles exported in April 2022**.

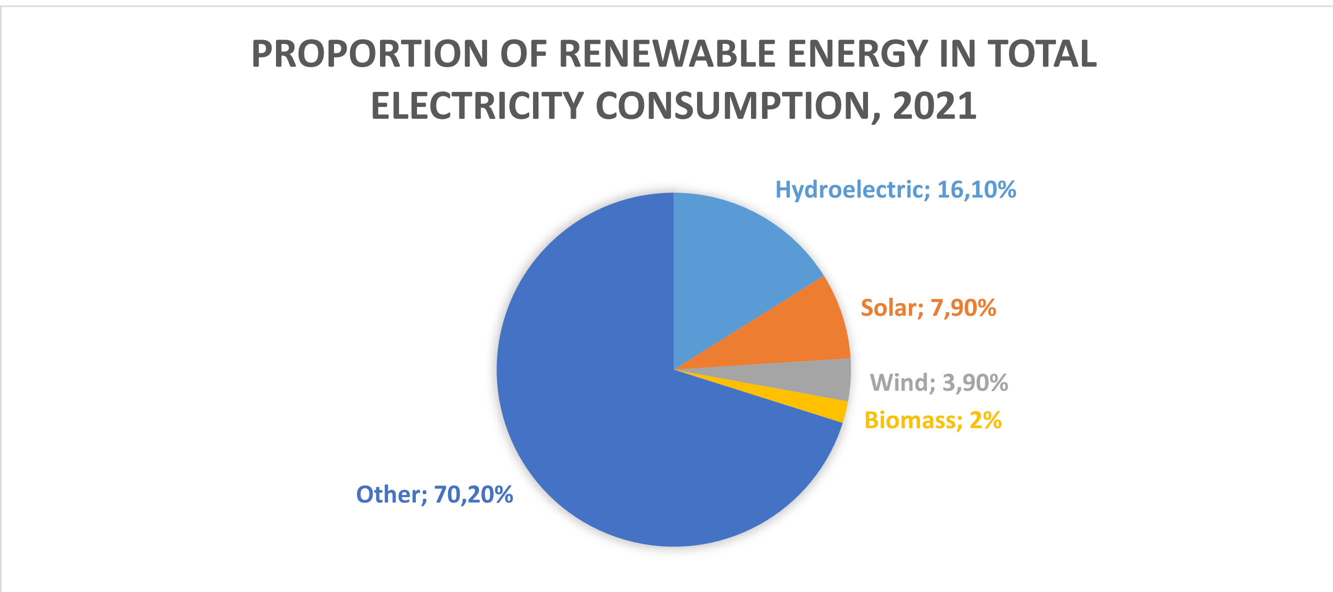
Aiways (Chinese brand) launched its U5 BEV in France in 2020

/Greentech & Energy efficiency

As of today, China still emits over **25% of the world's greenhouse gases** with more installed coal capacity than the rest of the world combined. Therefore, the Chinese authorities is willing to make important investments to reduce this impact for the last decade and reach carbon neutrality by 2060: Goldman Sachs estimates **this investment to be closed to USD 16 trillion**.

The plans announced by the Chinese government concern multiple sectors that will benefit from much support: energy, industry, transportation, iron & steel, nonferrous metals, petroleum, petrochemicals, natural gas, urban & rural development, agriculture & rural areas, and building materials.

In 2021, China reached **1063 gigawatts of renewable energy capacity** accounting for 44.8% of China's total power generation capacity, but only 29.9% of total electricity consumption.

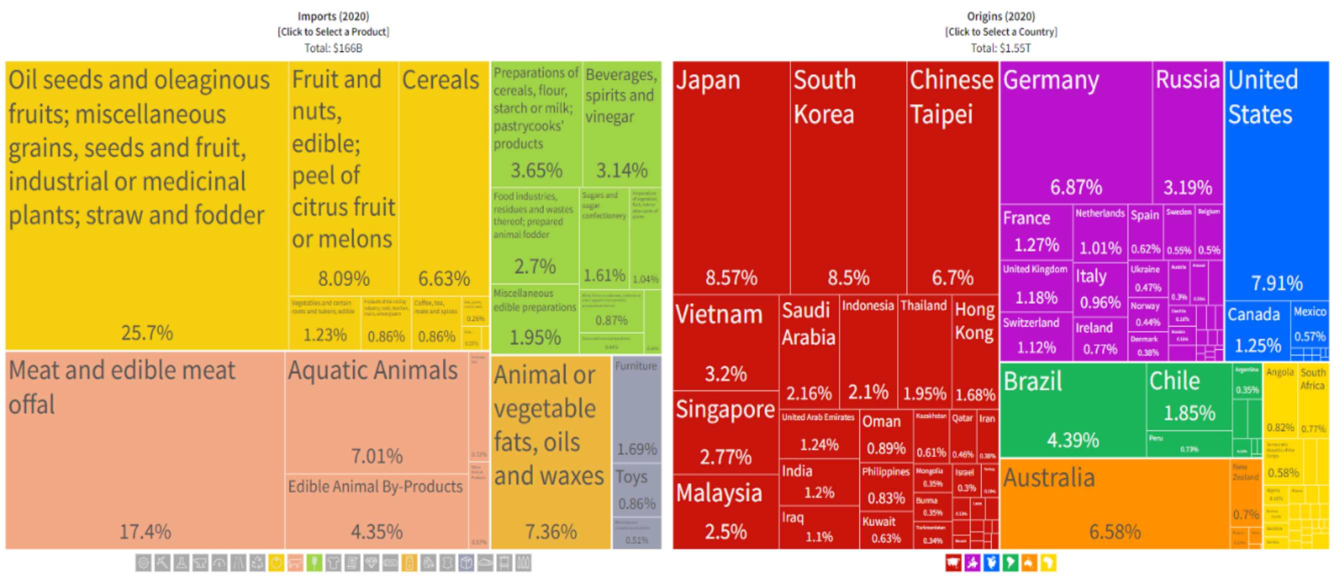


The market has also shown signs of maturity as Chinese authorities are **gradually removing subsidies, favorizing fair competition between local and foreign players**, upgrading existing investments, and enforcing strict regulations, standards, and rules. Foreign players are believed to own unique technological capacity and know-how that Chinese companies still lack to improve green energy production, waste management, recycling, energy storage, carbon capture, utilization, and sequestration.

The capacity and know-how of foreign companies, together with the high investments from Chinese authorities and companies, form an important pool of sustainable clients for foreigner players in the coming 10 years.

/Agriculture & Food industry

Agricultural and Food industries are accelerating their transformation to sustain the new demand by Chinese consumers. Since 2019, Consumer-oriented agricultural imports have been greater than bulk imports. In 2020, China imported for a total of **USD 166 billion** worth of food & agricultural products (meat, vegetables, fruits, transformed products, wine, spirits, etc.).



Despite only controlling only 10% of the world's arable land, China still registers a rural population of **300 million people** and is responsible of producing 18% of world's cereal grains, 29% of the world's meat, and 50% of the world's vegetables. Agriculture remains one of the key axes of the 14th five-year plan (2021-2025) with more dedicated projects than in the 13th five-year plan. Overall, the new plan is focusing on:

- Modernizing agriculture techniques
- Systemizing sustainable development & production
- Scaling up production
- Revitalizing rural eco-systems by creating investment and job opportunities

Foreign players have unique technologies to help Chinese companies to restructure their organization and to align high productivity standards and sustainable objectives. Wastewater management, soil performance, new fertilization technics, and Hydroponics are all technics that Chinese key players are interested in.

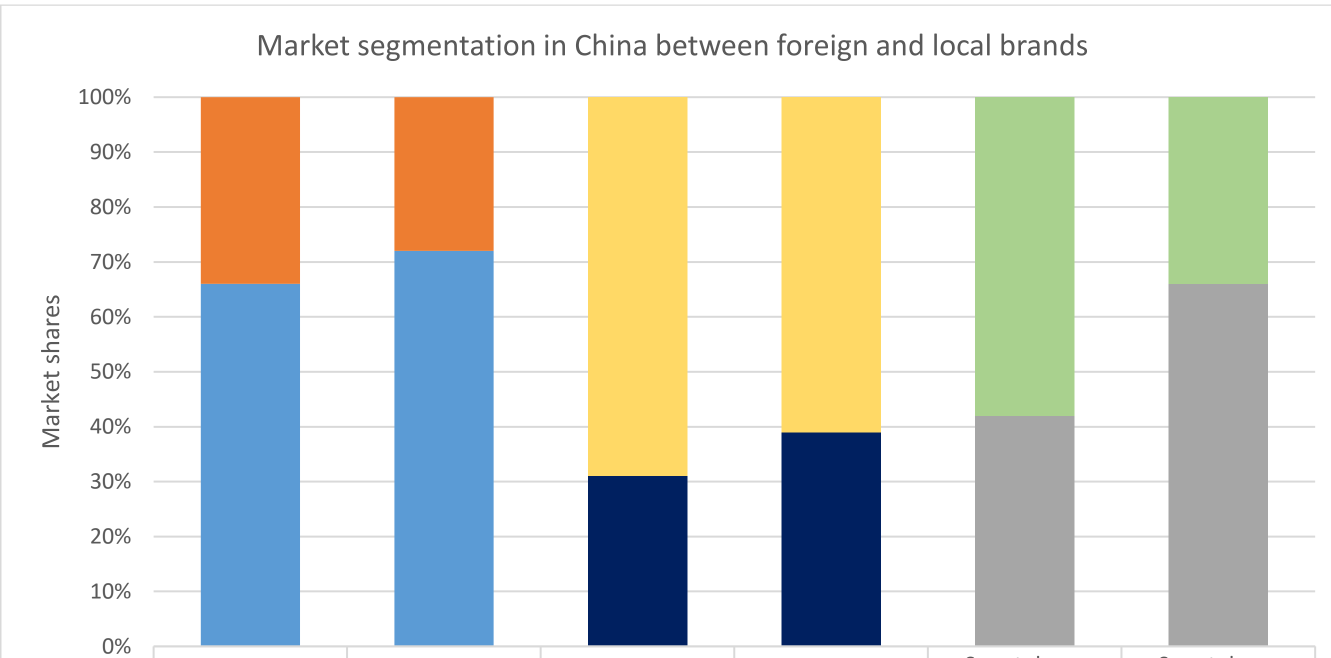
Organic products are also booming in China with more than **3.1 million hectares of land being officially registered as organic in 2019**[3]. Chinese authorities have implemented a new organic label to protect the farmers and allow the final consumers to track food products origin and alignment with official standards. Foreign imported food products that did not obtain the official Chinese certification cannot be labelled in mainland China as organic. As of 2020, **the Chinese organic market ranked as the 4^{th} largest worldwide for a total of size of USD 2,839 million**[4]. Organic production technics & knowledge are also highly welcomed to increase the national organic production and answer the local demand.

. *Chinese Organic Label*

[3] https://theconversation.com/why-china-is-emerging-as-a-leader-in-sustainable-and-organic-agriculture-132407
[4] daxueconsulting.com/organic-food-in-china/

/New consumption & consumers profiles

Dating pre-covid period but accelerating since then, Chinese consumers are more and more driven towards local brands. Already in 2018, this trend could be observed as Chinese brands started to take control of **72%** of the local FMCG market, **39%** of the automotive market and **66%** of mobile phone market[5].

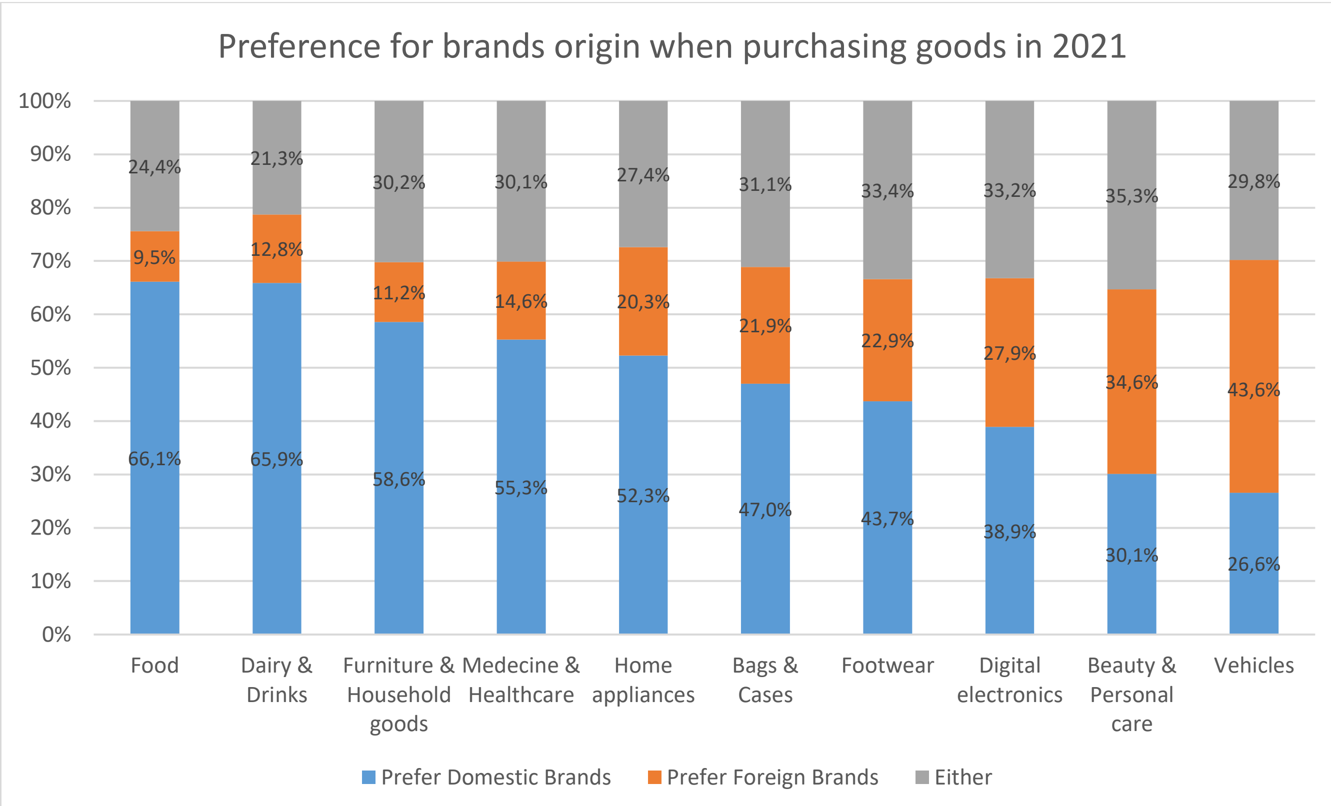


	FMCG 2012	FMCG 2016	Automotive 2012	Automotive 2016	Smartphone 2012	Smartphone 2016
Foreign	34%	28%	69%	61%	58%	34%
Local	66%	72%	31%	39%	42%	66%

Source: Kantar Worldpanel; JD Power; LMC; IDC; Bain analysis

Without totally putting aside foreign brands, more and more Chinese consumers are more willing to buy Chinese locally made products and brands for diverse reasons. This situation is challenging for foreign players that used **to argue their origin** as a key sales argument to succeed locally (*E.g., L'Oréal Paris, etc.*), but the impact is not as harmonious depending on the industry[6].

[5] https://www.weforum.org/agenda/2018/01/chinese-companies-winning-local-consumers/
[6] globaltimes.cn/page/202103/1218329.shtml



/Generation Z leading the "GuoChao" trend

Studies show that this trend is mainly supported by **young Chinese consumers** born after 1995. This generation grew in China after the Chinese economic reforms were implemented and is expected **not to hold any "prejudice" regarding local brands** and manufactured products according to Zhang Yi, CEO of iiMedia Research institute[7]. This tendency is also monitored by Tmall which noticed that Generation Z are ranking #1 for buying local brands with a per capita consumption rate above USD 815.

Li-Ning founded in 1990, by the Chinese athlete of the same name, is one of the many local brands preferred by Generation Z. Li-Ning is currently ranked #4 among China's top sportswear brands with a YoY growth rate of 65%.

[7] https://www.globaltimes.cn/page/202104/1221464.shtml

Generation Z believes that local brands are more aligned with **the needs and values of their generation**: Patriotism and Protection of the country. Generation Z is more attracted towards brands that put forward **Chinese culture and heritage**. This trend called Guochao has been a key factor for consumers to move away from foreign brands following multiple cultural scandals: Nike, Versace, Dolce & Gabbana, and Dior. This trend is also actively supported by local authorities since 2017 with the online sales event: China Brand Day. Successful foreign companies have been among the first to understand and adapt this strategy to this new demand in China.

/The "Silver-hair" generation

While Chinese seniors only represented 13% of the total population in 2015, they are expected to account for **25%** by 2050. "Staying in touch" is the key characteristic of this generation that is the fastest growing segment of mobile users. Chinese seniors are extremely interested in **keeping educating** themselves through online videos, news, information, etc. The pandemic has accelerated their digitalization as many of them relied on **e-commerce to purchase food and products of first necessity**. Already in 2020, **more than 55%** of Chinese seniors purchased apparels online and 44.2% in store. With a longer life expectation and solid financial situation, Chinese seniors are also interested in entertainment, travels, and health products.

/New Tier-1 cities

Following the super Tier-1 cities (*Shanghai, Beijing, Guangzhou, and Shenzhen*), the new Tier-1 cities are dynamic and innovative markets. Without being as developed or rich than the super Tier-1 cities, they do propose **many opportunities** to foreign and local companies with **lower competitive pressure and relatively high consumption rate**. The lower cost of life in those cities (*access to education, rental, house purchasing, etc.*) allows local people to maintain relatively high average annual disposable income.

According to Deloitte & SECOO in 2019, this allows new Tier-1 cities to capture **33% of luxury goods consumption**, while lower-tier cities capture the remaining 44%[8]. For foreign luxury brands, the cities of Chongqing and Chengdu represent their new Eldorado of the West regions of China. In 2019, Chongqing ranked as **#3 largest consumer of luxury goods** behind Beijing and Shanghai, while Chengdu ranked as #5.

[8] Deloitte & SECOO CIIE Blue Paper – China luxury goods consumption in China's lower-tier cities 2019

/A way to approach the market

We understand that foreign companies are at **a turning point** of their development in China. The traditional arguments that made foreign companies successful **are no longer valid** and it is vital for headquarters to understand that if they expect to compete with new players, **they need to reorganize themselves and localize their approach**.

Among all strategies implemented in China by foreign companies, the 4 Ds strategy remains one of the most efficient:

- **Design for Chinese consumers**
- **Decide in China**
- **Deliver at China speed**
- **Digitalize your activities**

While being efficient, this strategy can be expensive for many new entrants that have not yet secured a position in China, especially for SMEs and Mid-cap companies. To support the development of our clients in China, Altios has developed a range **of low-risk services designed to help SMEs seizing opportunities and adapted to the current situation in China**.

/Project implementation (2 months)

- Short diagnosis to confirm or update your existing knowledge of the Chinese market.
- Internal diagnosis to confirm if your current structure is aligned with your project in China.
- Recruitment of a dedicated consultant to support you project in China.

/Business activity management in China (minimum 1 year)

- A full-time employee dedicated representing you in China and committed to your long-term development.
- A full-time employee allocated to your local missions without the need to register a local company.
- Management support by Altios to monitor the progress of your local employee and provide guidance.
- Sharing our knowledge and experience to challenge your results and actions to generate higher growth.
- Centralizing cross-cultural communication and supporting you with the adaptation of your business plan and business model.
- Supporting you with the management of your network of partners in China (*marketing, distributors, etc.*).
- Expanding your business network and manage your current existing distribution channels.

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