REDEFINING SUCCESS
STRATEGIES IN CHINA
HOW TO WIN IN THE NEW NORMAL IN CHINESE INDUSTRY

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The information and insights shared by these companies have been instrumental to the report.
Swedish companies have an impressive footprint in the Chinese market. With a strong focus on leading-edge technology, high-quality offerings and long-term commitment, many of the Swedish companies have experienced rapid growth over the last decades. This has created many job opportunities in China as well as in Sweden.

We stay positive regarding China’s long-term prospects and believe that China’s global economic position and importance among Swedish companies will remain strong. In the short-term though, it is evident that there are growth challenges. In this report we point out a number of the concerns arising from the slowdown and the ongoing economic and political transformation in China.

Business Sweden concludes that a new approach is needed to ensure continued success in China in the coming decade. This report presents seven strategic recommendations for Swedish companies based on leading practice, current trends and market changes. What is highlighted is the importance of continued long-term commitment to China, increased local profile of the operations in China, expanded market partnerships and growth opportunities by mergers and acquisitions.

Business Sweden helps every Swedish company to reach its full international potential. It is with great interest that I present the findings and recommendations of this report, highlighting strategies and success factors for continued development of Swedish companies in China.

Finally, I would like to extend a sincere thank you to the Swedish companies and individuals who have contributed to this study.

Ylva Berg
President & CEO Business Sweden

Swedish industry has grown increasingly dependent on the success and growth of Swedish companies in China. The current economic slowdown and period of transformation in China are however causing considerable changes to the business environment, particularly to the premium segment in which Swedish companies primarily operate. The extent of these changes is more far-reaching than only temporary downturn in sales.

China’s old growth model, driven by infrastructure investment and fueled by cheap credit, has run out of steam. The build-up of artificial demand in the Chinese market created by the 2008 stimulus package has resulted in an oversized manufacturing apparatus in several segments with huge overcapacity and poor return on investments. The effects of the overall slowdown can be seen in changes to the market, changing customer behavior and intensified competition from more advanced local companies. The economy is in need of reforms, which will involve painful adjustments to the supply side of the economy, while at the same time implementing initiatives to stimulate demand.

EXECUTIVE SUMMARY

This report concludes that strategies which were successful in the past will no longer be sufficient going forward. Slower growth and ongoing structural transformation are threatening companies that are over-dependent on the old Chinese growth model. Furthermore, companies attempting to navigate this period of downturn by solely cutting costs risk finding themselves with shrinking market shares and occupy a weaker market position in this New Normal. Instead, a dual strategy to both maintain the premium position as well as expand in a growing mid-market is a necessity for most companies.

Based on the findings of this report, Business Sweden has formulated seven strategic elements for Swedish companies on how to adapt to the changing business landscape in China and support continued expansion. These include setting the benchmark for high industry and technology standards and being long-term. These two elements are considered fundamental for Swedish companies to stay relevant in China. The remaining five elements form an overarching strategy for Swedish companies to take the initiative in winning over the vibrant Chinese mid-market, while at the same time protecting leading positions and market shares gained in the premium markets. It involves strategic and in-depth partnerships with Chinese companies, in-organic expansion and to fully leverage leadership positions in the area of innovation.
INTRODUCTION

BACKGROUND
The development of China as an economic, manufacturing and trading superpower over the past decade has been exceptional in terms of both scale and international impact. Swedish industry has experienced rapid and solid growth in China lasting more than twenty years thanks to a long-term vision and its strong contribution to China. Swedish companies’ current footprint is significant with more than 150 factories and 16 larger R&D units. In total, Swedish companies directly employ more than 150,000 people in China alone. Industry leaders such as ABB, Tetra Pak, Ericsson and Atlas Copco have experienced extensive growth in China and have created employment opportunities both locally and in Sweden, with additional indirect employment opportunities that extend to more than 500,000 people in China.

However, in recent years concerns regarding growth pace, composition and state of the Chinese economy have increased, as well as worries about the ability of policy makers to deal with these issues. Meanwhile Sweden’s industrial sectors have grown increasingly dependent on the success in China. Consequently, the slowdown in economic growth and market uncertainties present considerable strategic challenges. However, the New Normal is not so much about a slower GDP growth as much as changes to the overall business environment. The reforms and rebalancing of the economy in addition to more sustainable growth figures mean that new business opportunities need to be identified.

ABOUT THE REPORT
China is Sweden’s most important trading partner in Asia and it is believed that its market and global economic importance will continue to grow. Swedish industry has outperformed most expectations over the last two decades in China, but what is becoming increasingly evident is that what brought us this far will not take us into the future. Several industries still continue to show healthy development, especially so consumer-related industries; companies like Ikea and H&M continue to invest in China based on positive prospects. However, for Swedish companies in other sectors, the shifts imposed by the New Normal are rather threatening their market positions. For these companies, sales in China constitute on average more than ten per cent of their respective global sales, which underlines the urgency of navigating the changes ahead.

Investments and readjustment of business models are needed to secure market shares and finding new areas of growth.

Business Sweden has conducted an analysis of the changing conditions of the Chinese economy, with a focus on B2B dominated sectors. This report aims to provide a better understanding of China’s current business landscape and recommendations as to how Swedish
industry should adapt to these changes.

The analysis consists of four parts. Firstly, chapter one describes the economy from a macroeconomic perspective and some of the causes of current issues such as the unsustainable growth model and industrial overcapacity factors which are affecting the operations of many Swedish companies in China. Secondly, we examine some of the key reforms that will have an impact on industry over the coming years. This is followed by a more in-depth examination of industry’s market dynamics, highlighting in particular the premium product segment and the trend towards increased protectionism. Lastly, we present our recommendations aimed at Swedish companies operating in B2B industries in the years ahead.

ANALYTICAL APPROACH AND KEY QUESTIONS
The report introduces a new framework which is mainly focused on how Swedish B2B business should adjust to China’s changing business landscape. The macroeconomic overview presented in the report is backed by relevant reports and supporting secondary resources as well as statistical data. The analysis and recommendations are based on interviews with executives at Swedish companies in China. A total of 16 in-depth interviews were conducted, with focus on the overall market situation, competitor landscape, customer trends and growth strategy.

The findings and recommendations have furthermore been validated and improved by follow-up discussions with the interviewees as well as additional stakeholders with extensive experience on the Chinese market.

“
For most companies, China has become critical for volume and profitability. China has gone from being nice-to-have to necessary”

Jan Debruyn
Alfa Laval
SWEDISH COMPANIES’ FOOTPRINT IN CHINA

Source: company annual reports and press releases, latest publicly available data as of May 2016
THE CHINESE ECONOMY IS IN TRANSFORMATION

CHINA’S OLD GROWTH MODEL IS OUTDATED
Gloomy headlines about the state of China’s economy are appearing more and more frequently in the Swedish and Western press. Uncertainties about growth figures, a highly volatile and nascent stock market, soaring debt levels and extreme industrial overcapacity are all examples of worrying factors for investors and companies. The slowdown in demand has motivated several headline mega shifts and subsequent initiatives in China. China’s old growth model, based on infrastructure investment, cheap credit and competitive strength, which were in turn built on low-cost manufacturing, has proved unsustainable and has been acknowledged by the communist leadership to be outdated.

Poor return on fixed asset investments
China mitigated the impact of the global financial crisis with the RMB 4 trillion stimuli package rolled out in 2008. This huge infusion of credit into the market as well as the frontloading of large infrastructure projects stimulated demand. But these investments were not always based on real demand and have in many cases led to poor asset allocation. An example of this is the real estate sector, one of the most important sectors in the economy, since it also attracts private investment. Estimates show that China has construction projects planned to meet the housing needs of 3.4 billion people. In addition to this poor asset allocation, the capacity of the housing construction industry is dimensioned for an ever-growing demand and building boom. Consequently, immense overcapacity has also been building up among suppliers to the construction industry. The decline in investment activity has already had a significant negative impact on this sector, and it is not surprising that figures are now starting to show severe excess capacity and low capacity utilization at major cement, steel and aluminium plants. For example, China’s production capacity for both cement and steel is capable of meeting 75 per cent of global demand and, needless to say, neither of these industries is achieving full utilization.

Low-cost manufacturing is at risk of losing its global competitiveness
The competitiveness of China’s manu-
facturing industry and its exports are under great pressure, arising from soaring labour costs in combination with a strong currency. Since 2001, hourly manufacturing wages in China have grown by an average of 12 per cent annually, whereas worker productivity has not developed as expected. As a comparison, the labour cost per hour in China today is almost 15 per cent higher than in Mexico, and when adjusted for productivity the difference is even more evident. In general, all sectors in China are facing productivity issues. For example, productivity levels in the service sector equate to only 15–30 per cent of OECD levels.

Additionally, in 2015 the RMB rose to an all-time high against a trade-weighted basket of currencies. The appreciation of the RMB has also contributed to smaller margins for companies manufacturing in China. Add to that global growth figures that are near recession levels, and you get an industry facing both a sharp drop in demand and increasing costs.

Reforming the Chinese economy

China got through the global financial crisis of 2008 well, and kept growing during the economically unstable period that followed. The Chinese economy has almost doubled since 2009, and today represents the world’s second largest economy in terms of nominal GDP. Domestic industry is very export-dependent, and China tried to mitigate the diminished demand inflicted on it by the U.S. and European financial crisis by resorting to major investment and stimulus packages. However, these over-investments were based on artificial demand. Even worse, manufacturing companies continued to build capacity based on assumptions on an ever-growing building boom. This discrepancy between real and artificial demand is at the root of many of the current problems and also the cause of the reforms recently announced to address structural transformation of the supply side.

It is clear that short-term cost savings will not get China out of this crisis; large-scale transformation is needed both to sustain demand and sort out problems with supply-side overcapacity. Otherwise China faces the risk of being trapped in transition between a developing and an advanced economy – the so-called middle-income trap – or never attaining the desired “moderately prosperous society”. Still, the reforms needed are no quick fixes. The slowdown in demand is a major reason for headline reforms and subsequent initiatives in China. The way forward for the country, described as the New Normal, places less emphasis on GDP growth and instead pursues structural reforms aimed at stimulating domestic consumption, developing the service sector, building on domestic innovation capabilities and exporting industries’ overcapacity. In parallel, China needs to realign its supply side to match more realistically-set demand scenarios, and in particular to improve the profitability of inefficient companies in the state-owned sector.

China’s new target of “around 6.5–7 per cent” still requires a large positive upturn in both domestic demand and exports. Slower growth and lower profit margins are already taking their toll on employment. The government now fears that economic setbacks with further unemployment and mass layoffs may threaten social stability. Strikes and labour-related disputes increased by 100 per cent year on year between 2014 and 2015, with the construction and manufacturing sectors combined accounting for almost 70 per cent of the total number of strikes and protests. The manufacturing sector alone directly employs over 130 million people, and many large State Owned Enterprises (SOEs) are of vital importance to local provincial economies. Social stability is of the utmost importance to the communist leadership and, even though China needs to go through a period of resetting and reconfiguring its supply side, it will need to continue stimulating the economy to maintain demand, which includes ramping up investments again.
Transforming the Chinese economy into a more demand-driven, innovation and productivity-focused economy is a huge task. To implement these reforms, the government has once again increased its level of control and centralised power rather than rely on market forces, which is why it is relevant to look at these reforms more closely.

Shift to consumption and services
China’s emerging middle-class is a major force for economic growth and an important factor in transforming the economy. It is forecasted that by 2022 more than 630 million Chinese will have entered the middle-class income span. Changing consumption preferences can be seen in the form of a growing demand for premium and quality products, including everything from foreign luxury brands and imported foods to more advanced services.

Services as a share of GDP surpassed the manufacturing sector share as early as in 2012, and in 2015 contributed as much as 50.5 per cent of GDP. Without the rapid expansion in financial services, education, healthcare and other services, the overall slowdown would have been much worse. However, domestic consumption needs to increase further. Demand among Chinese households for high-end services cannot be satisfied by domestic providers either; e.g., middle-class Chinese are visiting other countries to study, shop and receive advanced medical treatment. Furthermore, due to the lack of a reliable social safety net and uncertainties regarding retirement compensation, the urban savings rate has increased in spite of the significant growth in personal income. A number of recently-launched initiatives are aimed at stimulating consumption, e.g. tax cuts and improvements to the VAT system, removal of the one-child policy and improvements to the social security system and mobility for Chinese citizens.

Remaining competitive through innovation
China is making great efforts to upgrade its industry to become more innovative, which is permeating all aspects of the forthcoming five-year plan. Already in The National Plan for the Development of Science and Technology 2006–20 it was stated that by 2020 R&D investments should be 2.5 per cent of GDP and knowledge-intensive industries should be contributing more than 60 per cent of GDP growth. Domestic industries are being strongly urged to move up the value chain from low-cost manufacturing to more value-added products and advanced market segments. This will force companies to radically improve production processes and increase their level of productivity and automation, as well as to become more innovative.

China is already second only to the US in terms of R&D investment in absolute figures, and the country’s inventors are filing the highest number of patent applications in the world. Furthermore, the OFDI pattern and focus of Chinese firms have changed. Overseas investments are now increasingly targeting developed economies in the search for strong brands and technologies aimed at strengthening market position and compensating for the lack of R&D output and innovation.

Expanding the global footprint
As its domestic infrastructure investment is slowing, China has seized the opportunity to export excess capacity in industries such as construction and steelmaking. This strategy is already being implemented, and nowhere is this more evident than in the international investment arena; for instance, China’s rail companies are currently bidding on more than 25 high-speed rail projects internationally. Another example is the acceleration of international diplomacy and overseas investments, which is very much aimed at securing Chinese exports. President Xi has become a world traveller with several important state visits during 2015. Some of the major overseas investment projects
HOW TO KEEP UP DEMAND?

REFORMS TO GENERATE DEMAND

SHIFT TO CONSUMPTION AND SERVICES
- Stimulate consumption
- Develop the service industry

REMAIN COMPETITIVE THROUGH INNOVATION
- Invest in innovation capabilities
- Acquire foreign technology
- Increase productivity and create high-value-added jobs

EXPAND GLOBAL FOOTPRINT
- Accelerate Go-out strategy
- Push mega initiatives, co-investments and loans
announced in 2015 include China’s one-third stake in the construction of a new GBP 24 billion nuclear power station in the UK and a series of loans given to African countries for development. Most recently, China and South Africa signed deals and loans valued at USD 6.5 billion, with a focus on building infrastructure in the African economy. Meanwhile, Vice-President Li has kept a more domestic focus, shaping up industry to increase productivity and pushing SOEs on the Go Out Mission. According to some observers these international investments, rather than bilateral agreements, are aimed at benefiting Chinese firms and workers rather than the recipient FDI countries.

Major international initiatives such as “One Belt One Road” (OBOR), with its planned infrastructure projects throughout Asia, also support the international deployment of this strategy, with the intent to keep up demand and SOE factories at full capacity. Supporting institutions like the BRICS Bank and the Asia Infrastructure Investment Bank (AIIB) will also provide the necessary backing for Chinese companies for this manifest destiny-type expansion. What is more, each of these institutions serves to concentrate greater economic strength in Beijing, which will further help the implementation of strategic and political goals. However, whether this strategy will successfully solve China’s supply and demand problems remains to be seen. Many believe that anti-dumping measures will prevent this strategy from being fully successful and, furthermore, that too low ROI on foreign investments will make it unsustainable in the long term. One recent example is the 266 per cent tariff imposed on cold-rolled steel from China by the U.S. Commerce Department in response to what it ruled to be unfairly low prices.
A NEW CLIMATE IN CHINESE INDUSTRY

The Chinese market can in general be divided into three segments: the low-end market, the mid-market and the premium market. Swedish companies have occupied a strong premium position in the Chinese market since operations were first established in the 1980s. Strong brand recognition, technology and leading-edge solutions have been the foundation for this, while Chinese companies have traditionally dominated price and volume-led low-end and mid-markets.

Long-term investments and commitments by Swedish companies have resulted in rapid growth of profitable China business in the past decades. Swedish companies’ current footprint in China is significant. The top 20 Swedish companies alone have a total annual sales of more than 250 bSEK in China. Several Swedish leading companies generate more than 10% of their global revenue in China, e.g. ABB, Tetra Pak, Atlas Copco, SKF and Alfa Laval.

China’s global importance is unlikely to decline. Quite the contrary, it will continue to grow as a market of global economic relevance. China’s annual economic growth is still greater than Sweden’s entire GDP. Despite the tough current market situation in China,
Swedish companies are generally optimistic about the future and believe that China will continue to be a significant, if not the most significant, market going forward. Several industries are seeing healthy development, such as in the consumer and quality of life-related sectors, where companies like Ikea, H&M, SCA and EF Education First are investing heavily and expanding in China.

However, a major reshuffle and transformation are currently taking place. Swedish companies, along with other international companies, are facing a rapidly-changing and more saturated Chinese market. Many attest to the “golden era” of double-digit sales growth being over, at least for the time being. Three noticeable key shifts are shaping this new landscape; the Market, the Customer and the Competitor shifts.

The following descriptions of the changing Chinese business landscape are based on empirical analyses based on primary data from interviews with Swedish companies as well as examples from leading MNCs. The focal point of the analysis has been to see how this transformation is changing the traditional B2B industry in particular, and less emphasis has been given to the consumer sectors mentioned above.
THE MARKET:
The overall Chinese industrial landscape is changing

Over-investment
As mentioned in the first chapter, over-investment in the post-stimulus era is having a ripple effect throughout Chinese industry. The dynamics of central planning and local implementation coupled with poor communication and vested interests are making the problem worse.

The excavator market and the heavy-duty vehicle market provide points in case of the effect that over-investment has had on businesses. Both have experienced a sharp downturn in the last five years, with the total units sold in 2015 being many times lower than the total units sold during the peak year of 2010. In short, over-investment during the boom years means that some customers have neither the need nor capability to invest in new products in the foreseeable future.

Overcapacity
In most sectors the artificial build-up of demand has led to significant overcapacity, although official figures suggest the capacity utilization is nothing to be overly concerned about. However, according to the interviewees these figures grossly understate the problem. If looking at less official estimations, the situation is beyond alarming. The actual capacity utilization in some sectors is below 50 per cent, according to the interviewees.

The main result of this overcapacity is price pressure and distressed margins, as most companies want to retain a market share and keep operations going. Given the fragmentation of industry sectors in China and the large number of loss-making companies, observers have been waiting for years for a wave of consolidation to take place on a large scale, but this has yet to materialize.

Anti-corruption drive
Swedish companies welcome the anti-corruption campaign, anticipating that it will contribute to a healthier business environment. This campaign has been more far-reaching and long-lasting than expected with many high-profile trials. The majority of officials charged with corruption have come from SOEs and the military. It is debatable whether or not the campaign is designed to settle political vendettas or if it is actually a case of genuine concern about corrupted business. As one interviewee pointed out, it is most likely a combination of the two, where settling political scores can now be described as “mission accomplished”.

Although this anti-corruption drive has been embraced by Swedish companies, it has had negative consequences in the short term in that prolonged decision-making processes on the customer side have affected sales cycles. As an example, for an environmental technology company waiting for a new policy, nothing has changed in recent years because five policymakers have been removed owing to the anti-corruption drive. Another example, taken from the health-care industry, shows that hospitals postponed their purchases or procurements for fear of becoming targets of the anti-corruption drive. Purchases of critical medical equipment can however only be postponed so long, and in 2015 business started picking up again.

Sectors with greater government involvement, or where SOEs are main customers, have been more affected by the anti-corruption drive. In some cases the anti-corruption drive has even been used as an excuse for not committing to projects or previously agreed arrangements.

“Buy domestic” policies
Many Swedish companies have noticed a “buy local” trend in the Chinese market, with the authorities stepping up their efforts to reduce the market dominance of leading MNCs in...
certain industries. This trend has become more apparent since President Xi Jinping came to power. In addition, “Made in China 2025” is also being stressed in order to change China’s status as a manufacturing power from one of quantity to one of quality.

Authorities and policymakers believe that the market share of local suppliers is too small, and in some industries they have taken measures to further build up and promote domestic companies. One of the most obvious cases can be found in the medical device sector as regards the so-called “elimination of GPS”, referring to limitations on the business activities of GE Healthcare, Philips and Siemens. These three companies taken together have made up 80 per cent of the Chinese CT scan and MRI markets, two of the markets in which they dominate. The “buy domestic” initiative also affects Swedish companies. One measure implemented at provincial level is drawing up a directive for how much hospitals may purchase from foreign suppliers. At 3A hospitals, the highest hospital level in China, foreign products may account for a maximum of 50 per cent of their capital expenditure. At other hospital levels the maximum expenditure is set at 30 per cent. Furthermore, regulation has shifted from differentiating between imported or locally-manufactured products to focusing more on the ownership of the brand.24 This means that manufacturing a product in China to sell it may not be enough; it may also be necessary for the brand to be in Chinese majority ownership.

Telecom and IT companies such as HP, Cisco and EMC are facing the same problem. The market has been considerably skewed in favour of domestic companies.

Since becoming a member of WTO on 11 December 2001, China has signed agreements and committed itself to fair competition. The “buy local” initiatives have been implemented at provincial level throughout China. The decentralized control of the initiatives therefore enables the central government to distance itself from involvement in any wrong-doing.

**Impact on Swedish industry**

The macroeconomic situation and these policies are putting top-down pressure on the premium segment. Swedish companies are witnessing a general slowdown in sales, one very much ascribed to customers’ previous over-investments, leading to excess build-up of assets. The overcapacity issue in many industries has also put general pressure on prices, whereby local businesses are trying to stay in operation by lowering their prices below manufacturing cost. In some instances, the ongoing anti-corruption drive has spread anxiety among buyers, which has either prolonged or halted sales processes. Moreover, many Swedish companies are finding that domestic players are given a disproportionate and unfair competitive advantage through the “buy domestic” drive.
THE CUSTOMER:
A shift in B2B customer behaviour

Customers are turning to the mid-market
Overall uncertainty about economic development means shorter planning horizons and less appeal in terms of life-cycle thinking. To some extent this has always been an issue for foreign companies operating in China, since potential buyers calculate total cost based on project duration rather than product lifespan. In the past, companies operating in the premium segments have been spared this rationale. Now, however, premium customers are increasingly moving in this direction. Given the uncertainty of new projects in the sales pipeline as well as increased pressure from end-customers, the initial cost has become a key issue.

The mid-market is rapidly growing to become the most important segment for future growth in the New Normal. Meanwhile, key shifts on the Chinese market today are collectively affecting the size and market conditions of the premium segment.

SOEs and MNCs are increasingly buying local
Overcapacity has increased the focus on cost-saving “across the board” to stay competitive or even to stay alive. It has for instance been observed that traditional buyers of premium products, such as SOEs and MNCs, are introducing cost-reduction programmes with annual cost-cutting targets. Furthermore, where factories do not run at full capacity this reduces the need for the productivity level of premium products.

A European company interviewed had switched from a Swedish premium product to a considerably cheaper alternative from a local supplier in order to adapt to changing demands from customers. The risks associated with not having the 100 per cent guaranteed reliability of the premium product were ignored, despite any downtime in end-customer production being potentially disastrous.

A “good enough” attitude
Some of the Swedish companies are also witnessing a drop in customer requirements, e.g. technical standards and product features. If it was previously the case that complete compliance with technical specifications, functionality and quality was required, the prevailing attitude now is that 80 per cent is good enough, with much more emphasis being put on price. In reality this means that customers are willing to compromise on the product specification in order to push the price discussion one step further.

The impact on Swedish industry
Industry demand and resources which seemed to be never-ending in the past are never-ending no longer. Traditional customers for global premium products are now increasingly forgoing the benefits of previous standards and are becoming ever more price conscious and deciding in favour of mid-market alternatives.

THE CUSTOMER IS CHANGING
IMPACT ON SWEDISH INDUSTRY

The whole market will grow by more than 10 per cent per year, but the growth will be in the mid-market and low-end segments

Florian Mond
Getinge
THE COMPETITOR: Stronger, faster and increasingly global

A narrowing technology gap
The most significant change in the key shifts taking place is the competitiveness of local companies with their ever improving level of technology and stronger product offerings. Different industries show different levels of maturity and competitiveness, but the speed at which Chinese competitors are reducing the technology gap should be of concern to all foreign companies. Over the past few years, Chinese acquisitions of foreign technology have accelerated this trend. One company interviewed testifies to the challenge of having a local company acquire their main global competitor. Being on a par in terms of technology, it is hard to compete with a local company in their home market.

Constant price pressure
The local competition is not only improving in terms of technology and product offerings, but at the same time is doing so on the basis of low prices. Add to this the slowdown in investment, overcapacity on the supply side and a move towards local alternatives and an unprecedented level of price pressure has emerged. The premium segment, from which Swedish companies have traditionally earned the majority of their revenue, is far from untouched by this price pressure. Several of the interviewed companies point out that they have also had to lower their prices to match their global peers.

Local competitors are becoming global competitors
Furthermore, these local competitors are increasingly entering global markets. What is happening today in China in terms of competition will happen in other markets around the world. What happened in the telecom industry a few years back when Huawei became a global player will happen in other industries too. Other examples include the high-speed rail field, where Chinese construction companies and rolling stock suppliers are already gaining ground.

The impact on Swedish industry
Domestic companies are now serious rivals to foreign companies. In the past Swedish companies enjoyed vast competitive advantages in terms of their technological edge and brand recognition compared to domestic products. But the reality today is that this is no longer true. Domestic companies are quickly catching up in terms of foreign MNCs’ technology and performance edge. In addition to the improved technology they now possess, local competitors excel in cost-driven product development and time-to-market, which are strong advantages when competing in the fast-changing and price-driven mid-markets.
EXPANSION OF THE ADDRESSABLE MARKET

The vast majority of Swedish companies in China and respondents in this study are positive about the Chinese market in the mid-and long term, even though many are currently experiencing increasingly challenging business environments and declining sales volumes. The Chinese industry and markets are undergoing large transformations, but what the final outcome of all announced reforms and shift towards a more service driven market growth and innovation focused development is yet too early to say.

Premium market under attack
Domestic Chinese companies have in a relatively short time become formidable competitors to Swedish companies. Huawei’s transformation and expansion in the 2000s to a globally competitive telecom company is one example. China’s strongest companies have reached these positions through either aggressive acquisition strategies or rapid product development combined with speed and responsiveness in meeting customer requirements. Thus, their fast advancement is not only due to technology improvements enabled by acquiring or replicating western companies, it is also rooted in long-term visions, governance and go-to-market models optimized for the fast changing Chinese market conditions.

In short, the premium segments in B2B markets are put under pressure from all angles. It is now evident, and increasingly recognized by Swedish business leaders in China, that the premium market alone will not be sufficient to fuel continued growth and meet investors’ expectations on returns from the Chinese market.

Future growth expected to be in the mid-market
Swedish industry has both a strong legacy in China and a solid foundation in terms of technology, know-how and recognized brands to continue building on. However, to succeed with expansion into the mid-market Swedish companies need to invest in local innovation, shorten the time-to-market and increase the speed in decision making. Furthermore it is expected to require a proactive inorganic and partnership driven growth plan, in order to assure cost competitiveness and market reach.

Expand into the mid-market with dual purposes
The subsequent chapter of recommendations describes more in detail the dual market strategy of keeping and strengthening the position in the premium segment, while venturing into the mid-market for growth. The expansion into the mid-market, fueled by acquisitions or partnerships, is also an effective strategy to protect the profitability of the premium offering. The recommendations in the next chapter are not intended to be exhaustive, but rather guide and supplement company specific strategic plans.

DEVELOP A DUAL MARKET STRATEGY

1. Capture mid-market growth opportunity
Assure reach and relevancy for the large and growing mid-market

2. Protection of premium
Protect your premium by increased depth in your portfolio and a more differentiated offering
HOW TO WIN IN THE NEW NORMAL?

- LEAD THE MARKET
- MAINTAIN THE CORE
- SET THE STANDARD
- BE LONG-TERM
- IN CHINA FOR CHINA
- BROADCAST CHINA DOMESTIC
- INNOVATION AS A SERVICE
- ACQUIRE AND EXPAND
- TRADE YOUR GLOBAL SALES CHANNEL
- INCREASE YOUR ACCESS
- SET UP FOR GROWTH
- TEAM UP FOR SUCCESS
- STEP UP YOUR JVs AND PARTNERSHIPS
- INCREASE YOUR ACCESS

7 ELEMENTS
SEVEN STRATEGIC ELEMENTS FOR SUCCESS

SEVEN STRATEGIC ELEMENTS
The recommendations in this chapter have been formulated as seven strategic elements that are relevant to Swedish companies in the B2B and B2G sectors in China. These elements are a collection of strategic measures for future business development to tackle the patterns of the diminishing growth in the premium segment and the increasing significance of the mid-market. Business Sweden recognizes that the extent to which these measures are relevant varies depending on the business model and industry. The recommendations can therefore be implemented independently of each other rather than as a static program or check list.
Core elements of Swedish companies’ previous success in China need to be defended and sustained. Key contributors, such as leading-edge technology, high quality and long-term commitment, should not be discarded. No matter if approaching the premium market or the mid-market, Swedish companies need to continue developing its competitive edge and setting the benchmark.

BEST TECHNOLOGY, BEST SOLUTION
The position held by Swedish industry on the Chinese market today stems from a history of providing world-leading technology and solutions. Sweden has come to be considered a champion of leading standards – standards that are indeed used as a benchmark for local Chinese competitors.

The high standards for which Sweden has come to be known have naturally built a strong brand. The Made in Sweden label is considered to be one that represents the best possible solution in terms of quality, cost of ownership, performance, productivity, environmental impact and more. For the sake of future development in China, it is essential to maintain these standards in order to continue building on the brand recognition that Swedish companies currently enjoy.

IN CHINA FOR CHINA
Furthermore, Swedish companies have historically been successful in aligning themselves with China’s growth path and development goals. This has been made possible by early presence in China combined with a genuine long-term vision that has had China’s best interests in mind.

By being present from an early point and prioritizing local interests, Sweden has been able to contribute to the development of the Chinese industry and also shape it from the start. Investing in local R&D units and setting industry standards are just two areas in which Swedish companies have helped educate entire sectors and drive industrial development.

Having China’s best interests at heart has been an important factor in establishing solid credibility, an essential prerequisite for long-term collaboration and continued presence in any market. This also involves adapting in a cultural sense as well as finding reliable solutions to comply with local rules and regulations. To stay relevant it is crucial that Swedish companies continue to contribute to the overall development in China.
The Chinese market is becoming more mature, with slower growth and ultimately room for fewer players. Companies need to radically rethink how to compete in this new market environment. It has become quite evident that the key to succeeding will be based on leveraging local capabilities, particularly when meeting the requirements of domestic policies and countering increased local competition. Furthermore, this will be crucial for adapting to rapidly changing customer preferences in the mid-market as well as when defending the positions in the premium market.

**BECOME “CHINA DOMESTIC”**

**Prevent disqualification**

To successfully enter the mid-market, it is essential to find strategic solutions to deal with the increased pressure from domestic policies. Swedish companies therefore need to find an operational platform that provides a basis to operate on the same terms as Chinese competitors in terms of local production, localized operation, and local brands. By establishing production and product development in China, companies can leverage the competitive cost basis of local operations and better compete in China on Chinese terms. Companies can thus ensure having the necessary prerequisites to prevent disqualification or missed business opportunities owing to being perceived as not local enough.

**Ensure an adequate product offering and reduce cost**

The Chinese market is becoming increasingly characterized by strong price focus and changing customer behavior. The main priority in the mid-market should therefore be to produce the “right” product rather than the “best” product. Local R&D and innovation units for product development will consequently be important elements for ensuring a relevant product offering and staying up-to-date with customer preferences.

**Optimize your governance model and empower the local management**

In approaching the mid-market as well as the premium market, implementing a local governance model that ensures speed in decision making and action is a necessity to stay competitive. Business Sweden recognizes that the ways in which many Swedish companies’ governance models traditionally are organized are rarely aligned with the needs of the Chinese market.

As an example, a considerable share of Swedish industry is already operating in China with local production and local innovation and R&D units. These units are, however, often incorporated into a traditional global governance model – a model usually too slow and complex to keep up with local competition. The result of this is that the merits of local R&D units do not reach their full potential and are in many cases wasted. Hence, streamlined operations are to be prioritized with reduced overhead costs. The local R&D unit should have the mandate to initiate own projects, develop local offerings but foremost to bring the much needed speed into the process required for faster time-to-market.

Finally, this is very much about a shift in mind-set. Competitiveness will require an attitude of “In China for China” and will increasingly be led by Chinese. Success in the market will be a result of an operation at the same cost level and speed as domestic companies, while maintaining market leading technology, solutions and brands.

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“Localization is important in the current political environment. More and more Chinese customers are driven by nationalistic goals, especially in public procurements.”

Gregoire Blaise
Volvo Bus
CASE STUDY: Alfa Laval

Recognizing the limitations of western matrix organizations in the Chinese context, Alfa Laval has reviewed its governance model and made a number of changes in order to stay competitive. Some of the global processes can now be bypassed and Alfa Laval’s China president has direct access to the CEO for quicker decision making. Furthermore, the local R&D team in China has been given a larger mandate while still being part of the global R&D team. This provides a good dynamic as it increases two-way learning. More than ever before, Alfa Laval is running the company with a local management team which ensures continuity as well as thorough local understanding.
INNOVATION AS A SERVICE

Your innovation capability is your strongest asset

China has recognized innovation as one of the key elements that will take their economy to the next level of development. New innovative technology is used to bring productivity growth and many of the clients of Swedish companies today already have, or could acquire superior technology. An industry reaching a higher level of maturity put larger emphasis on, and increased demand for, services. In addition, the in-house R&D efforts of Chinese companies also evolve, but these are yet to pay off since most companies do not achieve innovative strides beyond incremental improvements or product development. This is a situation that creates a unique opportunity for Swedish companies to truly influence and reshape future industrial development. In moving forward, it will therefore be important to leverage all aspects of Swedish innovation capabilities.

Bring a higher degree of end-user lead innovation to China

Many Swedish companies would benefit from bringing a higher degree of end-user lead innovation to China. Companies need to expand their innovative capabilities further down the value-chain all the way to end-users or end-customers, for example by connecting existing products to end-user feedback or together with your partners define end-user issues. This will lead to a positive influence on customer needs, create a better position for products and brand recognition and ultimately also on industry standards or trends.

Furthermore, the most innovative local staff should to a higher degree be involved with end-user interactions, for example by being moved from R&D to your customer’s sales force or market department. This way you can influence your industry development and priorities of your customers, as well as keep building strong relationships. Eventually the market influence and goodwill will result in increased sales as well.

Further investments will be needed

Developments will likely increasingly turn from product centric to service centric and put larger emphasis on know-how or other intangible asset being put into the final product offerings. Innovative services should here be integrated into the offering, rather than being viewed as a stand-alone service to the product. Swedish companies can help their Chinese customers reach higher productivity or efficiency through know-how rather than just technology or products. Expanding and commercializing of all aspects of your innovative capabilities in China may initially need investments in highly skilled innovative resources locally, but this capability is so attractive that customers are likely to pay for the contribution.

Winning collaborations will come from using your innovative capabilities to enhance your customer’s abilities and help them differentiate themselves by being innovative. Involve partners, suppliers and customers to a greater degree of participating in the local value creation processes. Innovation is then co-produced with clients and founded in projects rather than lead by your R&D management. But also adhere to what your Chinese partner can bring to the table in terms of rapid application, cost-cutting processes, logistics and marketing capabilities etc. This is especially true when entering the mid-market where new products can be developed together with your partners. Swedish companies could then bring a more business model driven approach to support the partners in developing their offerings.
“THE TIME IS NOW FOR SWEDISH COMPANIES IN CHINA. INNOVATION IS A TOP POLITICAL AND BUSINESS PRIORITY, AND SWEDEN IS A WORLD LEADER IN INNOVATION”

Fredrik Fexe
Vice President, Strategy & Business Development, Business Sweden
**ACQUIRE AND EXPAND**

**A new segment calls for new measures**
The mid-market is attractive due to its size and growth rate. Chinese companies in this segment are extremely competitive and characterized by their speed, flexibility, low-cost structure and capacity to handle large volume business and can rapidly pick up on and respond to domestic trends. When entering the mid-market, this skillset needs to be at level or be obtained. Past experiences show that foreign companies typically struggle to organically develop the right organization and setup in-house. Instead, adopting an acquisition strategy is a short-cut and the most effective way to truly penetrate the mid-market.

Moreover, the recent protectionist tendencies, illustrated by the “buy local” directives, will risk to exclude companies which are not perceived as local enough. Being a truly local company will improve the odds of being fully competitive in the changing business landscape and stay relevant in public procurement processes.

**Depth in product offering to stay relevant**
Stripping away features of premium products have proven difficult as a mean to enter the mid-market. These new “standard” products are often loaded by the same R&D cost, western overhead levels and components from the same suppliers. Consequently they seldom become relevant or profitable on the more local mid-market, instead these products risk cannibalizing on the original premium offering. An acquisition of a local company may work as an alternative and can provide the necessary depth in the product portfolio as well as bring the established distribution channels to new customer segments and complementary brands positioned for the mid-market.

**Expand rather than integrate**
In order for the acquired company to stay relevant and competitive they should keep operating as standalone companies. The traditional western model of post-merger integration is deemed to hamper the acquired company and ultimately defeat the purpose of successfully entering the mid-market. The capabilities and strengths of the acquired company need to be maintained and upgraded. Expand is the key word in the sense that the Swedish investor can contribute with operational improvements, provide innovation support (although two-way learning certainly will be relevant) as well as strong brand building skills. Implementing western management practices typically suffocate the Chinese company due to the much higher overhead imposed, for example by implementing global IT-systems or back-office functions. One needs to remember that the mid-market is generally characterized by high volume sales and lower margins, but also that the competitive cost structures of local companies do not only come from lower salary levels. By bringing western management philosophy to these Chinese companies they risk losing their local profile and competitiveness.

> Many do it wrong. They acquire a Chinese company but then they do not preserve what works and differentiates the acquired company.

Ulf Söderström
SCA
CASE STUDY:
Atlas Copco
Atlas Copco has today around 30 fully owned companies in Mainland China. A few of them were started as joint ventures in the early 1990s, but most have been 100 per cent owned from the start, either through organic startup or through acquisition. The acquisition strategy has focused on entering and penetrating the mid-market and today the Atlas Copco group in China includes several local Chinese brands as well as a number of regional and global brands. The local brands must keep their cost competitiveness and therefore the integration should address the environmental-, legal- and ethical compliance issues, but as much as possible leave out the heavier internal business processes to avoid adding unnecessary overhead cost on top of their operations. The synergies with the current operations can balance additional compliance costs and result in upgraded and expanded capabilities. It has been important to keep what have made these companies successful in the first place, while also supporting them to upgrade. Not always an easy balance.

This approach of “acquire and expand” has increased the depth in Atlas Copco’s portfolio and enabled a more complete offering, ranging from the premium to the mid-market. The mid-market products can also serve as a door opener, providing a chance to enter into the discussion about the best solution and a good opportunity to differentiate the premium offer. Furthermore, it has enabled Atlas Copco to better get to know the local competition and compete with them head-to-head for delaying their entry into the premium segment.
TRADE YOUR GLOBAL SALES CHANNEL

A new generation of partnerships
In the past, many partnerships were entered into due to access restrictions in the Chinese market. Market access was given in exchange for technology transfer or majority joint venture stakes. The experience has left many Swedish companies with a bitter taste and understandably an aversion towards joint ventures. The next generation of partnerships and joint ventures need instead to serve the purpose of disruptive market growth. The future cooperation should cater for true win-win partnerships in the market growth space and strive to be less complex than the previous joint ventures for factory operations.

Exchange for overnight access to the mid-market
The high political importance of the “Go Out” strategy in China means that succeeding abroad comes with prestige and status beyond monetary value. Any foreign company supporting a Chinese company in this quest will be rewarded in the Chinese market. The point is not to help creating a global competitor, but to partner with a company that has a complementary offering, but relevant to the same customers.

The basis for “trade your global sales channel” is a strategic win-win partnership. Since Chinese competitors are closing the technology gap between themselves and their global competitors, what a Chinese partner stands to gain from a Swedish company today is essentially the legitimacy provided by international brand recognition, as well as marketing and global sales channels. Many leading Swedish companies can offer this and in exchange get access to the mid-market in China overnight, with access to new customer segments and a reach that would be impossible to build up organically.

“Export is a strategic priority for local companies, and they can benefit from foreign partners to succeed fast in the overseas market”

Gregoire Blaise
Volvo Bus
CASE STUDY: SCA

In 2007, SCA took a 10 per cent pre-IPO stake in Vinda as a pure financial investment. Over the years, the companies have started working more closely together and in 2013 SCA increased its shareholding to 51 per cent of Vinda who is now fully consolidated into SCA’s financials. The two companies truly complement each other with Vinda’s leading position in the Tissue business in China and SCA’s experience from Personal Care business globally.

Through its stake in Vinda, SCA has virtually overnight ten-folded its sales network across China, from 30–35,000 points of sales to more than 300,000. In return Vinda has reached the South East Asian market through SCA. Vinda is now responsible for running the operations in both China and South East Asia, while SCA provides expertise in terms of innovations, marketing and brand building. In this way the strengths of the two companies can be leveraged even further in Asia.
The success of Swedish companies in the New Normal will be highly dependent on joint ventures and partnerships. Strategic collaborations will be essential in moving forward and enabling Swedish companies to gain leading positions on new markets; the cornerstone for all of the elements described above.

**STEP UP YOUR JOINT VENTURES AND PARTNERSHIPS**

**A new purpose**
The main purpose of joint ventures and partnerships in the New Normal should be to open up new opportunities in the mid-market. Future collaborations will therefore need to have a wider purpose than previously to fully benefit from the capabilities of both parties. The focus of future collaborations should shift to a market-oriented rather than a technology and production-oriented exchange. What is needed in the mid-market are the capabilities of a Chinese partner with established sales and service networks and a deep level of customer understanding as well as local economies of scale.

**Identify your partner**
When seeking a partner, aim for a collaboration that will provide the prerequisites to operate on a market that places increasingly high demands on domestic production, brands and ownership. Be bold in selecting a partner with both significantly higher volumes and larger market footprint than your current operation.

**Joint ventures and partnerships with a forward-looking approach**
Many Swedish companies have found from previous experience that joint ventures and partnerships with local players can be both complex and challenging. However, in the past many joint ventures and partnerships were set up for the main purpose of satisfying industry-specific policy requirements and regulations, and they functioned as a means of access in exchange for technological solutions. Future joint ventures and partnerships should be initiated on the basis of an optimistic outlook of market expansion.
CASE STUDY: The Volvo Group

The Volvo Group’s 45 per cent stake in Dongfeng Trucks makes Volvo the world’s largest manufacturer of heavy-duty trucks. The Volvo Group will gain a significant foothold in China with access to a strong sales and service network throughout the country. By pooling purchasing power and local sourcing as well as sharing development costs for the next generation of engines, transmission systems, components and future technology, the competitiveness of the two truck brands can be further strengthened and their profitability will increase. Moreover, by upgrading the technology and developing the Dongfeng brand to make it a major brand in the global commercial vehicle market, the major upside for Volvo in this partnership is that they will share the profits.
A WINNING STRATEGY IN THE NEW NORMAL

The current business climate in China is very different from what Swedish industrial companies encountered when they initially established themselves in China. The current market shifts are triggering a number of changes that will affect future business in China. With a significant share of Swedish industry dependent on China, conditions on the Chinese market are of importance to Swedish industrial development, further increasing the relevance of future growth there.

The New Normal is putting global players under increasing pressure in China, and it is evident that proactive and bold action is required so as not to fall behind. Companies which continue to rely on former recipes for success and traditional governance models are taking a passive approach to the economic slowdown and will fall behind. Future success in China will be highly dependent on the ability to stay agile to the new and changing local requirements. Priority should also be given to striking a balance between the relative shrinking of the premium market and the increasing significance of the mid-market.

In order to ensure continued success in China, Swedish companies need to establish an operational platform that accounts for current market conditions, with high speed in decision making and time-to-market. Winning companies need to find ways to protect and maintain the premium market position as well as proactively approaching the growing mid-market. Swedish capabilities are robust and continue to offer a number of valuable differentiators vis-à-vis China. Optimizing these capabilities will be one of the key measures to ensure future advancement. Furthermore, changing customer behavior and domestically-driven policies increase the importance of remaining allied with domestic players.

The new China growth platform for Swedish industry will continue to build on world leading innovation capabilities, leveraged close to customers and end-users in joint ventures and market partnerships.