



Executive
Perspectives

JANUARY 2021

The China growth opportunity

Six things to know for business leaders

Preface

focus of this document



A lot has been said and written about China and its relationships with the rest of the world, especially in light of the COVID-19 pandemic that unfolded in early 2020.

This document provides a fact-based, economic perspective on China. It discusses economic growth opportunities in China and highlights what we identify as key implications for business leaders.

Undoubtedly, the trajectory of the economic development in China has been very dynamic over many years. Despite COVID-19, the past year has been no different, and we expect this dynamism to continue in the years ahead.

Six things to know about the China growth opportunity

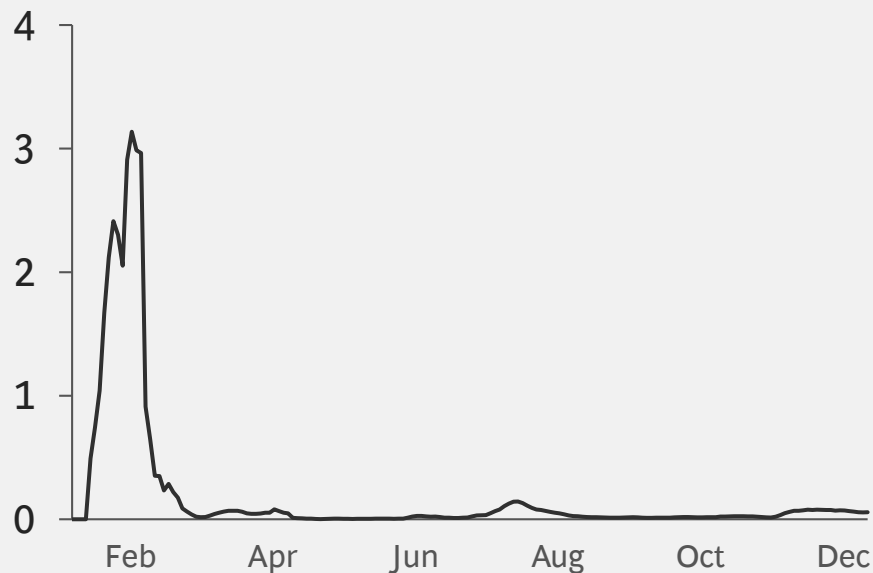
- 1 Specific COVID-19 steps have supported a quick rebound; the economy is back and will likely contribute **25-30% of the world's GDP growth over 2020-2030**
- 2 Behind the rebound is a structural shift in the economy towards **domestic consumption** – with 78% of the economy to be driven by consumer growth, **services, and innovation**
- 3 China has transformed from a low-cost manufacturing center to a **growing hub of business model and technology innovation**
- 4 **The trade war and decoupling** will have multiple consequences that will need to be managed but will not necessarily slow down growth
- 5 China's **commitment to the Paris Accord and the Net-Zero 2060 goal** will drive massive investment, innovation, and partnership opportunities
- 6 The **14th Five-Year Plan** will solidify focus on specific areas to drive growth

China has taken a very different approach to COVID-19 and has largely contained the impact since the initial Q1 shock

As of 31 Dec 2020

Cases in China peaked in February '20 but have been on a decline since with no major resurgence

Daily new cases per million¹



1. 7 day rolling average; 2. 14 days and two consecutive negative nucleic acid tests before being released from quarantine
Source: Our World in Data; BCG analysis

The government established control measures that restricted the epidemic to a relatively low level of cases

Dynamic regional & border control

- **High-, medium-, and low-risk regions** classified
- Border control: **quarantine** and **double tests**²

Rapid testing infrastructure

- **14K health checkpoints** in Wuhan & Hubei
- **Immediate & massive testing** in hotspots

Systematic multi-level isolation

- Special **hospitals for COVID-positive** people
- Close contacts: **home quarantine** for 14 days

Health code & monitoring

- Management of public areas with **QR codes**
- **Efficient tracking** of close contacts

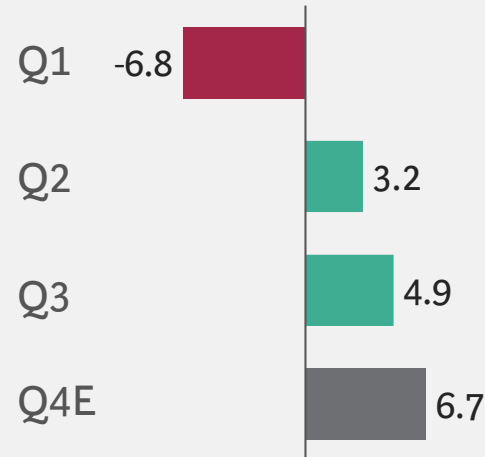
Change in health habits

- **People wearing masks in public** – even with 0 cases in many areas

China's economy had a quick recovery in 2020 and is expected to be a major contributor to the world's GDP growth in the future

Although GDP took a hit in Q1 '20, sectors rebounded quickly in a phased manner

Performance '20 vs. '19 (%)



Sectors rebounded

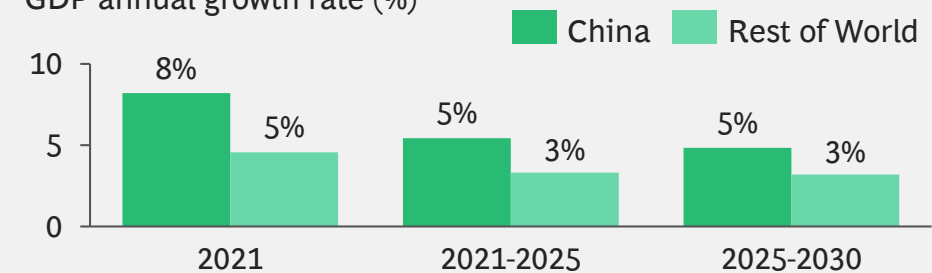
- Necessities, medicine
- Electronics, finance
- Auto, lux, liquor, real estate, infrastructure
- Consumer services, logistics

China's GDP growth expected to be +2% in 2020 vs. -4% for world¹

China's GDP is poised to demonstrate robust growth over the next decade

- 1 China is expected to be the only major country with **positive GDP growth** in 2020-21
- 2 From 2020-2030, China will deliver **25-30%** of the world's GDP growth

GDP annual growth rate (%)



Source: IMF, World Bank, OECD

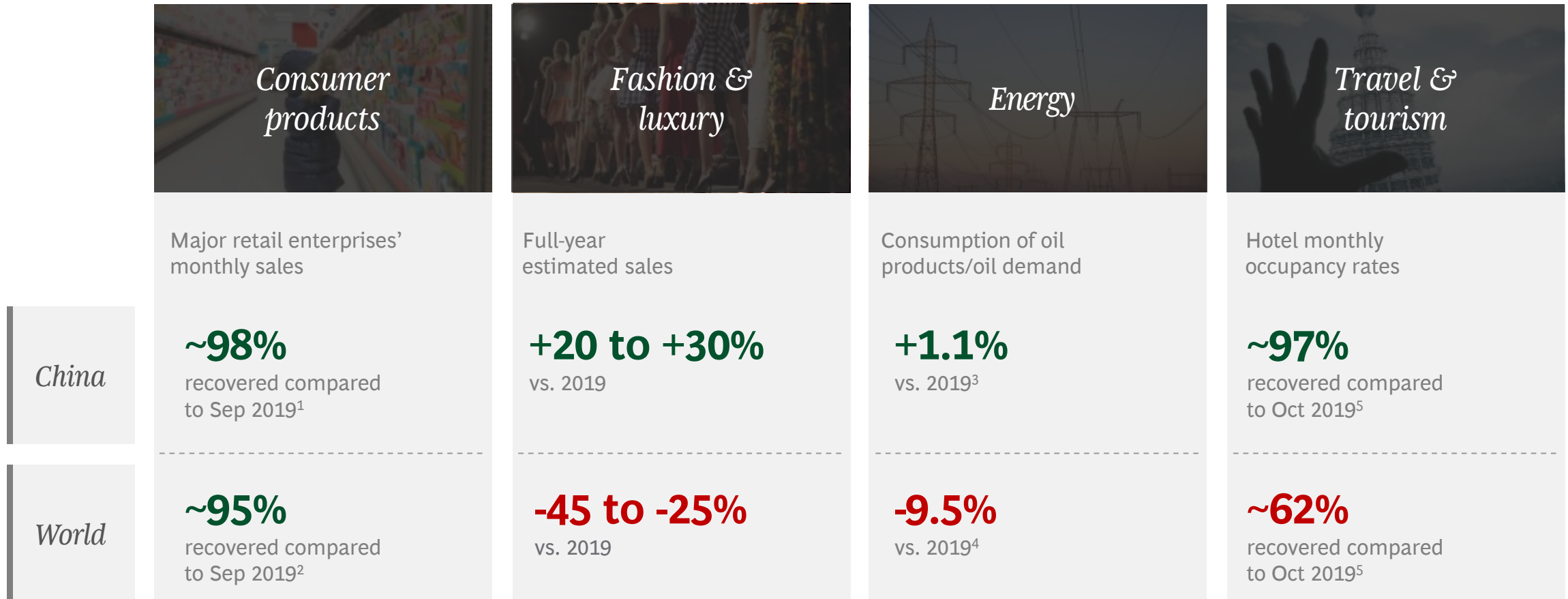
China is expected to account for ~20% of the world economy by 2030

1. China and world GDP growth forecasts are based on base case, a combination forecast with most recent data, global institute reports and BCG analysis
Source: IMF, World Bank, OECD, BCG analysis

Industries in China are demonstrating resilience and faster recovery compared to the world

ECONOMY

Non-Exhaustive



1. Major retail enterprises referring to 100 brands on the list of PRC Ministry of Commerce, recovery defined as YoY, data as of Sep; 2. Data as of Q2; 3. Consumption of refined oil products, cumulative value; 4. World oil demand; 5. Data for Oct 2020 compared to Oct 2019

Source: PRC Ministry of Commerce, Oxford Economics, 2020 BCG x Tencent Digital Luxury Report, OECD, J.P. Morgan PMI index, China National Bureau of Statistics, OPEC, STR Global, UNWTO, BCG

China is shifting from being the "World's Factory" to a consumption-driven economy

Before



Huge **infrastructure investment** by government



"**Factory of the world,**"
export orientation



Future



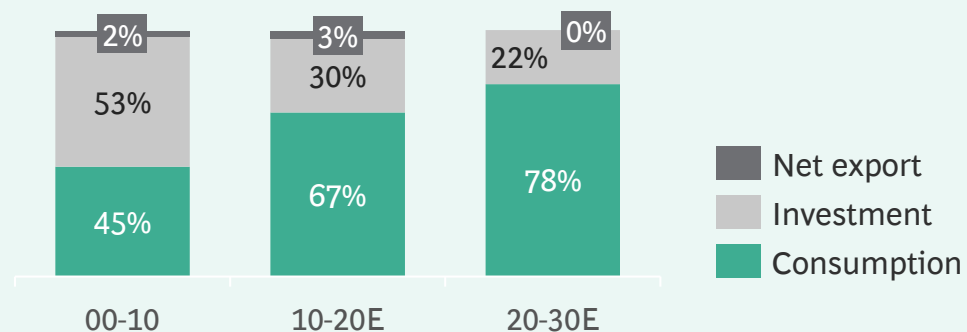
Growing **middle class** with
increasing **domestic consumption**



Diversified industries with **vital commercial services**

Increasing contribution of *consumption to GDP growth*

China GDP growth structure (%)



[...] As labor and land costs are growing [...], China is transitioning to a [...] services & consumption-driven economy.

- *China Briefing: Leading Trends in China's Services Sector after COVID Disruption, 2020*

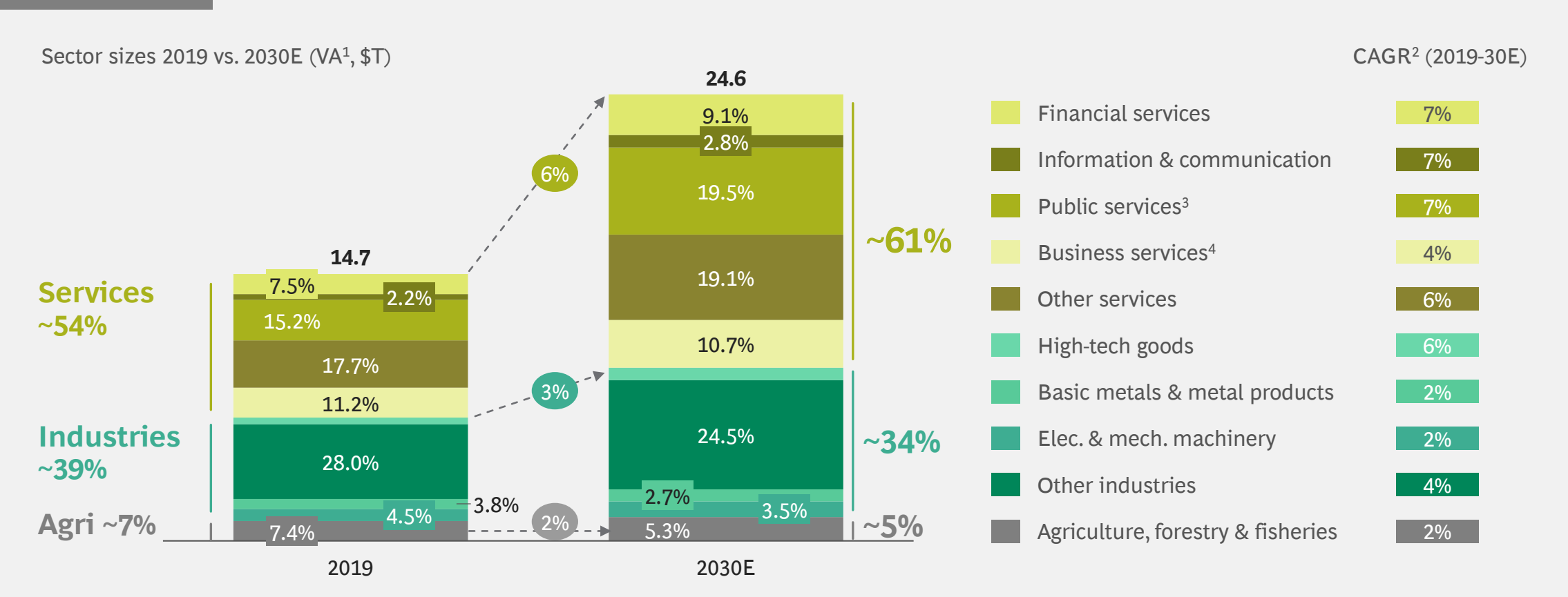


Benefiting from rising household income and technological advances [...], consumption & services have emerged to be the new engines for [...] economic growth.

- *S&P Global: China's New Economy Sectors: How Are They Doing?, 2020*

Services sector is expected to play an important role in driving China's growth over the next decade

Services estimated to contribute ~61% of GDP in 2030, up from ~54% in 2019; financial, information & communication, and public services fastest growing



1. Value-added output is a measure of the value of all the goods and services produced in a sector or industry, excluding the value of intermediate consumption. Real value-added is expressed in constant prices (adjusted for inflation and exchange rate movements); VA is in USD billions at 2015 prices; 2. CAGR is based on value-added output; 3. Public services includes public administration, defense & social security, education, health care & social work; 4. Business services includes real estate activities, R&D, leasing, legal, professional & maintenance services

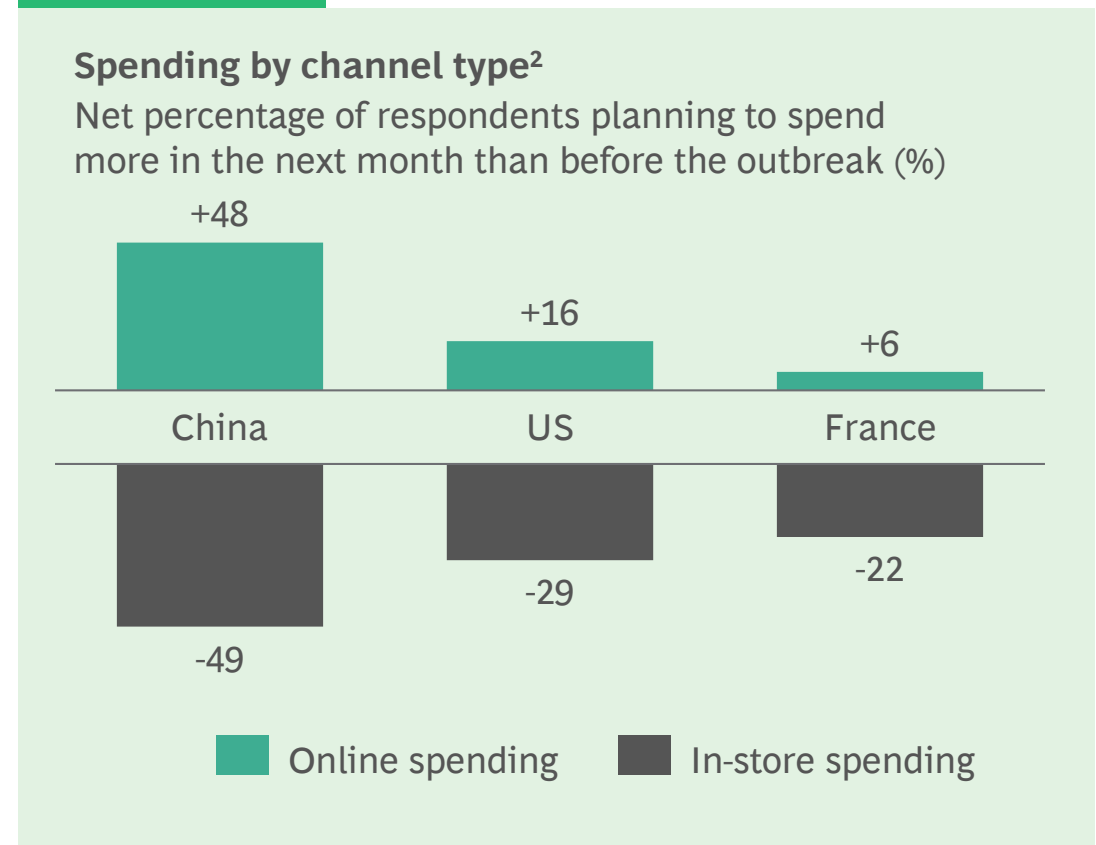
Source: Oxford Economics

Chinese consumers recognize the benefits of technology and are optimistic and ambitious

Top 10 attitudes among Chinese customers¹

1	I live a richer life because of technology	90%
2	Important to be respected by others	89%
3	Work-life balance is important	89%
4	Children will have a better life than me	86%
5	Plan finances independently	86%
6	Optimistic about future	86%
7	Connection to cultural heritage	85%
8	Structure my time to meet commitments	84%
9	Career is important	84%
10	Relaxed and easygoing	83%

High digital & online spending is a strong dynamic in China's rebound



1. Based on the question "How strongly do you agree or disagree with the following statements?" across 56 statements, % of consumers who agree with the statement

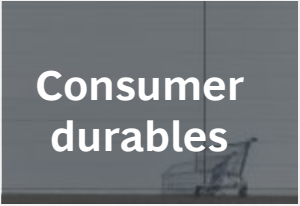
2. Question text: "In the next month, what do you expect your spend to be relative to before the coronavirus outbreak?"

Source: BCG CCI Global Consumer Attitudes and Needs research, China (N = 9100), September 2020; BCG COVID-19 Consumer Sentiment Survey, July–August, 2020 (N = 3,100–3,800), unweighted, representative within ±3% of census or national demographics

Manufacturing supply chain shifts are visible – some sectors are moving out of China whereas others are being reinforced

Export-oriented manufacturing industries diversifying supply chain

Selected examples, non-exhaustive



Consumer durables

Korean white goods maker moved **production of refrigerators** for US from China back to **South Korea**



Apparel

US **apparel maker** moving supply chain **out of China**; US imports from China dropped from ~40% to ~22%


High-end manufacturing industries reinforcing footprint to meet domestic demand

Selected examples, non-exhaustive



Automotive vehicles

German auto OEM increased **production in China** instead of exporting from US to meet demand



Telco equip. & semiconductors

Japanese electronics company expanding **production in China** to meet local demand esp. for 5G infra.

Three potential trade and geopolitical scenarios that need to be carefully observed to understand implications

	<i>Pessimistic Scenario</i> Decoupling	<i>Base Scenario</i> Perpetuation of status quo	<i>Optimistic Scenario</i> De-escalation of trade war
Situation	<ul style="list-style-type: none"> • Trade war escalates, Chinese companies blacklisted • Escalation in South China Sea & Taiwan • EU ends up leaning on US 	<ul style="list-style-type: none"> • Less aggressive protectionism by US & China for global leadership • Europe & China continue ties 	<ul style="list-style-type: none"> • Trade war de-escalates; globalization rebounds • Competition to become world leader in next-gen technologies continues between US & China
Trade Flow	<ul style="list-style-type: none"> • Strong decrease of trade flows between blocs • China trade decreases 	<ul style="list-style-type: none"> • Trade more resilient than expected • Trade with US and EU decreases, compensated for by trade with ASEAN nations 	<ul style="list-style-type: none"> • Trade flows continue to grow • More diversified trade, more intra-Asia trade & nearshoring
China GDP Growth	<ul style="list-style-type: none"> • Estimated at 1.6% in 2030 	<ul style="list-style-type: none"> • Estimated to be 3.5-4.5% in 2030 	<ul style="list-style-type: none"> • Stabilizes at 5.5-6% in 2021-2025 & at 4.5-5% in 2025-2030
Impact on Sectors	<ul style="list-style-type: none"> • Increased import restrictions on multiple industries • Encouraged local consumption 	<ul style="list-style-type: none"> • Electronics most exposed • Other manufacturing faces moderate risks 	<ul style="list-style-type: none"> • Continued boom in tech., healthcare, consumer sectors

The 14th Five-Year Plan is under development and will shape priorities

As of 05 Jan 2021

Innovation-driven development



President Xi's New Year Address clearly underlines the direction for Chinese economy to **focus on innovative growth**

Dual-circulation policy



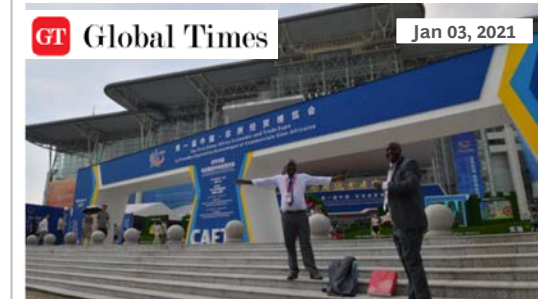
China to promote its dual circulation strategy by boosting consumption, forming strong domestic market

Opening up to foreign investors



EU and China announced the political approval of an agreement to open the Chinese market further to EU investors

International cooperation



China launched its 1st free trade agreement with an African nation, expanding its network of trade partners

Green agenda



Chinese President announced at the UN General Assembly that China aimed to go carbon neutral by 2060

Rural vitalization



Chinese government would undertake “a historic shift” to focus on comprehensively improving the rural economy in 2021.

Urban development



China promotes high-quality development of cities in 2021, while building livable, green, resilient, smart and cultural cities

Economic system's quality



Beijing has rolled out more measures aimed at increasing efficiency of China's capital markets & quality of its companies

Key implications for business leaders in light of the China growth opportunities



A

Increase focus on new drivers for economic growth

- 01 Tailor offerings to evolving demographics (e.g., fresh e-commerce for digital natives)
- 02 Rethink China strategy in line with opening up of sectors to foreign investors
- 03 Ride the consumption boom in China and evaluate potential offerings and opportunities

B

Keep pace with changing consumer behaviors

- 01 Learn best practices on innovative retail formats and digital use (online & offline)
- 02 Double down on growing demand consumption areas (e.g., health and wellness)

C

Use innovation as a growth engine

- 01 Leverage China as a source of tech innovation (e.g., by establishing innovation centers)
- 02 Adapt business model toward increasing tech-driven consumer behaviors

D

Drive a sustainability agenda

- 01 Explore sustainable investment & partnership opportunities emerging out of Net-Zero 2060 goal

A.02

Rethink China strategy in line with opening up

Focused agenda to improve business environment

Policy reforms to attract foreign investors

Foreign companies increasingly entering & expanding

Joint ventures commonly used for localized approach



Leaders need to evaluate opening-up opportunities & adjust China strategy

Improvement in business environment

Ease of doing business ranking:

2018		2019		2020
No. 78	>	No. 47	>	No. 31

8 key business reforms for better business climate

Joint ventures utilized for localized approach

- Ease of navigating local formalities, cultural know-how
- Access to partner's existing network



Examples | China announces plans for 3 new FTZs in Beijing, Hunan & Anhui (Sep'20)



- ~25% of Beijing FTZ to host a global startup innovation center
- Advanced manufacturing clusters to be set up in Hunan & Anhui

Examples | International players increasing presence in China



- US auto player opened first non-US factory in Shanghai (Sep'20)
- Leading financial institution held "cloud opening" in Shanghai (Mar'20)

Systemic interventions to attract foreign investors

Non-exhaustive

Regulatory: Foreign Investment Law, 2020, National & FTZ¹ Negative Lists (2020)

Financial: Tax cuts and direct financing

Economic: 18+ new Free Trade Zones

1. Free Trade Zone; lists imply fewer restrictions
Source: Doing business report 2020, World bank; BCG analysis

B.01

Learn best practices on innovative retail formats & digital use

Accelerated adoption of digital sales channel

Strong penetration of digital in offline retail

Innovative formats arising for e-commerce sales



Leaders need to experiment with innovative formats to succeed in China and be at the digital forefront

Strengthening the customer experience through a variety of innovative digital and offline channels and formats

Livestreaming shows	KOLs/KOCs ¹ recommend, consumers place orders live	Short video	Consumers watch KOL/KOC ¹ videos, click link & place orders
Online to offline	Consumers place orders online & product is delivered to door	Unmanned retail	Consumers purchase in vending machines
Community e-commerce	Community leaders initiate group purchase, consumers join	Social customer to cust.	Direct peer selling through social e-commerce platforms

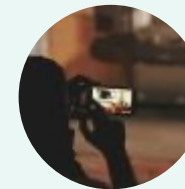


Example | China's shopping center group places AI robots



- Shopping group replaced info center staff with **AI robots**
- Wide range of services through robots (e.g., **store navigation**)

Example | Chinese electronics company demonstrated products in a livestream show



- **2-hour livestream show** with founder (Aug'20)
- **50M viewers & \$30M sales** in smartphones & TV

1. KOL - Key Opinion Leader, KOC - Key Opinion Consumer
Source: BCG analysis

B.02

Double down on growing demand consumption areas

Increasing consumer preference for health & wellness categories

Companies launching products into these categories based on shifting consumer demand



Leaders need to refresh their product portfolio in line with changing consumer demand

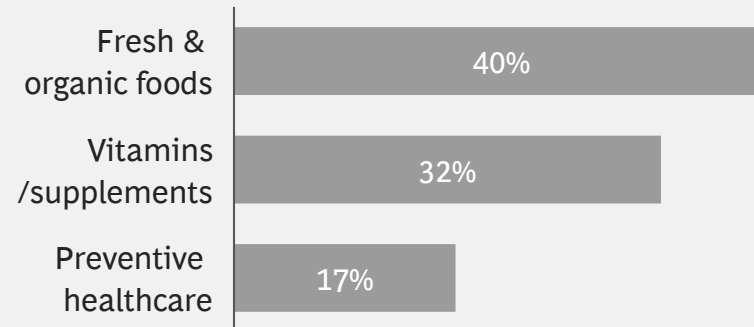
Chinese consumers, especially younger shoppers, focus more on health

70% of Chinese internet users consumed more health products during the pandemic¹

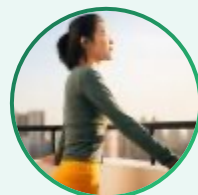
76% of affluent millennial Chinese consumers focus more on wellness than their parents do²

Health-based categories saw an uptick during COVID-19

% of consumers who claimed they purchased more expensive brands or products due to the virus³



Example | Leading F&B multinational launched healthy superfood drinks in China



- Uses technology to enable personalization of **healthy superfood drinks**
- Made with **100% natural** ingredients & recyclable packaging

Example | Chinese dairy giant launched new products to meet evolving consumer needs



- Launched **enhanced-nutrition** & sugar-free milk variants due to rise in consumer focus on health
- Developed **own big data platform** to use consumer purchase data to support R&D

1. As per April 2020 report by iiMedia Research; 2. As per 2019 survey by Singapore-based market research firm Agility Research & Strategy; 3. Question text: "How do you expect your spend to change in the next 6 months across the following areas?", exclude categories with N <~100; BCG COVID-19 Consumer Sentiment Survey, May 22-25 (N=2,963 respectively, unweighted, representative within ±3% of CN census)

C.01

Leverage China as a source of tech innovation

China evolving from low-cost manufacturing hub into a source of technology innovation

Attracting tech capital, and foreign companies establishing innovation centers

Focus on building new use cases of latest technologies



Leaders should consider leveraging innovations in China (R&D, tech hub)

Attracting tech capital

High-tech investment¹ (incl. seed/VC/PE), 2017-2020H1

Guangdong-Hong Kong-Macao Greater Bay Area

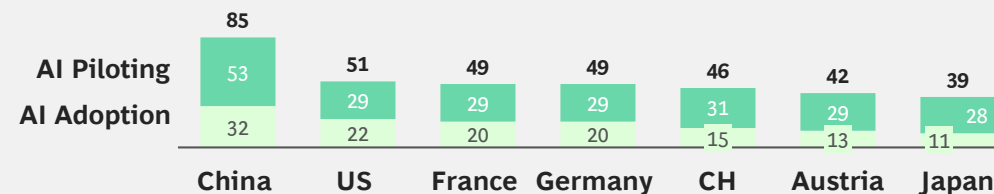
\$313B

US Bay area

\$231B

China is leading in AI progress

Share of active players in AI²



Examples / International players fostering innovation from China

German industrial manufacturing player set up innovation hub, including:

- **Digital innovation:** Implement & upgrade digital transf. for Chinese partner companies
- **Intelligent manufacturing:** Generate smart solutions through converging IT & manuf.
- **Internet of Things (IoT):** Collaborate with Chinese tech giant to build IoT infrastructure

US industrial conglomerate opened innovation center, including:

- **Joint product build:** Cooperate with Chinese company to build cheaper aircraft type
- **Smart logistics:** Provide smart solutions to increase productivity
- **Talent access:** Leverage additional high-skilled talent in China

1. Including AI, big data, AR, autonomous cars, life sciences, etc, 31 high tag vertical categories tags; 2. BCG Report "Mind the (AI) Gap". BCG surveyed more than 2,700 managers in September and October 2018, from a broad and representative spectrum of industries including consumer, energy, financial services, health care, industrial, technology, media and telecom, as well as professional services and the public sector. Source: Pitchbook, press search, BCG analysis

D.01

Explore sustainable investment & partnership opportunities

China emphasizing sustainability

Net-Zero 2060 goal & Paris Accord commitment

Opportunities arising across sustainability areas

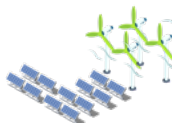


Leaders should leverage green investment options in China and learn best practices

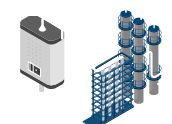
Selected sustainability opportunities



NEV¹: Push R&D, product strengths & penetration



Renewable energy: Scale up alternative power generation



Process optimization: Increase efficiency of energy utilization

International agreements, EU examples

NEV cooperation: Chinese & German companies co-build 100k charging stations

EU-China Energy Cooperation Platform (ECECP)

Chinese-European-Emission-Reducing Solutions (CHEERS)



Example | German car manufacturer

JV on R&D and production of **hybrid vehicles** in China

JV's **fully electric small car** to be **introduced** in 2022

Example | UK platform for energy & technology

JV between **UK & Chinese research centers** for offshore energy


Agreement to apply **UK tech-nologies** in Chinese market

Example | Australian resources company

Knowledge sharing with Chinese steel producer to **reduce emissions**

Australian player to invest **\$35M**

1. NEV = New Energy Vehicles, Source: Press search, BCG analysis



“ China’s fast recovery continues thanks to resolute measures in combatting the virus, mitigating its impact, and supporting growth... China will secure the recovery and ensure balanced and high-quality growth, which will benefit China and the world.”

—Kristalina Georgieva, MD of the International Monetary Fund

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