



China's challenge

Maintaining economic leadership in an uncertain world

Executive Report

Strategy

How IBM can help

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A renewed vision

China's economic growth over the past 30 years has been extraordinary. The benefits are manifest – from helping more than a half billion people transcend poverty to transforming China into a strongly urbanized society. However, if recent slower growth continues, the local and global implications could be significant. To better understand the challenges and opportunities before China, we surveyed 1,150 Chinese executives, who revealed a renewed vision for the Chinese economy. We establish specific actions for Chinese executives based on their particular roles in executing a transformation to help secure China's economic future.

Economic context

China's industrialization is unprecedented in scope and magnitude. From predominantly agrarian roots, China has become a global industrial titan seamlessly integrated into global supply chains. Hundreds of millions of people have been lifted out of poverty and into the middle class. Rapid urbanization has created a network of sophisticated metropolises across the nation characterized by robust infrastructure and interconnectivity.¹

China's economy today reflects a duality between those sectors exposed to intense market forces competing on a global stage in manufacturing or internet-oriented businesses, for example, and other areas of the economy dominated by state-owned enterprises.² Despite its manifest success, China's GDP growth over recent quarters has begun to slow. Commercial lending has not regained the peaks of the last decade.³

Economic frictions previously obscured by healthy global economic conditions have become increasingly visible, with rising calls for significant industrial restructuring and economic transformation.⁴ According to a recent IBM Institute for Business Value global skills survey, Chinese executives find it more and more difficult to acquire the right mix of people skills to address the needs of rapidly changing global and domestic economies. The gap between skills demanded and available as reported by executives is wider in China than in other competing economies such as Australia, Germany, the United Kingdom and the United States (see Figure 1).⁵



80% of Chinese executives want Chinese businesses to assume a leading role in new ecosystems.



78% of Chinese executives believe more aggressive deployment of new technologies will help transform the economy.



77% of Chinese executives look to encourage more entrepreneurship in the economy.

Figure 1

Chinese executives find it difficult to acquire a workforce with the right mix of skills



Source: 2016 IBM Institute for Business Value Global Skills Survey.

To better understand the challenges and opportunities facing China, the IBM Institute for Business Value in cooperation with Oxford Economics surveyed 1,150 executives from across China. Survey respondents represented a variety of industries and included executives from Chinese corporations, start-up enterprises, the government sector and educational institutions (see *Study approach and methodology* section). These Chinese executives summarize the current economic environment in China as encompassing five key challenges (see Figure 2).

Figure 2*China's executives spell key challenges to growth**Source: 2016 IBM Institute for Business Value Future of China Survey.*

Chinese executives identified the greatest constraint on the Chinese economy as the country's immature services sector, cited by 48 percent of executives surveyed. Forty-six percent highlight concerns that China's declining consumption rate is constraining growth. Forty-four percent believe that over-liberal lending decisions in some sectors are constraining available capital elsewhere. And 37 percent report declining export growth and issues created by environmental damage as economic challenges.

The survey results also reveal strategic opportunities for China to sustain its economic power and ways to accelerate an economic transformation. In this report, we not only share the executives' vision for a new Chinese economy, but also recommend specific actions to help spark growth and positive change. By focusing on strategic growth imperatives and initiatives to drive rapid change, Chinese leaders can help their country maintain control of its economic destiny.

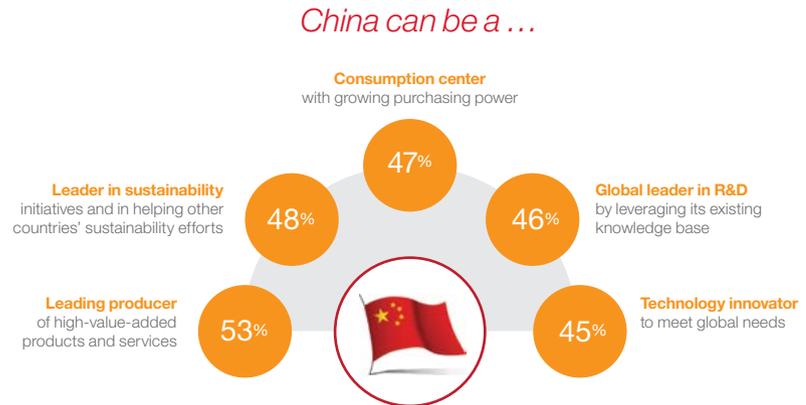
A vision for China

Despite challenges, Chinese executives are optimistic about the Chinese economy's ability to transform and thrive. They are confident in the country's economic growth prospects. In fact, 93 percent of executives believe China will maintain stable to high growth of more than 5 percent over the next five years. And of those, 23 percent believe China will be able to return to its recent very high growth rates in excess 8 percent.

The Chinese executives seem to appreciate, however, that this growth will require shifts in focus. We asked them to select the biggest areas of opportunity for the Chinese economy in the next five years. In doing, the executives identify five specific roles China can play (see Figure 3).

Figure 3

Chinese executives target areas of global economic leadership



Source: 2016 IBM Institute for Business Value Future of China Survey.

1. Leading producer of high-value-added products and services

Fifty three percent of executives see an opportunity for China to become a leading global producer of high-value-added products and services. For example, China could focus investments on high-value-added products and services and leverage integration within global value chains.

Some Chinese businesses already excel in this space. Alibaba, the global e-commerce giant, has diversified into other services such as cloud computing through Alibaba Cloud – Aliyun. Aliyun is already China's biggest cloud services provider and fourth biggest website hosting provider globally.⁶

2. Leader in sustainability initiatives

Almost half of those surveyed believe China could lead in sustainability initiatives, as well as help other nations become more sustainable. For example, China could prioritize adoption of new technologies and identify new applications to expand sustainability.

Numerous investments and initiatives are already underway that point toward leadership in this area, such as Goldwind's success in renewable energy. Founded in 1998, Goldwind is an international wind power company based in China. A leader in manufacturing wind turbine generators and associated wind power solutions, Goldwind overtook long-time market leaders in Denmark and the United States to become the global leader in new installation of wind power capacity in 2015.⁷

3. Consumption center with growing purchasing power

Forty-seven percent of executives envision China becoming a consumption center with increased purchasing power. Given China's high household savings rate, this transition will likely require concerted efforts to mitigate underlying reasons of excessive spending and actively encourage increased spending.⁸

As an example, consider Xiaomi, a Chinese smartphone manufacturer. The company recently embraced a strategy to boost sales that focuses on opening physical stores in smaller Chinese cities, where consumers are more comfortable buying from a retail store than online.⁹ By catering to an underserved population, the company could help drive consumption.

4. Global leader in R&D

Forty-six percent of Chinese executives see an opportunity for China to become a global leader in R&D by leveraging its extensive industrial capabilities and knowledge base. Many companies in China already have a deep focus on R&D, such as GREE Electric, a China-based white goods company. As part of its commitment to exploration, GREE rewards employees' achievements in technological and management innovation. It encourages investigation and tolerates the failures that inevitably result from continuous experimentation.¹⁰

5. Technology innovator

Forty-five percent of those surveyed believe China could become a leading global technology innovator. Achieving this goal involves encouragement of expanded entrepreneurialism and investment in technology or innovation-oriented education.

BYD has already assumed a global leadership role as an innovator in the electric vehicle space. The company, a leading provider of green energy technologies, has invested significantly in new types of automotive vehicles and has become one of world's largest rechargeable battery manufacturers. BYD is also the single largest seller of renewable energy vehicles in China, with 60,000 electric vehicles sold in 2015 and plans to double sales to 120,000 in 2016.¹¹

Prioritizing growth accelerators

In addition to asking survey respondents to identify opportunities for economic growth, we also sought their input on the best ways to accelerate economic change. The Chinese executives we surveyed identified six principal accelerators that might hasten China's economic transformation (see Figure 4).

Figure 4

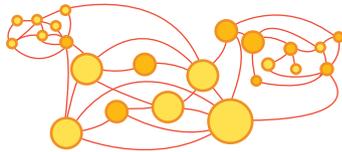
The survey revealed six key ways to accelerate China's growth



Source: 2016 IBM Institute for Business Value Future of China Survey.

Defining business ecosystems

Business ecosystems are complex groups of interconnected organizations possessing mutual goals. They are formed through engagement and interactions with each other and their environment, typically creating higher value for participants than would be possible if organizations operated alone.



1. Build ecosystems

According to 80 percent of executives, Chinese organizations should assume a leading role in building new business ecosystems to accelerate growth and economic transformation. Indeed, the 2016 IBM Institute of Business Value Global Ecosystem Study revealed that 93 percent of Chinese executives expect ecosystems will change the primary activities of their organizations. From the same study, 66 percent believe value creation within their organization will increasingly center around ecosystems, and one third predict that more than a quarter of their organization's business activities will occur within business ecosystems over the next few years.¹²

Chinese executives believe their organizations and the nation as a whole need to engage within emergent ecosystems in new and different ways. Of the Chinese executives we surveyed for this study, 78 percent indicate that business ecosystems are emerging across industries. Indeed, 83 percent suggest ecosystems will underpin the future growth of the global economy, and 75 percent believe that China as a nation needs to drive the formation of new business ecosystems.

Some Chinese companies have already started to embrace the ecosystem economy. Founded in 1999 as a provider of travel services, Ctrip constructed a business ecosystem platform to create an environment of integrated, compelling travel experiences aimed at consumers and businesses. Ctrip's integrated set of services, designed to appeal to the needs and aspirations of individual customers, has brought the company significant financial success, including public listing on the NASDAQ exchange.¹³

2. Promote innovation

Eighty percent of executives surveyed also suggest Chinese organizations aggressively promote expanded innovation. Creating and aligning business structures with innovation activities, cultivating a culture where innovation can thrive and building new processes that help translate ideas into innovation all support an innovation agenda.

Some Chinese companies are already heading down this path. Mengniu, a food company, is deploying cutting-edge technologies to accelerate innovation and enterprise transformation. Focusing on its two driving forces of globalization and digitization, Mengniu strives to build a win-win ecosystem. By working with business partners to leverage mutual capabilities in the areas of big data, social and mobile, Mengniu aims to break traditional industry boundaries and accelerate innovation.¹⁴

3. Transform workforce skills

Workforce transformation and skills improvement are key to accelerating economic transformation, according to 78 percent of Chinese executives. An imperative to expand, deepen and improve workforce skills would include creating infrastructure to nurture and share capabilities and expanding platforms to connect businesses more closely with universities.

Uniquedu, a leading education solution provider in China, is at the forefront of these types of initiatives. Uniquedu focuses specifically on educating software development professionals and project managers across a wide range of cutting-edge technologies through its Kaikeba online education portal. Backed by several noteworthy Chinese universities, Uniquedu offers more than 900 courses and appears primed for continued growth.¹⁵

4. Promote new technologies

Seventy-eight percent of executives believe that organizations should aggressively deploy new technologies to speed the transformation of their businesses and the economy in general. Identifying key areas in which new technology could most effectively be deployed; setting measurable goals; and engaging new partners to expand capabilities, markets and efficiencies all play a role in successful promotion of new technologies.

LOVOL, the largest agricultural equipment manufacturer in China, has certainly embraced new technology. The company applies IoT technologies to agricultural activities to promote vastly improved monitoring, control and decision management. Leveraging its R&D centers around the globe, LOVOL has created a new range of devices and platform that monitor equipment and collect real-time data, which can dramatically improve maintenance and repair, governance and efficiency. With these, LOVOL is now looking to gain market leadership globally.¹⁶

5. Transform education

Seventy-eight percent of Chinese executives believe that traditional education structures require fundamental rethinking. Education access, content, delivery mechanisms and quality all present challenges, but successful transformation of the education sector can be a powerful spur to improved workforce skills.

Geely automotive has found itself at the vanguard of an education transformation due to its deep commitment to industry training. Geely has invested billions of yuan to establish universities and colleges such as Beijing Geely University and Zhejiang Automotive Vocational and Technician College. With enrollments of over 40,000 students, these institutes offer nearly 10,000 graduates a year to China's automobile industry, including some with master's and doctoral degrees.¹⁷

6. Encourage entrepreneurship

Finally, 77 percent of executives conclude that encouragement of entrepreneurship is fundamental to the growth and development of their organizations and the economy in general. Initiatives to build broader, deeper startup ecosystems that encourage collaboration between startups and traditional business are central to achieving this objective.

An example of this type of collaboration can be found with Chinese smartphone manufacturer OnePlus, a recent but dynamic market entrant. OnePlus aligns with long-established titans to quickly scale operations and enter new markets. For example, as part of its plan to rapidly expand in India, OnePlus partnered with Foxconn to build devices locally. The company's goal is that 90 percent of devices sold in India are also made in India by 2017.¹⁸

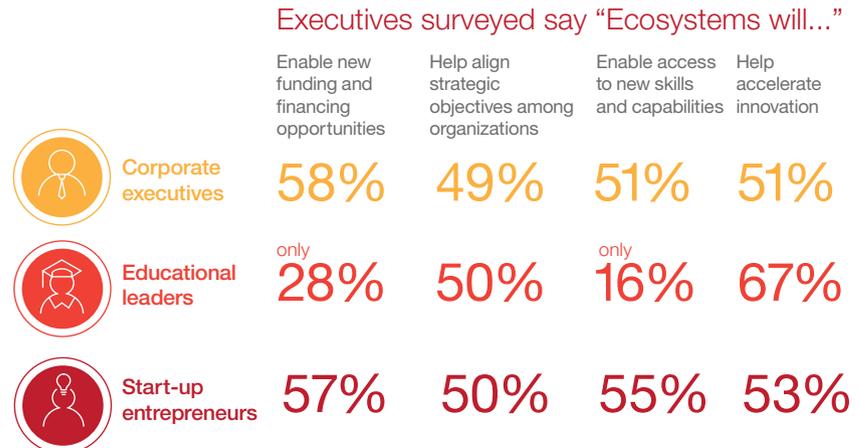
Toward a new vision

In looking at the six accelerators, we found building ecosystems to be foundational to the other five. Effective ecosystems can enable innovation, skills development, technology deployment, education reform and collaboration among entrepreneurs and corporations. Because ecosystems will play such an important role in China's future economic success, we asked survey participants about the benefits and power of ecosystems.

We discovered that China's leaders have unique perspectives based on whether they are from the corporate, education or entrepreneurial realm (see Figure 5). While there is relative consensus on the ability of emerging business ecosystems to accelerate innovation and help align business objectives, there is less agreement around other ecosystem attributes.

Figure 5

Different types of Chinese leaders have varying views as to the impact of ecosystems



Source: 2016 IBM Institute for Business Value Future of China Survey.

Regardless, leaders from each area can take positive actions to promote China's growth within the rapidly changing global economy.

Key actions for corporate leaders

Corporate executives in China recognize how ecosystems can expand and accelerate economic growth. To help transform the Chinese economy, we suggest they consider the following actions:

Lead with an ecosystem-centric view

Become proficient in new and emerging ecosystems, identify new sources of value and define what role your organization might play. In addition, scout for the right partners who can further the objectives of the organization and decide what types of relationships are to be built with partners, including startups.

Place innovation at the organization's core

Underpin all aspects of day-to-day business with innovation, from operations to customer interactions. In addition, embrace and deploy new digital technologies to build capabilities, establish fresh ways of operating and create new customer experiences. Also, look at whether investments in startups can help drive innovation and culture change by sparking an entrepreneurial spirit within the corporation.

Invest in developing employee skills

Act decisively to up-skill employees, with a particular focus on future-proofing and helping them adapt in an age of disruption. Additionally, invest in deepening employee soft skills – developing capabilities including collaboration, innovation and entrepreneurialism, among others.



Key questions for corporate leaders

How do you plan to connect with ecosystem partners to explore new opportunities?

How will you use digital technologies to pursue disruptive innovation?

How will you create an environment of agility and entrepreneurship within your organization?



Key questions for education leaders

How can higher education improve engagement and relevance by partnering more with industry?

In what ways can higher education better produce a more dynamic, agile, flexible workforce whose skills match or exceed those of leading global workforces?

How can new technologies be better leveraged to improve access, experience, variety and outcomes in higher education?

Key actions for education leaders

Educational leaders in China are less convinced about the broad benefits of ecosystems, in particular that they will enable access to skills and funding. While they do see how ecosystems can accelerate innovation, education leaders will need to become more comfortable with ecosystems' greater potential.

Below are recommended actions for education leaders to help drive economic leadership in China:

Benchmark to global best practices

Embrace global best practices in curricula, education methods and delivery by engaging with leading educational institutions globally. Also, assess existing curriculum to identify where opportunities and needs exist to infuse experience based learning techniques and new technologies.

Partner to extend capabilities

Build and expand alliances with industry partners to identify and validate needs or opportunities for specific skills. At the same time, work with industry partners to develop programs for real-world learning experiences, and foster support for investment in internships.

Reinvent education delivery

Identify and evaluate new opportunities to improve access, experience and variety through ecosystem partners that could not be realized acting alone. In addition, monitor, validate and embrace new disruptive technologies to improve education access, experience, variety and outcomes.

Key actions for entrepreneurial leaders

Start-up entrepreneurs have a strong belief in the transformational benefits of ecosystems, in particular their ability to enable new funding opportunities. Based on this, we suggest the following actions in moving forward:

Initiate new ecosystems

When venturing into disruptive products/services, actively assess potential partners from non-traditional industries. At the same time, conceive the full range of complimentary capabilities around new products or business models.

Organize for ease of participation

Design organization and operations with a view to readily plugging into ecosystem environments with other partners. Also, create opportunities for other, complementary ecosystem partners to easily integrate into your operations.

Augment value proposition

Rethink traditional business models with a mind to leveraging new capabilities of potential ecosystem partners. Pursue new markets, be they geographic, categorical or behavioral, that would be accessible through new ecosystem partners.



Key questions for entrepreneurial leaders

What benefits might you expect when you partner with traditional organizations?

How can you maximize value delivered to end customers through participation in ecosystems?

What organizational or other changes might you affect to be a better, more attractive partner to other ecosystem entities?

Conclusion

China already encapsulates one of the most rapid, impactful examples of modern industrialization. And the economic benefits for its own population and the world cannot be overstated. But China now faces a new challenge in its development. By recognizing the tidal forces impacting traditional industries and value chains, China can transcend current global uncertainty and establish a central role in the new ecosystem economy.

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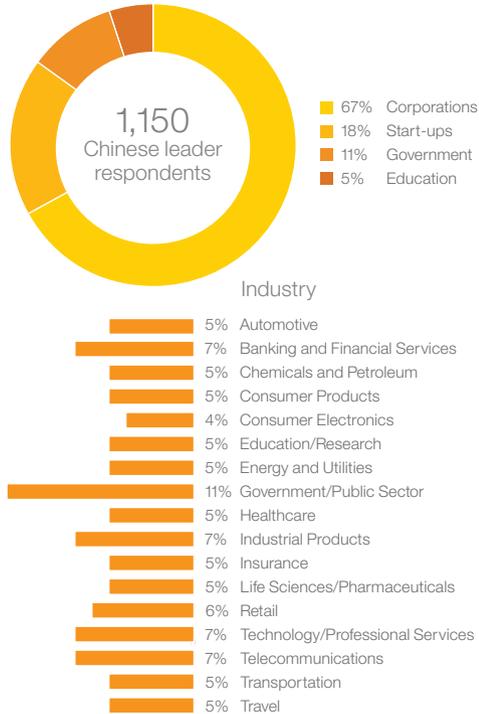
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Note: Percentage totals may not equal 100 due to rounding.

Study approach and methodology

In cooperation with Oxford Economics, the IBM Institute for Business Value surveyed 1,150 Chinese executives representing 17 industries. While the majority of executives were from Chinese corporations, survey respondents also included entrepreneurs in start-up enterprises, as well as executives from the government sector and academic or educational institutions.

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