

THE HUNGRY DRAGON

Trends and opportunities in China



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The Hungry Dragon – trends and opportunities in China

The growth figures of China have become a measure of the state of the world economy. The slowing demand in the world market is one reason China wants to diversify its sources of economic growth. In the future, China's growth can be powered by innovations, the booming service sector and quickly growing domestic demand. China can modernize its manufacturing sector and also boost private companies to embrace globalization. This report, which is based on interviews with leading Chinese experts and researchers, looks into the future trends of China as it enters the next phase in its long history. Special emphasis is put on the characteristics of the Chinese consumer market and the future Chinese consumer. The new China will offer many possibilities for Finnish companies in many sectors.

China as part of the world economy

Less than two decades ago, close to 100 million Chinese were living in poverty. Ten years later, the number was down to 30 million. China has raised itself, with double digit growth over many years into an urbanized, prosperous country with a big influence on the world economy, as well as also having an increasing say in world politics.

The Chinese growth numbers have become a symbol for the world economy. A large number of countries are directly dependent on the direction the Chinese economy takes. On many economic measures, China is now on a par with, or ahead of, the USA, the largest economy in the world. Even if the country is unlikely to see annual double digit growth again in the near-term, The World Bank estimates the growth to stay around six to seven percent, at least until 2018.

China has made clear steps towards the liberalization of its economy and the financial market. The direction is deliberate and the development will not be stopped. Many of the steps have increased China's influence in the international economy, like its membership in the WTO and most recently, adding the Chinese currency renminbi to the IMF basket of currencies. This adding of the currency, along with the dollar, euro and the Japanese yen, makes China, at least symbolically, a part of the world economy's big players. The next step might be getting the free market economy status from the European Union.

The huge growth numbers China saw from the beginning of the 2000s until recently, were due to heavy investing in the building, infrastructure and urbanization process, along with exporting manufactured goods produced with low labour costs and well organised logistics. However, as the world economy has taken a downturn, the revenues from this growth model are beginning to decline and come with a growing risk.

The demand for Chinese products is currently stagnant, in fact in many cases, the other growing economies in Asia are catching up as makers of low value-added goods. In infrastructure investments, the risks are growing, as they have been mostly financed by the central bank and state owned institutions with low interest rates. There is pressure to shift the emphasis in the economic growth model from infrastructure investment based growth to more modern, consumer demand, service sector and innovation driven economic growth. This will be the biggest challenge for China in the coming years and a major emphasis is being put on managing the transition by the government.

China opened its doors in the late 1970s under the leadership of Chairman Deng Xiaoping and has, in recent years, attempted to systematically increase its international influence to match its new economic status. Previously, China was reluctant to fully step into the international community, as it had been sensitive in letting other countries comment on subjects it considered internal matters. However, it can be seen that China is increasingly acting like a fully functioning market economy and is also learning to cooperate internationally.

The majority of Chinese people have benefitted greatly from the economic growth and have seen the benefits of the economic development in their everyday life.

That said, whilst the possibilities for an average Chinese person to increase their wealth has increased, the opportunities remain limited. There are over 13 million private enterprises in China. Small and medium sized companies produce 60 percent of the GDP, 80 percent of the jobs and over 30 percent of the exports. The possibilities for finance for private companies are limited in terms of negotiating a bank loan. Consumer credit is unknown.

Until now, the possibilities for Chinese private companies to fully benefit from the advantages of globalization have been small. In the Fortune 500 list of the biggest companies in the world, there are 98 Chinese companies, but only 22 of them are private.

Investing in property has been an important means of increasing personal wealth for the Chinese, but the possibility has been reduced due to the 30 percent deposit required for the loan. The stock market, however, has been attractive for many small investors. The market, however, has recently proved to be volatile and even more unpredictable than the situation in Europe.

During the Beijing Olympics, for example, optimism dramatically increased and the value of stocks rose to new highs. Since then, there have been several notable downturns, most recently in early 2016, as the slower growth numbers and mistrust in the government's efforts to keep the growth at sustainable levels spread concern among investors. This also resulted in capital flow abroad.

In the year 2021, the Communist Party of China will celebrate its centenary. Current President Xi Jinping will continue in power until 2022. His term and the celebrations for the party have to be, by definition, a success. Due to this reason and to maintain the current level of satisfaction among the Chinese people, it is important for the establishment to maintain the economic growth number steadily at around seven percent per annum.

The most recent five year plan will be published in March 2016. The outline was already made public in the autumn of 2015. It puts emphasis on economic reforms and sustainable economic growth. The means to achieve the goals are innovation, regional balancing, environmental protection and by deepening international cooperation. The decision to loosen the strict one child policy has created considerable publicity abroad, but it remains to be seen whether that will encourage couples to have more than one child, as the costs of living and education are continuously rising in the cities.

Chinese society has undergone a revolution

Chinese society has undergone a total revolution in the past 40 years. The speed of change has been so fast that when it comes to China, there is not just a gap between generations, but even people born just a decade apart can have completely different perspectives. The most common term used when speaking about generations in China is *balinghou*, which literally means people born in the 1980s. This generation has lived its whole life during the era of the one child policy and has experienced first-hand the leap from tightly regulated economy to free market economy. This generation forms the core of the working population in China and comprises the largest demographic of adults in comparison to other age groups.

The parents of the 80s generation, the Chinese born in the 60s, lived their young adult life in Mao's China. Their experience is altogether very different. It was a generation that experienced famine, the chaos of the Cultural Revolution and lived their whole adult life in a country closed off from the outside world. It is no wonder that the 80s generation feels the gap between itself and its parents most widely.

The 80s generation has grown-up listening to Korean pop music and watching American movies and commercials. They have seen the opening up of China and the possibilities of a market based economy. They are optimistic and believe in the individual, rather than the

collective. They have been riding the first wave of increasing personal wealth, but on the other hand, many have consequently not started a family, but instead have chosen to enjoy life and its possibilities.

The Chinese people born in the 90s have been labelled as ‘little emperors’ and ‘material girls’. They have been raised in a 4-2-1 family model where every child is looked after by two parents and two sets of grandparents. They are used to getting a lot of attention, but conversely, they also suffer from high expectations. Spending and seeking individuality through consumerism come naturally to this generation.

Children born in the 2000s in the cities have only experience of the wealthy, prosperous China. There will likely not be the same kind of age gap between children and parents like people born in the 80s experienced, but the difference might lie in trust whether the situation will remain so. Parents of the Millennials understand clearly that China has never had things as good as they have now. Their children live much more care free existence.

The change from self-supporting society to full blown consumerism has been so quick that poverty in China is still close. Even for the middle class, they are the first or second generation to share in the wealth. Those that have, like to spend. Conscious, critical consuming is still new in China, but some experts see a gradual shift towards more meaningful consumption, as the market becomes both more mature and saturated.

Even if sustainable buying is still a distant development in China, they are well ahead of Europe in terms of numbers of users of social media and especially in internet shopping. The government run China Internet Network Information Center states that in mid-2015 there were 668 million internet users in China, of which 89 percent uses mobile internet. Over 70 percent of internet users live in the cities, the majority are under 40 years old and slightly over half of them are men.

China has a well-developed portfolio of internet portals, as globally successful tech companies like Google, Twitter, Facebook or YouTube are not accessible. Chinese consumers have quickly moved from games and surfing to buying online and searching for the best deals. For the biggest sellers, volumes are huge. But even smaller players can get into the Chinese market thanks to a now well established internet shopping culture. The biggest online shopping sites sell ads that are costly, but by using different search engine tools, even with small marketing budget – or no budget – it is possible to find a niche target group.

Marketing and advertising in China cannot be done without the use of social media. WeChat is the most widely used application, commonly even the only one used. 600 million Chinese use WeChat on their mobile phone. It is common to add bank card details to a WeChat account and buy and pay quickly with a mobile phone.

Stepping up the productivity ladder

Premier Li Keqiang launched an initiative in May 2015, called ‘Made in China 2025’. The program is concentrated on encouraging innovations and moving manufacturing up the value chain to produce more advanced industrial products and services. The hope is that China would no longer be just a country for manufacturing low-end products with cheap labour costs, but more innovative, a quality rather than quantity producing country. From Made in China to Made by China, the country’s goal in the future is to be on a par with

manufacturing countries like Japan and Germany. The goal for the program completion is 2049, when the People's Republic will celebrate its centenary.

China wants to raise the percentage of GDP used for research and development to 2.5% by the year 2020. China has been recruiting talent from all over the world to contribute to its quest for more innovations. It is also encouraging foreign investment in research. In the future, China would not only be adapting to technology that already exists, but also creating it. The speed in which China advances in creating innovations will have many consequences in terms of global competition.

The 'Made in China 2025' program puts special emphasis on developing robotics, electric cars, automation and bio-medicine. The target is to advocate transition through the private sector, even if the initiative comes from the government. Success in 'Made in China 2025' will mean competition for foreign companies in the long-term, but it will be an advantage as well, if Chinese industries develop new, more modern and efficient technologies. In the short-term, it might increase the labour and production costs, but the investment will be returned via an increasing domestic demand and a growing market for high-end products. The real opportunities for foreign investments, however, remain to be seen. Even if China is encouraging foreign investments in science and technology, as well as research in the country, it currently keeps several sectors closed from foreign players.

One interesting initiative is Internet Plus, another idea of Premier Li Keqiang. In diversifying the Chinese economy, it is one of the means to achieve a jump in the value chain. The 'Internet of Things' network is being developed by Western countries as well. China has a few advantages here, if compared to other developing countries, like India, for example. China has high Internet penetration, especially with mobile Internet. Internet banking and consumer electronics are advanced already; especially since the consumer market has already been digitalized. China has a good chance to be one step ahead when it needs to produce quality rather than quantity.

Price of the economic growth

China's economic growth has been strong and fast, but the hungry machine has craved a considerable amount of energy. Due to its economic growth, China has become world's largest emitter of greenhouse gasses, the biggest consumer of energy and the largest producer and consumer of fossil-derived energy. China's energy comes from 90 percent of fossil-derived sources. Of all the worlds' coal, China is using half.

According to China's own estimations, 40 percent of rivers, 60 percent of groundwater and half of the biggest lakes are polluted. From bottled water, just half fulfils the requirements for clean water. The World Bank estimates that water contamination is already costing China several percent of its annual GDP.

Soil contamination has not been as widely discussed. China's own Ministry of Environment published their latest data back in 2014. Their data is collected from 2005 to 2013. According to this study, 16 percent of the soil and one fifth of the agricultural land is contaminated.

Pollution also represents an image problem for China. Air pollution dominates western society's picture of Beijing. We read about food scandals and see pictures of polluted lakes. Even the Chinese people are increasingly aware of pollution and how hazardous it is for their health. It is a new potential risk of unrest. President Xi Jinping published the estimated year of 'emission peak' during his highly-publicised tour of the US in 2015. The peak will happen

in 2030 it was stated. Since then, it has been estimated that it could be even earlier that a peak in emissions occurs.

The Paris Climate Change Summit 2015, saw a changed attitude in China. China is seeking a growing international role and wants to be seen as an equal, diplomatically equipped, and a country prepared to negotiate. China is still holding to its argument that the developed countries have gained their wealth, with heavy pollution a by-product, and developing countries should not be forced to take on less pollution, with not as efficient and more costly methods of producing energy. President Xi Jinping used this argument during the Paris 2015 conference.

China has already achieved a great deal in terms of shaping the environmental laws to match the demand. It is also building a nuclear energy infrastructure, giving tax reductions for electric cars and building and developing solar energy. The goal is to increase the percentage of renewables in the energy sector to 15 percent of the total by 2020. For many years, the economic growth for China was the number one priority and the environment was side-lined; to be taken care of later. But lately, in a poll conducted for the Chinese citizens, the majority named climate change as the biggest threat to their safety. The results were an indication that to meet the citizens' growing demands, the government needed to show the public it was addressing the environmental concerns.

New middle class – the new masses of China

Just a few decades ago, there was no concept of hobbies or free time in China. Free time that is used for shopping, relaxing and seeking fulfilment is new. Interests like golf or skiing, that were unimaginable a few decades ago, are increasing in popularity.

When President Xi Jinping visited the USA in 2015, he mentioned in his speech that there were 300 million Chinese middle class people. From a society with just one class, to mass middle class, represents a dramatic change. It is unclear what criteria President Xi used when defining the term middle class, but it is close to the estimates of several Chinese experts.

Purchasing power only increased significantly as late as the 1990s. Before that, the Chinese middle class had been virtually non-existent since the Cultural Revolution. The Bank of Finland states in its own studies that the general income in China has increased from 97 euros in 2006 to 373 euros per capita per month in 2015. The minimum monthly wage is around 290 euros and it varies from area to area, with the highest minimum wage in the industrial hub Shenzhen. The consulting company McKinsey estimates that by the year 2022, 75 percent of Chinese living in the cities will earn between 8,300–32,000 euros annually.

The Chinese middle class is still beginning its journey as consumers, but already they have been spoiled by choice in terms of luxury and foreign brands. All foreign brands are present in the Chinese market. For many years, the most expensive luxury brands and products have found their fastest growing market in Asia. President Xi Jinping started his anti-corruption, anti-extravagance campaign in 2013, but as a result, the flaunting of extreme wealth became frowned upon. Sales of luxury imported alcohol and clothes have consequently plummeted. But what is rising, however, is the concept of buying affordable luxury products and brands that can be within the reach of the middle income office worker.

Also doing well in China are brands like Apple and Starbucks that portray a very strong image of a successful, but still affordable lifestyle and status.

Likewise, the buying of foreign, imported food is gaining in popularity. China is currently the world's largest market for imported food. The middle class especially, has developed a taste for western food, a change in preference from traditional Chinese products. Also influencing this development have been the highly published food scandals in the country. Those that can economically afford to make conscious consuming decisions are suspicious of the cleanliness and safety of domestic food.

The middle class is also eager to see the world. Though just five percent of the population has a passport, in 2014, some 117 million trips were taken abroad. The Chinese are the fastest growing group of tourists in virtually all tourist spots around the world.

There is still catching up to do, if Finland wants to have its share of the Chinese tourism market, but the latest figures have been promising. By late 2015, the number of Chinese tourists had grown 30 percent in comparison to the year before. Finnair has an impressive presence in the Chinese aviation market and the growing number of tourists makes the future look bright.

Finland and China as trade partners and in business

There are over 400 Finnish companies present in the Chinese market. They employ an estimated 60,000 people in China. Investments by Finnish companies in China exceed ten billion euros. Combining investments and trade, in relative terms, Finland's presence in the Chinese market is strongest among the EU countries.

The majority of the Finnish companies present in China are operating in traditional industries, especially wood and machinery. But China is also a growing market for the Finnish fur industry and for consumer goods as well. Imports from China are mainly electronics.

China is quickly becoming the largest investor around the world. Finland is not among the top destinations for Chinese money in Europe, but there are some examples of promising developments in that field. One of the most important Chinese investments in Finland is the research centre of the technology and IT giant Huawei, which was established in 2012.

As China is changing its economic model to diversify the sources of growth, it is looking into putting more emphasis on creating innovations and modernising the manufacturing sector. There is great potential for Finnish companies to find partnerships and investment opportunities. The Chinese private sector, in particular, is rapidly becoming increasingly competitive globally, and is looking for expertise and innovations from foreign companies.

Potential fields for cooperation could be in cleantech, cloud services, Internet solutions and robotics. In accordance with the Paris climate summit commitments, and as drafted in the new five year plan, China is also looking for solutions for the environmental challenges it faces. Greener energy, energy efficient buildings and waste and water management are sectors that China needs foreign partners to work together with. All are sectors where Finland has much to offer.

Economy will be diversified but questions remain

The Chinese economic miracle was largely made possible by the availability of migrant labour. Hundreds of millions of Chinese people left their homes in the countryside to work in 'Made in China' factories. What has changed is that they no longer dream of returning back to the village of their birth. Their life is now in the cities. They are also increasingly not sending their entire salary back home, but rather using it for their own living; their new life.

More and more Chinese people are satisfied with their increasing living standards and greater proportional wealth. For them, the China Dream has become reality. For the individual, the Chinese dream of a good life does not differ very much from those in western cultures. But the China Dream drafted at the governmental level is not based on the individual. It is a dream of a nation, a country lifted from poverty, to its arguably rightful place as one of the most important countries in the world. However, to keep the dream continuing, the economy needs to keep growing.

Economic growth that exclusively relies on exports is not considered sustainable. As infrastructure projects also come with an increasing risk, for continuous growth, the whole economic model must be rethought. More modern and efficient technology needs to be introduced; and more innovations are needed to keep industries competitive. Growing domestic demand for products and services will help diversify the economy further.

There are two parallel developments in China, on the one hand, the path to more liberal, market based economy, and on the other hand, the decision in terms of keeping the current system of government as it is. China is balancing a system of keeping people happy with a growing economy, whilst also keeping people supportive of the system, despite the limitations the establishment requires from people. There is a growing uncertainty about the direction the economy will take, which can be seen in the capital flow abroad in early 2016 and the downward volatility of the stock market.

China is passing through a challenging transition in terms of diversifying its sources of growth. In the next decade, it needs to generate growth from innovations, domestic demand and make investments in green technology. The extent and speed of transformation will determine whether President Xi Jinping's term is a success and China can unequivocally become a globally competitive country.

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