



Navigating China New Chapter

Bain perspectives (Jun 2023)

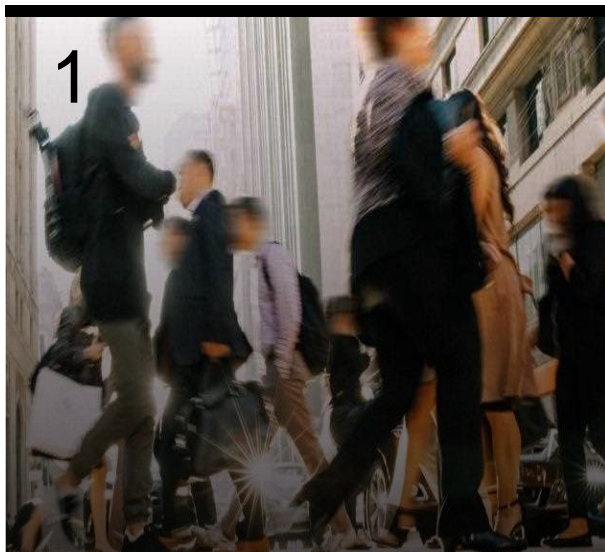
June 20, 2023

BAIN & COMPANY 

New dynamics of macro-environment in China

What **HASN'T CHANGED** in the past 2 years

1



China is still your **BEST CONSUMER STORY**

Massive consumer market, Urbanization, Gov. supports, Meaningful P&L contribution

2



China is a **GREAT GLOBAL LEARNING GROUND**

with learnings continuously being exported

What **HAS CHANGED**

3



China is undergoing **STRUCTURAL CHANGES**

End of Covid, more government control, Demographic shift, Debt risks



Globally there are **RISING GEOPOLITICAL TENSIONS**

US-China decoupling, Taiwan tensions, Russia-Ukraine war, energy crisis, etc.

China resilience is threefold

Country Resilience



How will China's **general economical and geopolitical environment** evolve?

Sector Resilience



What are the likely regulatory and economic policy development of **Company X categories**?



Company Resilience



How is Company X **relatively positioned to the political & regulatory headwinds / tailwinds** in its industry sectors?

HAS CHANGED: MNCs are exposed to risks along seven dimensions

COUNTRY RESILIENCE

		Key factors	<i>Favorable to MNCs in China</i>	<i>Unfavorable to MNCs in China</i>
Demand 	Demographics	Population e.g., middle class, new birth	Populous demand with strong purchasing power	Limited demand and purchasing power
	Consumer behavior	Nationalism-cultivated confrontation	Limited nationalist-oriented purchasing patterns	Strong nationalist-oriented purchasing
Supply 	Trade / Supply chain	Tariff	Fair tariff	High tariff on wide sectors
		Restricted goods	Limited restricted goods	Long list of restricted goods
	R&D / Innovation	Scale of R&D restriction on cross-border investments on R&D, collaboration	Limited sector exposure to R&D restriction	Wide sector exposure to R&D restriction
	Technology/ Data	Cybersecurity / data transfer	Limited restriction on cybersecurity/ data transfer	Strong restriction on cybersecurity/ data transfer
		Core technologies e.g., 5G, AI, semiconductor	Limited restriction on core tech collaborations and trades	Strong restriction on core tech collaborations and trades
	Talent / Operating model	Talent mobility accompanied with governance change	High willingness/ free mobility	Low willingness/ restricted mobility
	Financing / Capital	Cross-border capital flow e.g., financing, listing	Few restrictions on capital flow	Systematic barrier in capital exchange

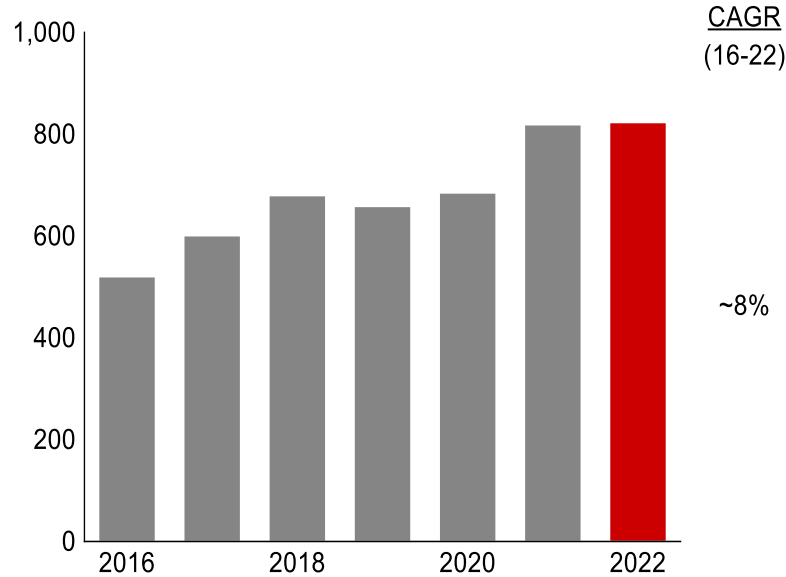
Source: Expert Interview; Analyst reports; Lit search; Bain analysis

China's importance has constantly increased over the past 5 years

COMPANY RESILIENCE

China's importance increased

Top 200¹ European, Japanese, and US companies' sales in China (B USD, 2016-2022)



% of global revenue:

10% → 14.5%

China is a top market for winning MNCs across different sectors

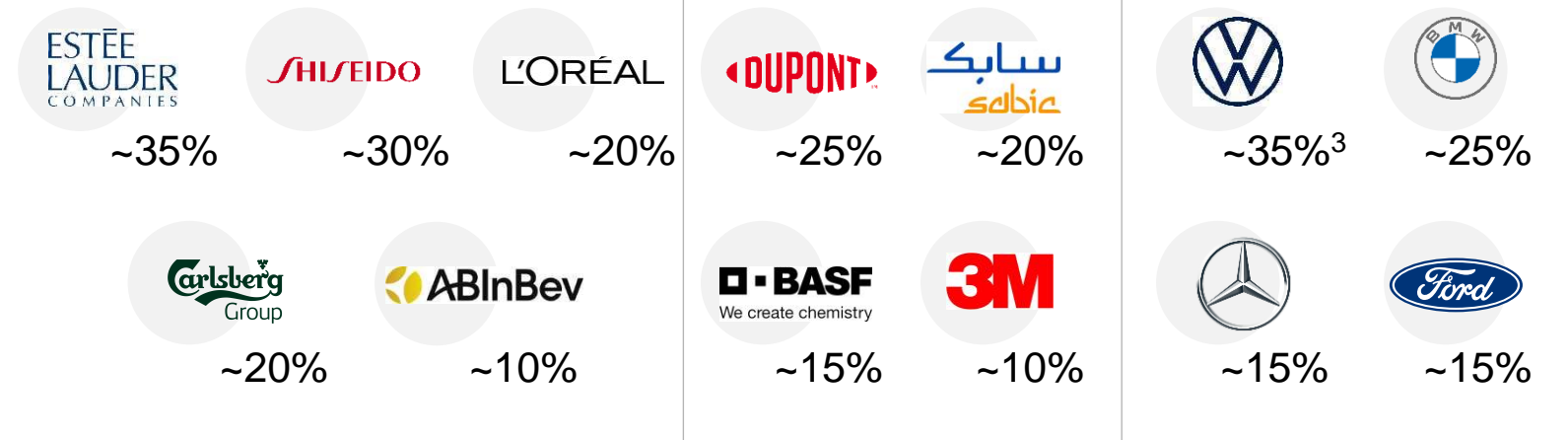
FMCG

Chemical

Automotive



China share out of global revenue²



Note: 1) Top 200 that disclosed sales in Bloomberg platform; 2) As of 2021; 3) On unit basis

Source: Bloomberg; Euromonitor; The Economist; The Brookings Institution; Capital IQ; EMIS; Annual reports; Analyst reports; Lit research; Bain analysis

Company resilience can be assessed across four dimensions

COMPANY RESILIENCE

Company capability can be scored along each dimension below ● High ◐ Mid ○ Low



Evaluation criteria

▶ **Objective financial contributions** ○
(e.g., Tax revenues, Jobs creation)

▶ **Intangible business values** ○
(e.g., ESG, innovation)

▶ **Coverage of gov't relations** ○
(e.g., Coverage of central and local governments in China)

▶ **Support to gov't work** ○
(e.g., # of attended forums / conferences)

▶ **Supervision cooperation** ○
(e.g., Voluntary inspections)

▶ **Connection with associations** ○
(e.g., Leverage of Chamber of Commerce)

▶ **Existence of Government Affairs / Government Relations department** ○

▶ **Profile of GA team** ○

▶ **Ability to track and respond to public opinion** ○

▶ **Coordination with GHQ on China related messages** ○

▶ **JV with local champions** ○

▶ **Listed on HKEX** ○

▶ **Ecosystem of China partners** ○
(eg: Coke model, Nike model)

▶ **Others...** ○

Implications for MNCs : recalibrating strategies for a new era



Re-learn

China's **market & regulatory environment and consumer behavior** have changed quite dramatically over the past three years.

China is still **the best consumer story and the best global learning ground for MNCs**



Re-connect

In last 3+ years, global executives have been connected to China through global media with **mostly negative narratives about China**
China teams need to be re-assured that **GHQ regains confidence in the Chinese market**

Government plays an increasing role and need to be engaged regularly by MNCs global executives



Re-commit

With a **renewed market knowledge and confidence, and proper scenario planning**, MNCs should seize the opportunities created by the “New China Chapter”, and **re-commit to create a “second home market”** and achieve long-term sustainable growth

Overall context of China consumer markets (1/2)

Management of expectations: post covid recovery in China is **different than in the western market**

- In western markets, we had stimulus before re-opening, and this is why consumers rushed to spend as the countries re-opened; now they pay the price with high inflation and high interest rates
- In China, the country re-opened without stimulus;

However, China economy has suffered in 2022, with **lingering consequences on consumer confidence**

- Real estate deleveraging with drag on real estate, new constructions on local public finances
- Many companies shut down
- High unemployment (~20%) of young population
- Lower income in 2022
- Higher savings rate

However, **mid-long-term prospects are strong:**

- Growing middle class and urbanization
- No inflation and low interest rate (credit is encouraged)
- Low energy costs



Overall context of China consumer markets (2/2)

/ China economic growth model **will need to evolve:**

- Traditional growth engines (infrastructure, export, real estate) will not drive future GDP growth
- Domestic consumption will be the major GDP growth driver, as we have already seen in Q1
- Services will outgrow manufacturing

/ Post-Covid **consumers have changed in 4 main ways:**

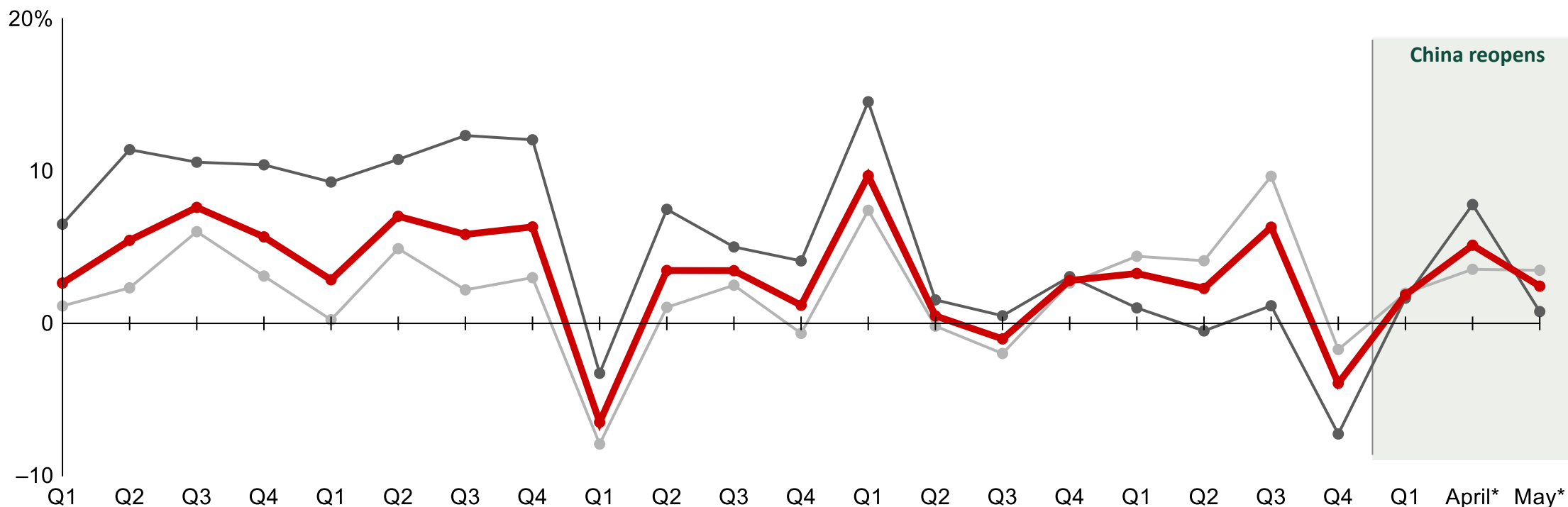
- Focus on experience-based consumption such as travel, tourism, OOH meals
- Health and Hygiene focus
- Higher price sensitivity / deflationary environment
- Acceleration of interest commerce (Kuashou, Douyin) and convenience commerce (O2O)



China FMCG slowly recovered by ~1.9% in Q1 2023, with uneven recovery trajectory observed in April and May

— Total FMCG — Food and beverage — Personal and home care

Year-over-year change in urban shoppers' total spending on fast-moving consumer goods



Year-over-year value growth

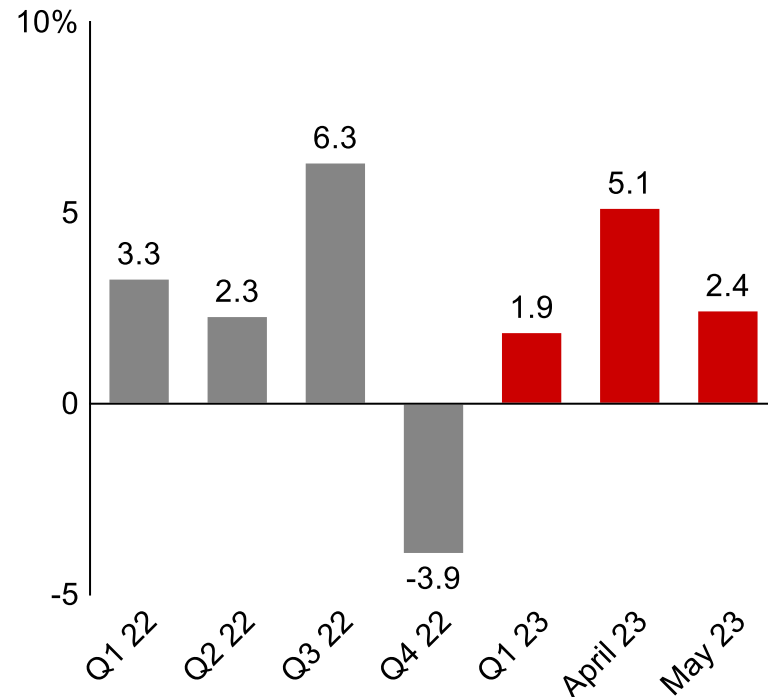
2018	2019	2020	2021	2022	2023Q1
5.2%	5.6%	0.1%	3.1%	1.5%	1.9%

Notes: Kantar Worldpanel has excluded cigarettes from total FMCG data in 2017 and adjusted online channel weight factor upper threshold for paper products to better reflect market realities in 2020. Consumer universe updated in 2022 and 2023; skin care and makeup covers ages 15 to 64, Tier 1 to Tier 5; infant formula and baby diapers covers 0-36 months, Tier 1 to Tier 5; all average selling prices are calculated based on RMB per Kg/L except diapers and toothbrushes per piece, skin care and makeup per pack, and toilet and facial tissue per 100 sheets/rolls; all these changes may lead to some inconsistencies with previous years' data; *4 week ending 4.21.2023; 4 week ending 5.19.2023
Sources: Kantar Worldpanel; Bain analysis

Home care achieved significant growth in Q1 / April / May, beverage recovering since Q1, while overall FMCG slowed in May,

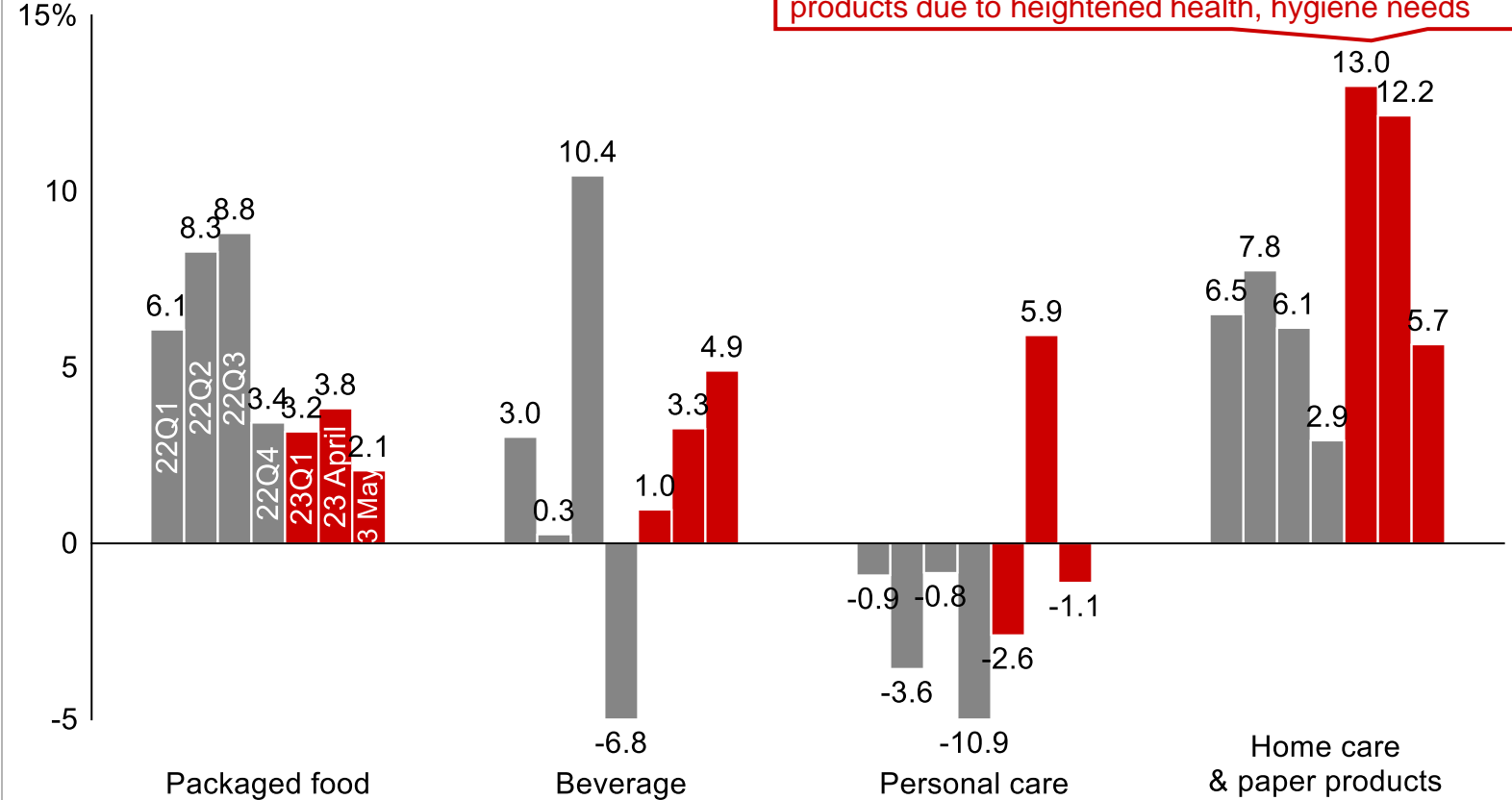
Total FMCG

Urban FMCG market value growth
(%, Q1 2022–Q1 2023 vs. Q1 2021–Q1 2022)



FMCG Breakdown

Urban FMCG market value growth
(%, Q1 2022–Q1 2023 vs. Q1 2021–Q1 2022)



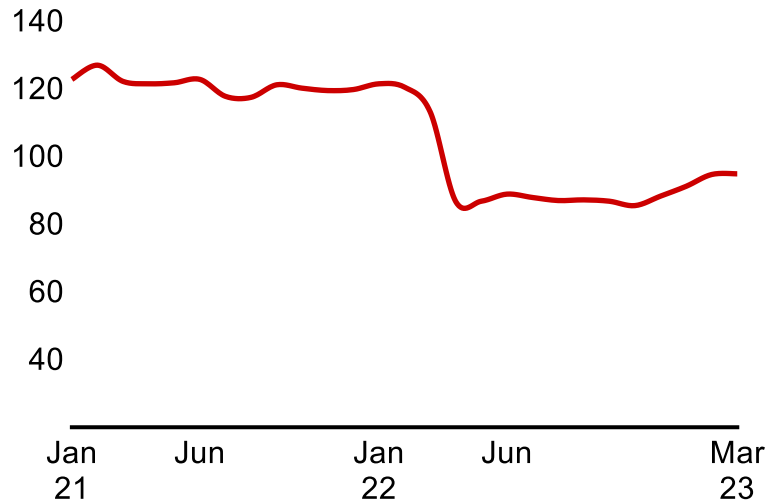
Achieved the highest quarterly growth since Q3 2020, driven by paper (e.g., facial tissue) and disinfectant products due to heightened health, hygiene needs

Sources: Kantar Worldpanel; Bain analysis

Though challenges in short term, we see fundamentals and opportunities in place from mid to long term perspectives

Re-opening is here, but slower than expected because of 2022 scars

China Consumer confidence index

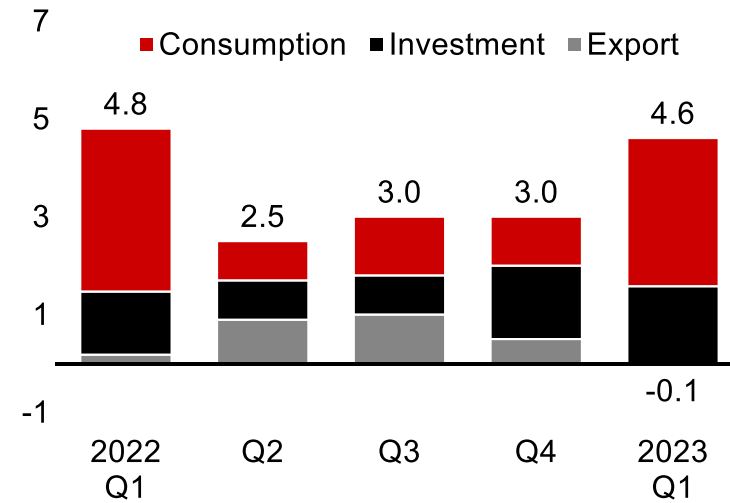


Real estate investment **-6%**
23' vs. 22' Q1

Urban unemployment rate at **5.5%**
relatively high compared with historical data

Consumption will be the main GDP driver, in particular services

China GDP growth contributed by driver (%)

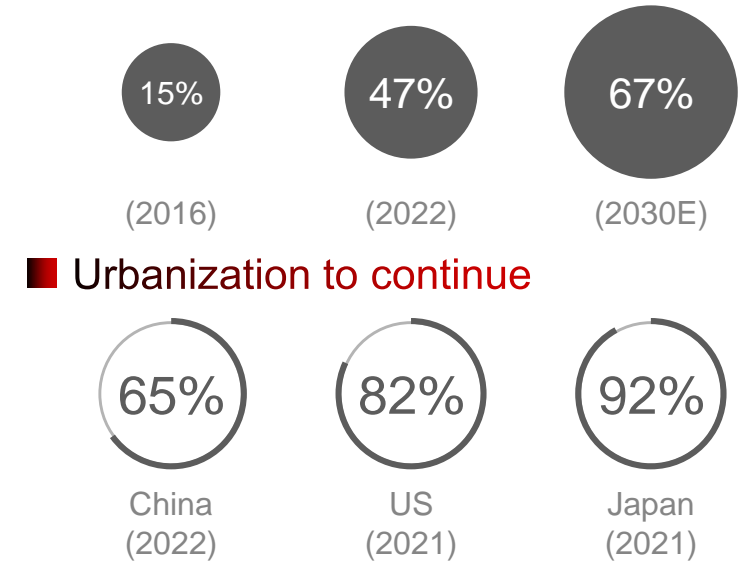


Consumption contributes **70%**
of Q1 GDP growth

Service outgrows at **6.2%**
23' vs. 22' Q1

And Mid/long-term macro fundamentals in place

% of middle-class households*
% of total households



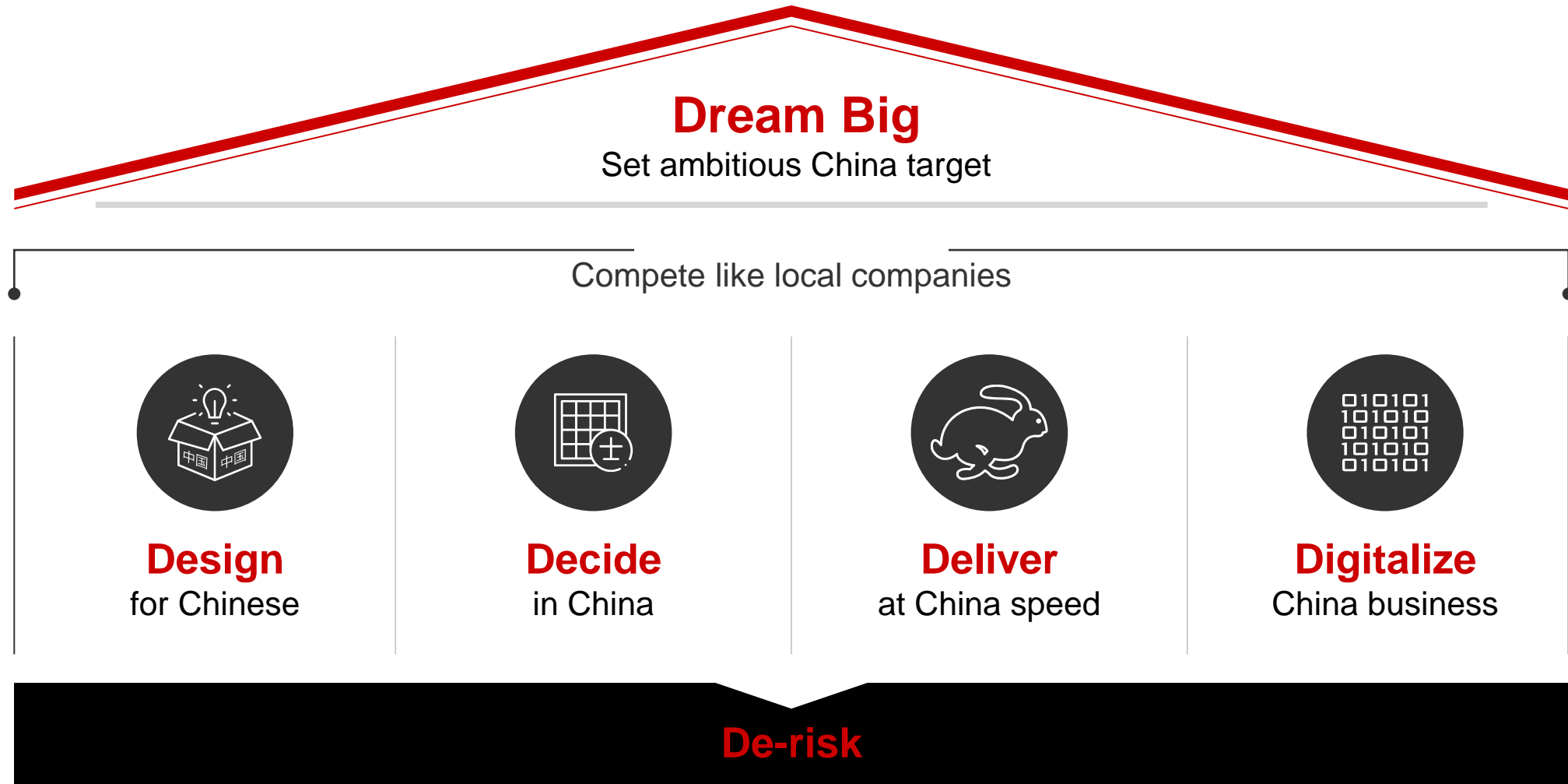
Urbanization to continue

Low inflation, low energy costs

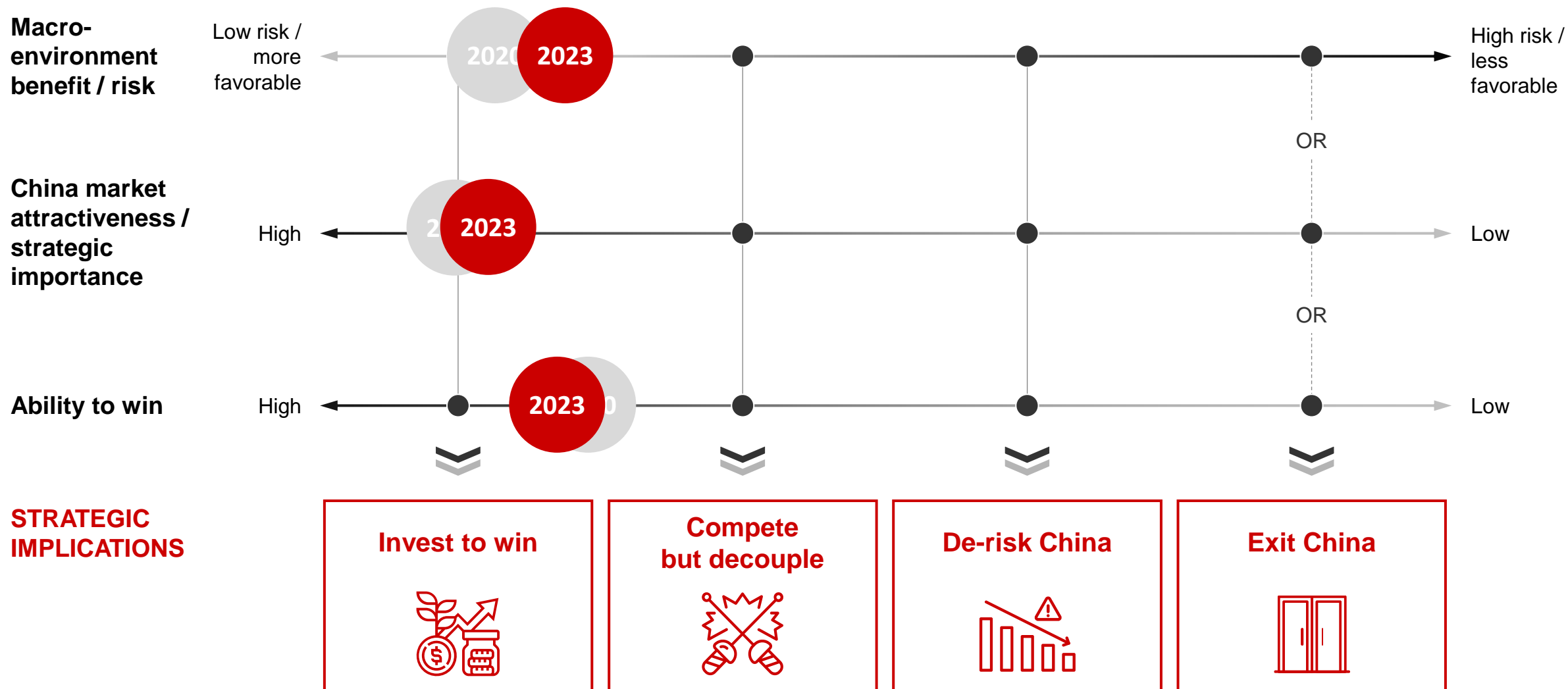
Government commitment for economy growth

Note: *Household disposable incomes breakdown: low income household monthly disposable income <-\$1K; middle income ~\$1-4K, high income >=\$4K; middle class includes middle income and high income households
Source: NBS, CEIC, World Bank, JP Morgan, National Bureau of Statistics

Winning in China requires MNCs to set ambitious targets and compete like local companies, using the 4D+ model



Based on the MNC position across these 3 dimensions, there are 4 strategic options to manage the China business



Source: Bain experience

