Relearn, Reconnect, Recommit to China: A New Playbook for MNCs

How MNCs can navigate volatile times and continue to thrive in China

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At a Glance

- As China continues to emerge as a major global market and geopolitical tensions persist, leading MNCs find that business practices in the region require a new playbook.
- In this new economic landscape, characterized by deglobalization, MNCs must understand that decoupling is not likely, but they need a framework to develop resilience strategies at three levels: country, sector, and company.
- In this context, global executives traveling to China after four years need to invest to relearn, reconnect, and ultimately recommit to China.

China's new economic outlook

In a context of global economic slowdown and deglobalization, China is entering a new chapter of its development. The government's release of a new Catalogue of Industries for Encouraged Foreign Investment (2022 Version) reiterates China's support of foreign companies. Efforts include expanding market access, optimizing the investment environment, streamlining regulations, and improving intellectual property rights protection. Meanwhile, China also encourages well-qualified local companies to engage in outbound investment around the world.

China aims to both reduce its reliance on foreign technology and be seen as a global leader in technology and innovation. Significant research and development (R&D) investment and development in semiconductors, artificial intelligence, biotechnology, e-commerce, and new energy are expected to drive China's economic growth in the coming years. The country's manufacturing sector is becoming more modernized through the encouragement of advanced technologies, domestic innovation, and international cooperation.

National security and environmental, social, and governance (ESG) initiatives are important elements of China's economic transformation. A dedicated chapter of the 20th Congress of the Communist Party of China report highlights the importance of economic stability and ensuring the security of food, energy, and resources as well as key industrial and supply chains. Likewise, the government has made green and sustainable development initiatives that include carbon neutrality pledges (CO_2 emissions peak before 2030 and carbon neutrality before 2060), conservation planning, and tree planting (70 billion trees by 2030).

China and the world

The size of China's economy will continue to grow and represent an increasing share of global revenues for multinational corporations (MNCs) doing business there.

China is the second-largest world economy and boasts the top market share spot in sectors that include food and beverage, automotive, textiles and apparel, chemicals and chemical products, iron and steel, and consumer electronics. Recognized as "the world's factory," China has the largest manufacturing base in the world. According to the Ministry of Industry and Information Technology of China, the added value of the country's manufacturing industry in 2022 will account for nearly 30% of global manufacturing, and its manufacturing scale has ranked first in the world for 13 consecutive years.

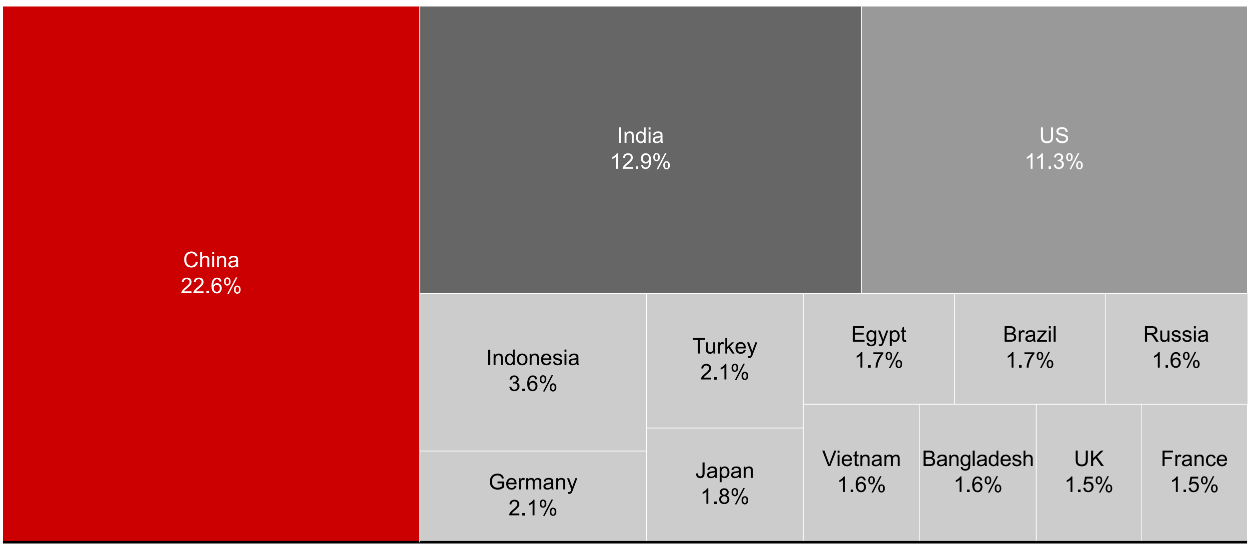
China is expected to be the leading contributor to global GDP growth over the next five years, accounting for 22.6% of total growth, ahead of India (12.9%) and the US (11.3%) (*see Figure 1*).

China's GDP reached RMB 59.3 trillion (about USD 8.3 trillion) in the first half of 2023, up 5.5% year over year, indicating a "good momentum of recovery" in the national economy, according to the National Bureau of Statistics (NBS) on July 17. Domestic demand led the way, with consumption accounting for 78% of GDP growth, the largest consumption share over the past 18 months.

It is no surprise that many MNCs consider China one of their most important markets. For the top 200 companies from Japan, Europe, and the US that report their China revenues, China accounts for about 15% of total global revenue (*see Figure 2*), with some reporting considerably more (Shiseido: 24.2%, Tesla: 22.27%, Mercedes-Benz: 37%).

Figure 1: China is expected to be the leading contributor to global GDP growth over the next five years

2023–28 world economy growth contribution

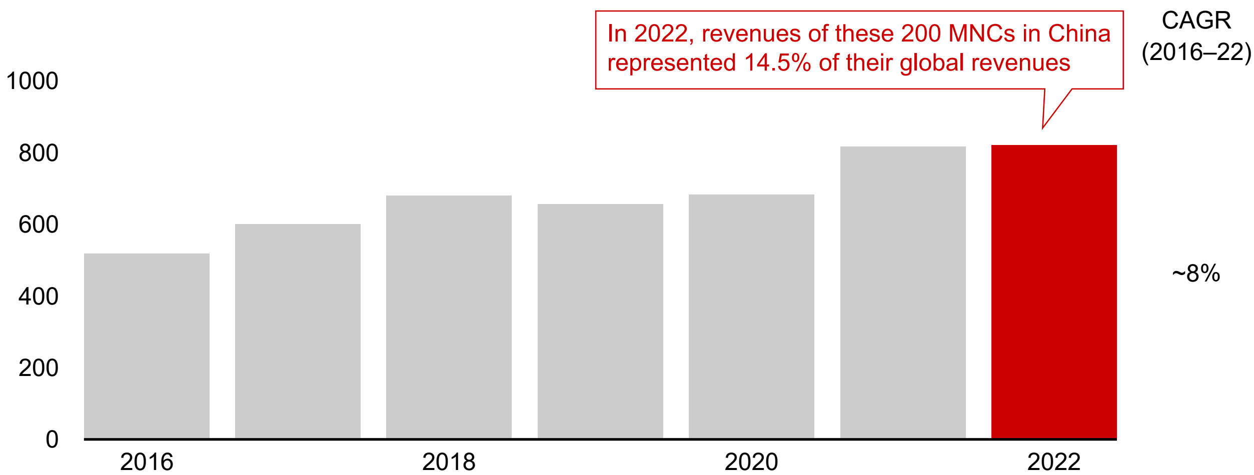


Source: Bloomberg; IMF

Figure 2: Many MNCs consider China their most important market

2016–22 share of MNC global revenues from China

Top 200 European, Japanese, and US companies' sales in China[1]
(B USD, 2016–22)



1) Top 200 MNCs that report their sales in China in CapitalIQ, sorted by total revenue
Sources: CapitalIQ; Euromonitor; The Economist; The Brookings Institution; EMIS; annual reports; analyst reports; lit. search; Bain analysis

In total, the China National Bureau of Statistics estimated the revenues of MNCs in China at $3.4 trillion in 2020.

However, the current environment has led to ongoing tensions and created barriers that tend to manifest in trade and technology. For example, China tiers global trade openness differently, based on industry and sector, and key technologies are and will continue to be highly regulated and protected. MNCs seeking business opportunities in the region must cope with these challenges.

Relations between China and the US are likely to remain strained, as the long-term and short-term agendas of both parties are at odds. In Europe, bilateral relations have been relatively complicated and mixed. Overall, decoupling will not happen, or only very selectively, for example in areas of sensitive technologies. Many top-level US government officials—including Treasury Secretary Janet Yellen and Commerce Secretary Gina Raimondo—have made statements that the US isn't seeking to decouple from China. US National Security Advisor Jake Sullivan told a gathering at the Brookings Institution on April 27 that, instead, "we are for de-risking and diversifying."

Even if decoupling is not likely to occur, this nascent environment requires MNCs to develop a new playbook in China and address these current realities. As Premier Li said during his visit to Germany in June 2023: "Companies should return to the driving seat when it comes to risk prevention as they feel the risks most directly and keenly and know how to avoid and respond to them."

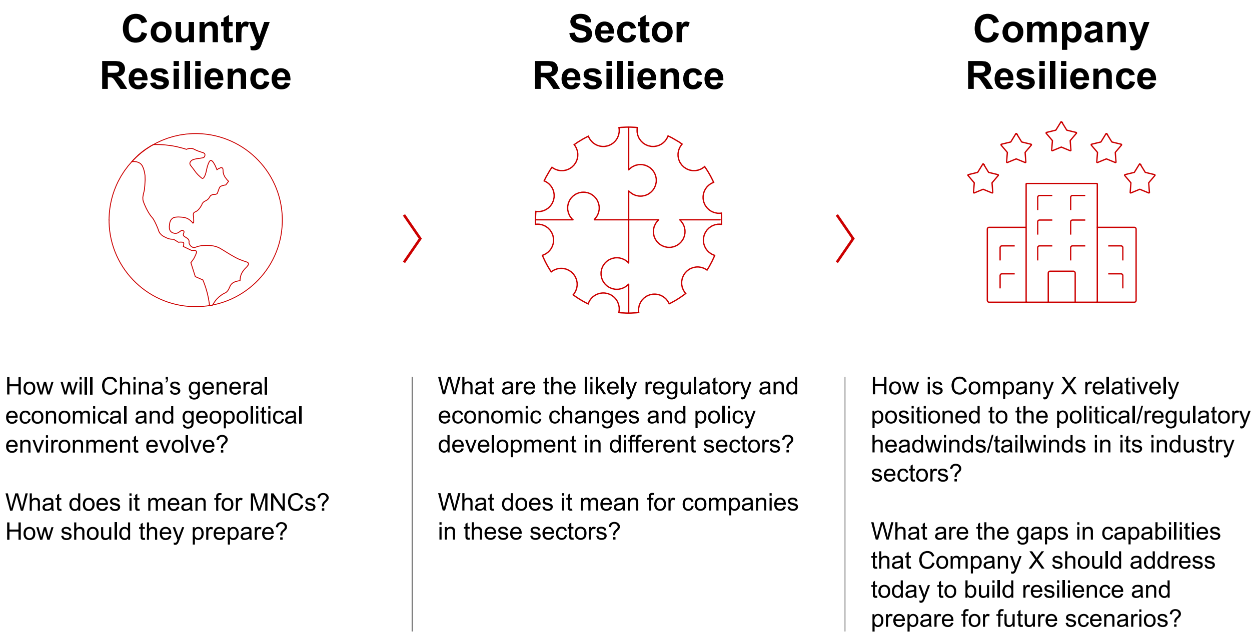
Resilience framework

Despite a more complex and volatile environment, the fundamentals of business remain the same. To achieve success in the new Chinese economic landscape, MNCs must continue to assess their respective sector attractiveness and their own ability to win. In addition, MNCs must assess geopolitical risks and develop a corresponding resilience strategy. To accomplish this, the Bain framework focuses on risks and resilience responses along three dimensions: country resilience, sector resilience, and company resilience (*see Figure 3*).

Country resilience

Companies have no control over shifts in China's overall economic and geopolitical environment. However, they can build scenarios and prepare mitigating actions against these scenarios. A Bain-authored September 2022 *Harvard Business Review* article, "Strategy-Making in Turbulent Times," described a new scenario-based dynamic model to address volatility. Some key considerations include trade and supply chain, financing, talent retention and mobility, data security, and technology access.

Figure 3: Resilience in China is threefold



Source: Bain experience

Success starts with identifying extreme but plausible scenarios to assess risks and opportunities in China. The goal is not to predict the most probable outcome but to uncover the best ways to compete and win. After creating these scenarios, MNCs can develop no-regret moves and mitigating actions across the different dimensions most likely to be impacted in these scenarios. It is important that MNCs define likely trigger points, signposts, and metrics that signify disruption, and be willing to continuously revise and refine these predictions. This prescriptive tracking discipline will help keep companies focused when pursuing new opportunities and better positioned to alter course when the scenarios change.

MNCs can further strengthen their country resilience by diversifying operations within China, acquiring local companies, creating new partnerships, and investing in alternative markets. Increased self-reliance with regard to raw materials, technology, and capital expenditure needs, as well as a diversification of supply chains, will add to their resilience by reducing dependency on some countries.

Sector resilience

While all industry sectors in China are subject to national security regulations, not all are treated equally. Some are encouraged, others are not, and some are considered with conditions. In an effort to expand market access, the Chinese government added 239 items and modified 167 items to its 2022 edition of the Catalogue of Industries for Encouraged Foreign Investment. The Special Administrative Measures (Negative List) for Foreign Investment lays out which sectors are not open to foreign investment.

Sectors for which foreign investment is encouraged include consumption, healthcare, green and low carbon, and advanced manufacturing. Prohibited sectors include defense and tobacco. Some sectors—like finance, biopharma, and telecommunications—are conditionally open to foreign investment.

Resilience assessment extends beyond regulatory concerns. Review of the intrinsic attractiveness of a sector is also important. For example, the declining birth rate in China has rendered baby-related categories less attractive than a few years ago. In response, some MNCs like Mead Johnson and Abbott have reconsidered their level of participation in the Chinese Infant Milk Formula (IMF) market. Similarly, other companies are diversifying into other sectors. Chinese H&H Group, known for its infant nutrition line Biostime, diversified its offering by expanding into the adult health market with Swisse supplements and the pet food market with Solid Gold products.

Additionally, sector regulations are constantly evolving, with a combination of favorable and less favorable implications for MNCs. In the automotive sector, for example, it is now possible for foreign original equipment manufacturers (OEMs) to own 100% of their passenger car operations in China, as was the case for Tesla in 2019. At the same time, foreign investment in mapping technology is forbidden, preventing foreign OEMs from developing autonomous driving in China. Similarly, the Ministry of Industry and Information Technology plans to strengthen its Internet of Vehicles rules to avoid data transfers abroad. This means foreign automakers will probably need to customize their localized products in response to the new requirements.

MNCs, therefore, should regularly assess the status of their industry and connect regularly with their relevant China regulatory bodies to understand and anticipate the future regulatory environment in which they will have to operate. In addition, understanding sector headwinds and tailwinds will provide them with a full picture of their sector resilience.

Company resilience

This component of resilience considers what is in the company's control and what they should do to ensure they are well-positioned to navigate the current and future turbulent times. Company resilience can be assessed across four dimensions: contribution to the China agenda, connectivity with government officials, company capabilities in government relations, and company operating model.

MNCs contribute to the Chinese government's agenda in many ways, such as tax revenues, job creation, R&D development, products that contribute to health improvement, and ESG contributions. They strengthen connectivity with the Chinese government by actively participating in Chinese-sponsored forums and exhibitions, such as the China International Import Expo in Shanghai or the China Development Forum in Beijing. To deepen and improve government relations, MNCs need to consider the multiple constituencies of the government (local, regional, and national) as well as any relevant regulatory bodies. Frequent and high-level discussions are recommended to describe the company's initiatives and progress in China, and to ask for the relevant support to unlock a situation or advance an important investment.

Once appropriately aligned to Chinese objectives, companies should also review their own operating models. They should ask themselves if they are well-positioned to face the likely political and regulatory issues and determine whether they are still equipped to adapt to this new, volatile environment. If not, they should identify any specific gaps in capabilities and operating model they can immediately address to build resilience and prepare for future scenarios. Potential changes to the operating model include a separate listing of the China business in Hong Kong, a joint venture with a local partner, or even an outright partial or total disposal of the business.

While the macro environment of China continues to shift in its complexities, the fundamental rules of business remain the same. As the China market becomes more competitive every year, MNCs should regularly review the attractiveness of the sectors in which they operate. Assessment of their ability to win in these sectors will inform strategic decisions to double down, partner, withdraw, or partially withdraw from a sector in China.

Adopting a 4D China-centric approach

In this increasingly uncertain geopolitical environment, the "laws of gravity" of business apply more than ever, given the highly competitive nature of the China market. In our April 2022 paper, *How to Behave Like a Chinese Brand,* we described how, in many fast-moving consumer goods (FMCG) categories, local brands have been gaining share against international brands, and we recommended that MNCs apply a Chinese brand playbook around the 4D model:

- **Design for Chinese consumers.** As China expands its commitment and capacity for innovation, more companies are establishing an R&D presence in the region. Those that rigorously tailor products for Chinese consumers are reporting major success.
- **Decide in China.** The multinationals that are most successful in China are those that create a China-centric operating model. This includes giving China more visibility and influence at their global headquarters, empowering local decision making, adopting China's unique talent recruitment strategies, recalibrating key performance indicators, and implementing hyper-agile ways of working.
- **Deliver at China speed.** The importance of speed in China cannot be overemphasized. The ability to move fast is enabled by an ecosystem of organization and cooperation among companies that creates a win-win collaboration model.
- **In a Digital way.** As the most digitized consumer market in the world, China provides an unparalleled ability for companies to leverage consumer data for wide-ranging marketing and promotional opportunities. Winning brands are those that adapt most quickly to China's digital ecosystem.

This 4D model is even more relevant today as China begins its new chapter of economic growth and with local competitors that are stronger than ever. We also believe that this 4D model can be applied to sectors beyond FMCG.

Recalibrating strategies for a new era

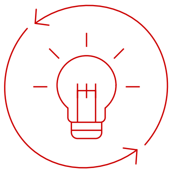
Moving ahead, MNCs' global leaders and their China teams must be willing to reconsider many things they thought they understood about China. Global leaders who have not visited China after four years may have outdated perceptions of current market opportunities. To reset strategies for successful engagement, we recommend MNC global leaders relearn, reconnect, and recommit to China (*see Figure 4*).

Relearn

The economic landscape in China has drastically changed since the last visit of many MNC global leaders. Covid-19 accelerated the adoption of digital technologies. The digital media landscape continues to rapidly evolve as convenience commerce through online-to-offline (O2O) platforms intensifies and interest commerce platforms like Douyin (TikTok in Western markets) maintain their dominance. Given the speed of change in the Chinese economy, spending four years without direct learning in China is risky. In-person visits, therefore, are an important component of the relearning process. There is much to be gained by reconnecting with relevant local market participants, government officials, and local teams.

Figure 4: MNCs should relearn, reconnect, and recommit to China to recalibrate their strategies for a new era

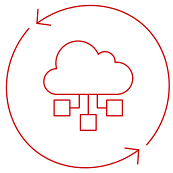
Relearn



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

China still presents an **excellent consumer story** and **global learning ground for MNCs.**

Reconnect

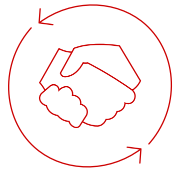


Over the past three-plus years, global executives have been connected to China through global media with **mostly negative narratives about China.**

China teams need to be reassured that **global headquarters regain confidence in the Chinese market.**

Government plays an increasing role and needs to be engaged regularly by MNCs' global executives.

Recommit



With a **renewed market knowledge and confidence**, as well as **proper scenario planning**, MNCs should seize the opportunities created by the "New China Chapter" and **recommit to create a "second home market"** to achieve long-term sustainable growth.

The auto industry is a prime example of how much China has changed in four years. Because charging station infrastructure had been built in parallel with electric vehicles (EV), China rapidly developed EV penetration in China. Western visitors to the Shanghai auto show in April 2023 were struck by the innovation on display. It even gained attention in the silent streets of Shanghai despite its vibrant 25 million population. The numbers speak for themselves. In 2022, penetration of total EV passenger car sales was about 25% in China (this figure is expected to rise to 30% to 40% in 2023) and made up more than 65% of the global EV market. Today, China is the world's leading exporter of automobiles.

Reconnect

As global leaders plan their trips to China, they should take enough time to really understand how the environment has changed and the direction the country is headed. China is in the Western media every day, and many negative narratives have developed over the past few years. It is crucial, therefore, for Western visitors to make up their own mind based on direct observation and progressively rebuild their confidence around the market potential through direct conversations. This starts with their own teams, customers, partners, and government. The message of these conversations should be very clear. China teams need to be reassured that China matters to global headquarters. Most businesses expect a strong rebound in 2023 and beyond, and the government is playing an increased role in welcoming foreign investments in China.

For some companies, the increase in China business will compensate for the potential decline in the Western recessionary markets to maintain a strong global performance trajectory. Experience in China also serves as a rich learning environment for MNCs. The lessons they learn and obstacles they overcome there can be transferred (with necessary adaptation) to their other businesses around the world, with a newly acquired competitive advantage.

Recommit

Multinationals who are recommitting their efforts toward China are reporting big successes. Major brands like Panasonic, Nestlé, Bosch, A.P. Moller-Maersk (Maersk), and AstraZeneca are investing in new infrastructure and R&D capabilities to expand operations throughout the region and gain visibility around the world.

In January 2023, Bosch announced plans to invest about USD 1 billion over several years in the development and production of components for new energy vehicles and automated driving in China. The company will build a research, development, and production center in Suzhou, with the initial construction phase expected to be completed by mid-2024.

Maersk and the Shanghai International Port Group signed a memorandum of understanding in March to collaborate on green methanol bunkering for Maersk's ships at the Shanghai port. Maersk's CEO expressed confidence in China's economic growth and indicated that the company is exploring potential business opportunities in the country.

AstraZeneca plans to triple its R&D investment in China this year compared to 2020. The company also intends to recruit more than 900 R&D personnel, representing a 70% increase from 2020, according to company data.

L'Oréal's chairman and Alibaba's chairman inked a memorandum of understanding in April 2023 to promote a circular economy in China's beauty industry. The partnership, which runs until 2025, seeks to establish green and low-carbon standards, develop new products, and create measurable circular economy solutions in China's beauty and personal care industry.

Similarly, Airbus signed an agreement in April 2023 with the Tianjin Free Trade Zone Investment Company and the Aviation Industry Corporation of China to expand A320 family final assembly capacity with a second line at its Tianjin site.

By recommitting or continuing their investments in China, MNCs can create a stronger second growth engine alongside their home market, improve competitive advantages in other markets, and address potential future shortfalls in other markets' performance.

Uncertainty will likely continue to characterize the economic landscape in China for the foreseeable future. But companies equipped with adequate preparation, renewed knowledge, objective risk assessment, and sound competitive strategies around the 4D model can seize the rich development opportunities the China market has to offer.

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