EXECUTIVE SUMMARY

THE RECIPE FOR SUCCESS IN CHINA

LESSONS LEARNED FROM SWEDISH SMES IN CHINA
INTRODUCTION AND SUMMARY

China remains the fastest growing market in the world in terms of nominal values. However the general economic slowdown in combination with other factors, e.g. increasing competition has made many Swedish SMEs wonder if the best business opportunities in China lie in the past. On the contrary, Business Sweden believes that opportunities still exist for Swedish SMEs; and that it is rather a matter of finding the right prospects, customers and partners.

This study conducted by Business Sweden covered three areas; (1.) market movements and trends on the Chinese market; (2.) examples of market opportunities in China for Swedish SMEs over the coming years, (3.) insights from established SMEs on the Chinese market based on interviews and (4.) main conclusions and recommendations.

The study recognizes that China’s next growth wave will be fueled by consumption largely from a growing middle class. The study also recognizes that the largest opportunities for western companies are within industries that are reliant on innovative technologies. As the technology gap between western and domestic companies narrows, growth in traditional industries is expected to be propelled by domestic companies. Innovation-driven industries however are expected to remain in need of international influences. Hence there should be opportunities in innovation-driven industries. Knowledge of the market and the competitive landscape however is necessary. For SMEs it is essential to be able to pinpoint the addressable market as well as a launch market. Subsequently choosing the right market entry strategy is vital.

Swedish has numerous examples of innovative companies that are successful in various industries in China. Product innovation, local presence and brand awareness are the most important success factors while qualified staff and different business culture are recognized as the most common challenges. Devotion to market entry, active selection of partners, a holistic mind set on IPR and an agile business model have been proved key for succeeding in China.

1. MARKET MOVEMENTS AND TRENDS

China is today an economic super power and the largest contributor to global growth. Even though there is an evident economic slowdown, this mainly affects traditional resource intensive industries, e.g. steel industry.
As China’s traditional investment driven growth is slowing down, consumption and innovation are two identified mega trends that are expected to drive future growth.

Consumption accounted for 51 percent of GDP growth in 2015, and this is expected to be a lasting trend for the coming years. A growing middle class and an increased demand on services such as healthcare, education and insurance lead the way.

The pressure to increase process automation and efficiency in traditional industries (e.g. mining, steel and construction equipment) due to decline in investments, over capacity and anti-corruption efforts has led to China excelling in manufacturing driven innovation. Incremental improvements, cost cutting and production efficiency are examples of where Chinese innovation has seen breakthroughs. Despite vast investments into innovation infrastructure and R&D the quality output does not match the input with only a few commercially successful breakthroughs as a result.

In summary, China has a huge consumption base that will only keep growing, and while the nation is investing heavily in innovative capabilities and infrastructure, efforts have yet to pay off. China’s innovative strengths lie where time to market and scale are competitive factors, which means that opportunities exist for SMEs with innovative or complementing technology.

2. MARKET OPPORTUNITIES IN CHINA

Many industries in China show a promising outlook, examples of such industries are: Aerospace, ICT, E-commerce, High-value machinery, Life sciences, Health care, Private education, CleanTech and Food and beverages. In this study Business Sweden assessed and mapped industries based on market opportunity (which included factors such as market growth, projected growth, governmental support and other market inflection points) and potential for innovation (which included factors such as; growth in PCT applications*, investments in industry, global innovation index, Chinese innovation track record and other need for innovation inflection points) as evaluation criteria for industry attractiveness. ICT and Life Science stood out in terms of both market opportunity and potential for innovation.

* A PCT (Patent Cooperation Treaty) application is also known as an international patent application. By filing one international patent application under the PCT, applicants can simultaneously seek protection on multiple markets.
Further examinations of these two industries were then conducted and in-depth analyses, including interviews with Chinese companies, were performed for three sub-industries that showed large promise, namely; Internet of Things (IoT), Pharmaceuticals and Medical Devices. Examples of Swedish SMEs, potential Chinese partners and recommended market entry strategies were distinguished per sub-industry.

Conclusion of the analysis is that for an SME’s success on the Chinese market, it is critical to understand your specific launch market in terms composition, segmentation, demand and entry strategy. All of the above mentioned industries are sizeable markets with significant market opportunities. To capture these however in-depth knowledge about the market and how to approach it is essential. The methodology for this study on selected sub-industries above can be replicated for this purpose.

3. INSIGHTS FROM ESTABLISHED SMES

Sweden has numerous examples of successful innovative companies with operations in China. Twelve of these companies were selected to participate as interviewees in the study to share their learnings. Interviewed companies included traditional industries, such as Somas and Car-o-liner, as well as more up-and-coming industries, such as Cleanergy. The responses however were strikingly similar regardless of industry.
During the interviews the responding companies were asked to score a few common success factors in terms of importance (1-5). The top three success factors were: (1.) Product innovation (2.) Local presence and (3.) Brand awareness. Product innovation was ranked as most important as it was considered an efficient way to differentiate and stay ahead of competition, Local presence was ranked second since relationship building and showing commitment to the market are key. Brand awareness was ranked third since brand and status is central in China and thus often is a reason for price premium.

While offering an innovative product is of the utmost importance, having local presence and working with the right local distributor is also essential for success. Differentiating China from other emerging markets is that there’s a premium for western brands that customers are willing to pay for.

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<tr>
<th>COMMON SUCCESS FACTORS</th>
<th>ESTIMATE OF IMPORTANCE TO COMPANY (1-5)</th>
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<tbody>
<tr>
<td>1 PRODUCT INNOVATION</td>
<td>4,8</td>
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<tr>
<td>2 LOCAL PRESENCE</td>
<td>4,5</td>
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<tr>
<td>3 BRAND AWARENESS</td>
<td>4,2</td>
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<tr>
<td>4 DISTRIBUTOR COOPERATION</td>
<td>3,8</td>
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<tr>
<td>5 MARKET RESEARCH</td>
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<tr>
<td>6 LOCALIZED PRODUCT OFFERING</td>
<td>3,2</td>
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<tr>
<td>7 CUSTOMER SEGMENTATION</td>
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<tr>
<td>8 ENGAGED INVESTOR/S</td>
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<td>9 POLITICAL CONNECTIONS</td>
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Conversely, the most common challenges in ranking of importance were: Qualified staff, Different business culture and guanxi (relationships). Qualified staff was ranked as most important since it is hard to find competent, educated and loyal labor, Different business culture was ranked second most due to the differences in business acumen, for example agreements changed overnight without logic business related explanations, guanxi (relationships) was ranked third due to the importance of network and business socializing. Guanxi is a Chinese term meaning “networks” or “connections”. To acquire guanxi one may need to dedicate personal time for business purposes, e.g. attend informal dinners after business hours to discuss contractual terms, which is quite different from Swedish business culture.

Finding the right local personnel to fit in with the corporate culture is a commonly experienced difficulty. Having one or more Swedish representatives during an initial phase to demonstrate corporate culture and values has proved to be a successful strategy.

<table>
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<tr>
<th>COMMON CHALLENGES</th>
<th>ESTIMATE OF IMPORTANCE TO COMPANY (1-5)</th>
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<tbody>
<tr>
<td>1 QUALIFIED STAFF</td>
<td>3,5</td>
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<tr>
<td>2 DIFFERENT BUSINESS CULTURE</td>
<td>3,5</td>
</tr>
<tr>
<td>3 GUANXI (RELATIONSHIPS)</td>
<td>3,3</td>
</tr>
<tr>
<td>4 INTELLECTUAL PROPERTY</td>
<td></td>
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<tr>
<td>5 COMPETITION</td>
<td></td>
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<tr>
<td>6 COMMUNICATIONS</td>
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<tr>
<td>7 BUREAUCRACY AND RED TAPE</td>
<td>3,1</td>
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<tr>
<td>8 ENVIRONMENTAL ISSUES</td>
<td>3,1</td>
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<tr>
<td>9 BRIBERY / CORRUPTION</td>
<td>2,4</td>
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4. MAIN CONCLUSIONS AND RECOMMENDATIONS

From the scoring of key success factors and challenges as well as the qualitative input from the interviews, five key takeaways (A-E) for how to succeed on the Chinese market were concluded:

A) **Invest and devote** – Entering China requires 100% devotion and focus
   - Ensure you know your market and entry segment
   - Choose internal leader with solid product understanding
   - Expect “double” lead time and budget for establishment
   - Carefully consider alternative legal structures
   - Hold back on major structural investments until you have the first customer on board
   - Devote time to internal communication and adapt to the business culture

   “China is still a complicated market to operate in, especially within Greentech due to all regulations, hence one need to be dedicated even if your conditions for making business changes.” – Cleanergy

B) **Active choice of partners** – Choose who to cooperate with, don’t get chosen
   - Decide if you need a partner or a distributor
   - Dedicate time and money to find your business partner
   - Over-invest in educating of your business partners – you need true ambassadors
   - No distributor can cover whole China
   - Evaluate by number of business cards rather than “CV”

   “Our market is a bit special since the hospitals buy everything through agents or distributors. They cannot simply have too many suppliers. Hence, it is important with good relationships to the suppliers which provide the bigger hospitals.” - Mentice

C) **Be local** – Sales in China require local presence
   - Establish local presence to build trust based relationships
   - Start with existing product but be ready to adapt
   - Adjust price to local market but do not underprice by default
   - Understand recruitments of partner, licensing and JV in your specific industry

   “Being in China is A and O! You have to be physically in the market in order to be able to travel to see and meet your customers. You cannot do this sitting in Sweden.” – Somas
D) **Protect IPR** – IPR is more than patents and trademarks
- One needs a wider perspective on IPR including patents, know-how, trademarks and intangible assets
- Do not underestimate risk of infringement
- China practice the principle of “first to file” – be the first to register your own trademark
- Know-how will be passed on – do not be naive when sharing sensitive information

“Issues concerning intellectual property is still a hassle even though things are getting better for us. One has to try to turn all obstacles into an advantage.” - Car-O-Liner

E) **Stay agile** – Be ready to constantly adjust the business and the business model in order to stay relevant on a fast paced market.
- Local customer support is crucial
- Establish redline market adaptation loop to HQ
- Local mandate to tailor offering
- Speed and flexibility is key
- Be set for sudden changes and always have a plan B

“Working in China one can never relax as the market changes so fast, an inflexible business model means that you will lose out on business opportunities.” – eBuilder
ABOUT BUSINESS SWEDEN

Business Sweden – The Swedish Trade and Invest Council helps Swedish companies reach their full international potential. We do this by offering strategic guidance and practical support, whether it is in Sweden or on location in one of the almost 50 markets where we are represented. In addition to our work with internationalization and exports, our mission is also to attract foreign investments to Sweden, which brings competence, capital and innovation to Swedish companies. Business Sweden is owned by the Swedish government and the industry, represented by the Ministry for Foreign Affairs and the Swedish Foreign Trade Association. The shared ownership provides access to contacts and networks at all levels.

By tailoring our offering to your company’s specific needs we can help you; analyze the market, identify business opportunities, advise on market entry strategy, implement the strategy and establish a presence in China and to support in growing and developing your business. Whether you are looking to enter a new market or expand where you are already present, Business Sweden is your preferred partner in international growth.

Examples of advisory and consultancy services in our portfolio:

- Market analysis
- Partner network
- Market entry strategy
- Legal establishment
- Organization mobilization and recruiting
- Trademark and product registration
- Growth strategy
- Sales channel expansion
- Partner and distribution performance
- Inorganic expansion
- White label sales support

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