

China: Up or Out!

How to win in changing and challenging China?

Munich, November 15th, 2011

EAC- Euro Asia Consulting PartG, Munich / Shanghai / Mumbai

Overview of content

I. Introduction EAC- Euro Asia Consulting

II. Changing and Challenging China

III. Adjustment Requirements for Foreign Invested Enterprises

IV. Summary

EAC provides long term experience across major industries and global accounts predominately in China, India and Eastern Europe

EAC at a glance

Key highlights

- Established in 1992
- Independent: Partners hold 100% of the shares
- App. 54 professionals: European/ Asian bi-cultural team
- Full service provider from strategy development to implementation

Broad regional network



Customers: Major MNC's and SME

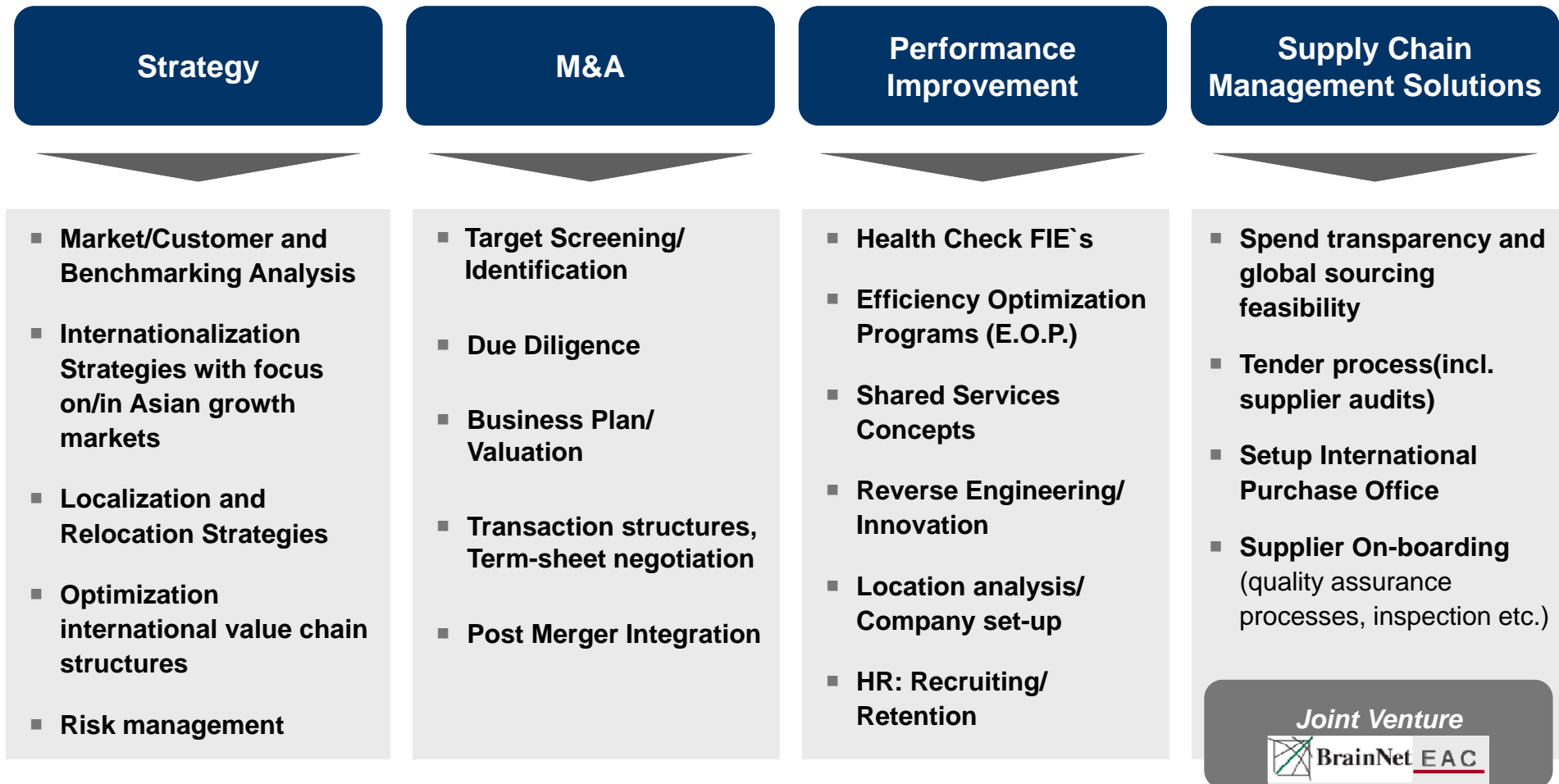


Long term industry experience



The product portfolio covers strategy development, M&A, performance improvements and SCM (in our JV BrainNet EAC)

EAC Consulting Portfolio



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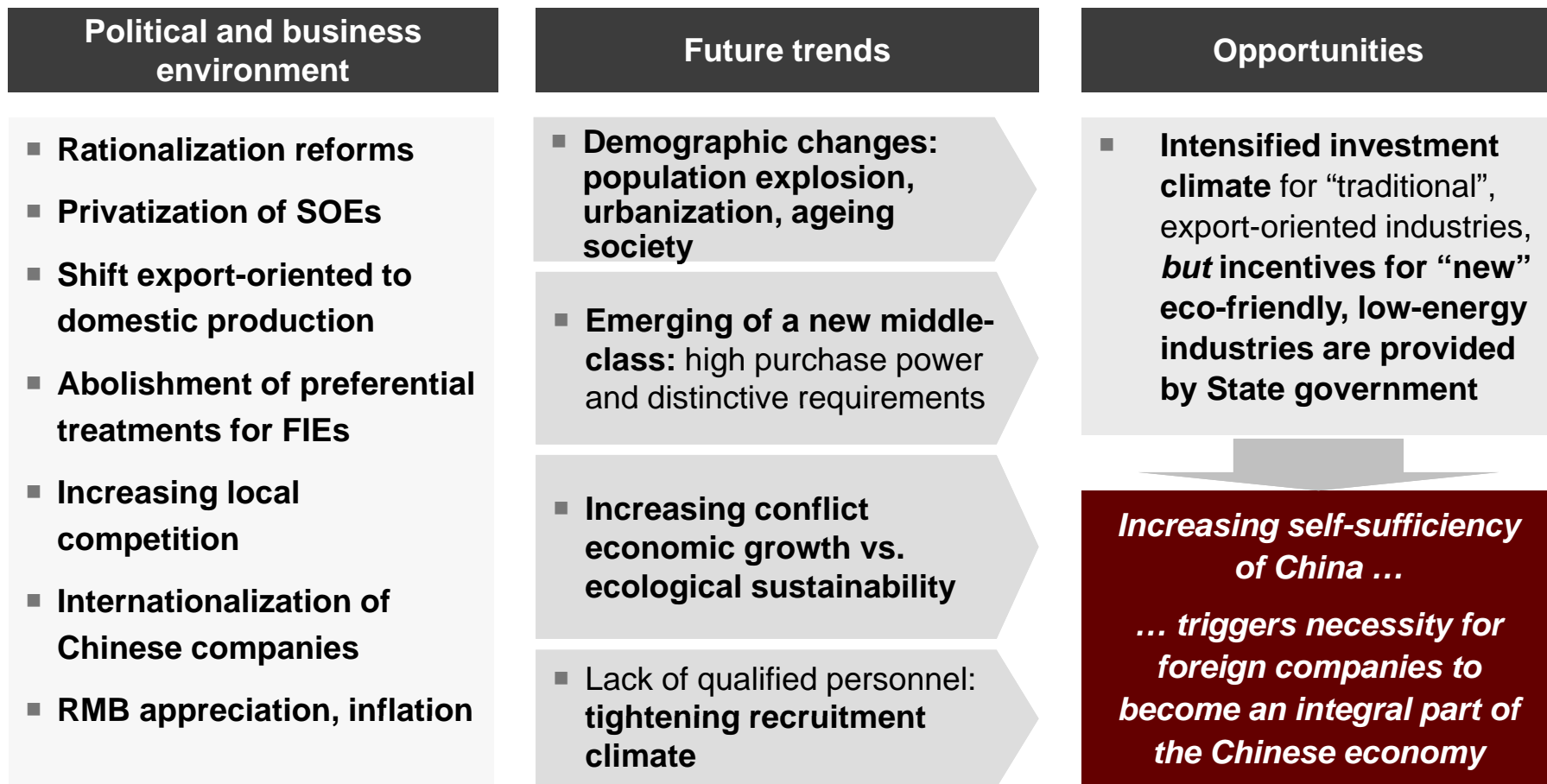
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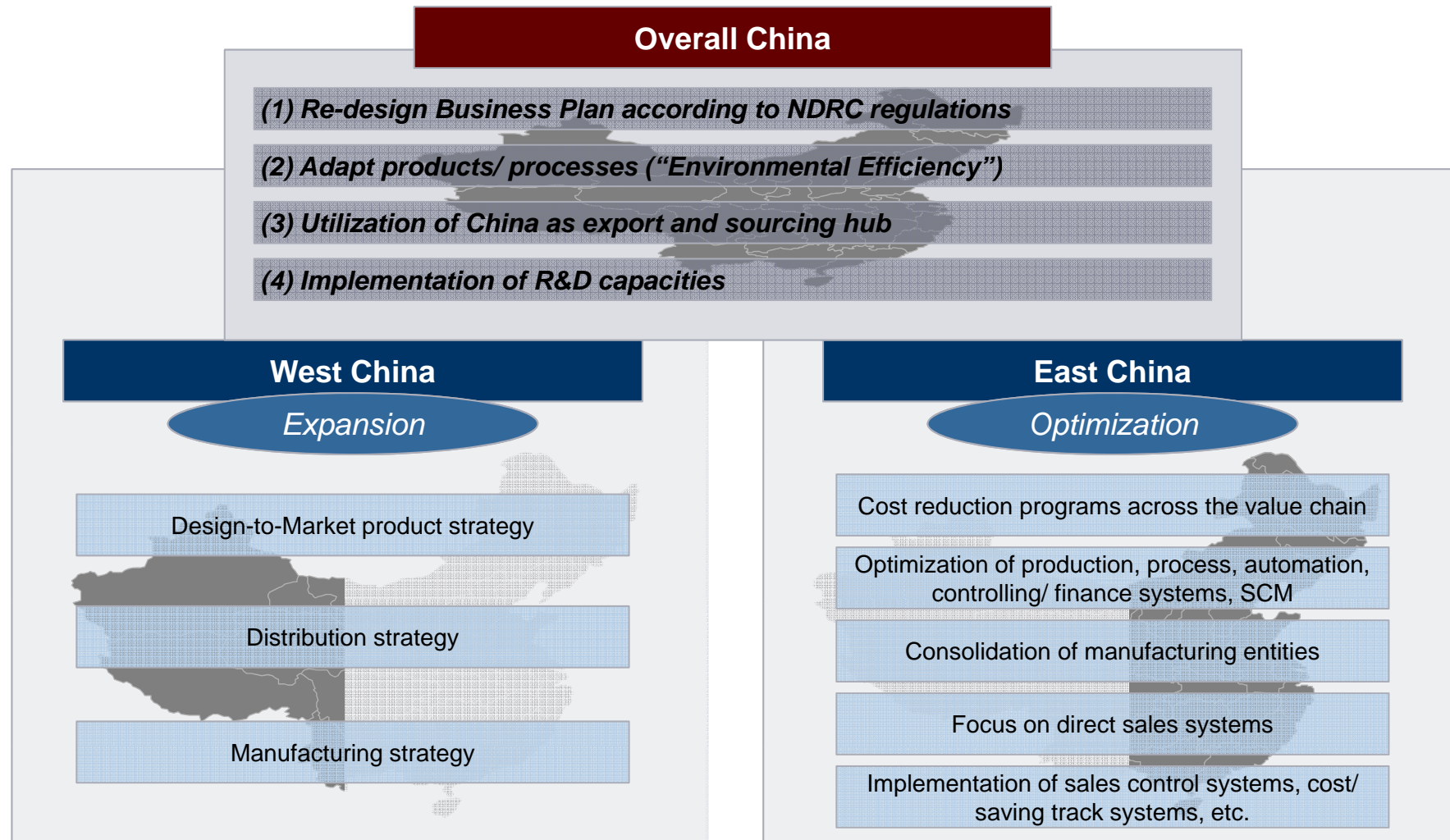
IV. Summary

China is undergoing structural changes leading to an increasing self-sufficiency – further adaptation crucial for foreign investors

"Changing China" – developments and prospects



Whereas central environmental regulations refer to all FIE's, challenges of established East ("optimization") and Western regions ("expansion") differ



Published in October 2010, the 12th Five-Year Plan defines strategic roadmap until 2015: Sustainable growth based on domestic demand and value-creation

Outline of 12th Five-Year Plan (2011 - 2015)

Macro-economic policy focus

- Accelerating the **transformation of China's economic growth pattern**
- Promoting the **market-oriented interest rate reform** and enhance a **market-based managed floating exchange rate**
- Increasing **financial support for medical services, deepen health-care reforms**
- **Optimizing foreign trade structure** and opening **more service sectors to foreign investors**
- Developing more **balanced regional development and urbanization**
- Improve its **income distribution mechanism**
- Reducing **energy consumption intensity and CO₂ emission**

Industry-related policy focus

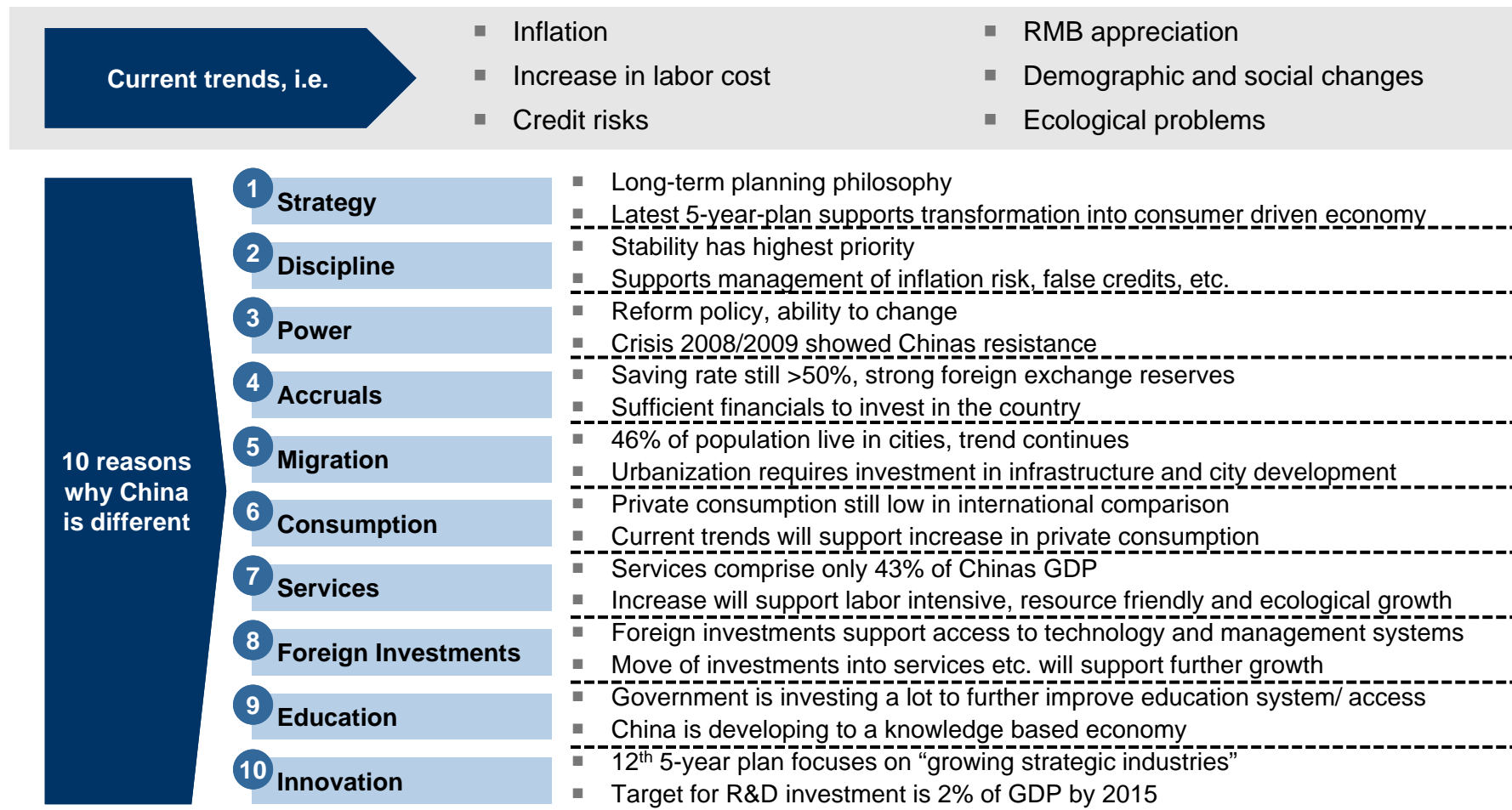
- **Energy conservation and environment protection: 10% of GDP, 2015**
- New generation information technology being with **annual growth of local demand >15%**
- **Biological industry** gets **1.1 bn EUR investment**
- **Renewable energy** will generate **10% of GDP** by 2015
- New energy automobiles: **Chinese auto and parts** should be **10% of global market share**

Technology-/ innovation-related policy focus

- Pushing development of **indigenous innovation** in the fields of information, life science, space, etc. – funding of national innovation with over 420 bn EUR during 2011-2015
- Strengthening the capability of self-reliant innovation by **setting up more national labs, research institutes and universities**
- Uniting the enterprise and research institutes to **set-up new innovation system**
- **Stronger awareness of IPR protection**; developing patent, trademark, and copyright transfers, etc.
- Increasing **high-tech investment and R&D expenditures to 2.0-2.5% of GDP**

Despite some people fear that current global developments might have a negative influence, China will continue to grow

Why China is different



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Due to the particular country and industry challenges in China foreign invested enterprises have a tremendous need to adjust- up or out is the question
Major challenges China

Challenge 1

Assessment of competitiveness of strategy and operations in China and **identification of the right levers to improve current position**

Challenge 2

What are the **right products** to address **mid range and low end markets** (focus China, but also for export into emerging markets)?

Challenge 3

Identification of **cost gap** to leading international but more importantly **local competitors** and levers to close the gap

Challenge 4

Addressing **market potentials** in **growing Tier II/III cities** and developing the **right distribution approach/partnering options**

Challenge 5

Target screening in highly fragmented Asian markets to identify the **“best of best” fit** of target for subsequent M&A process

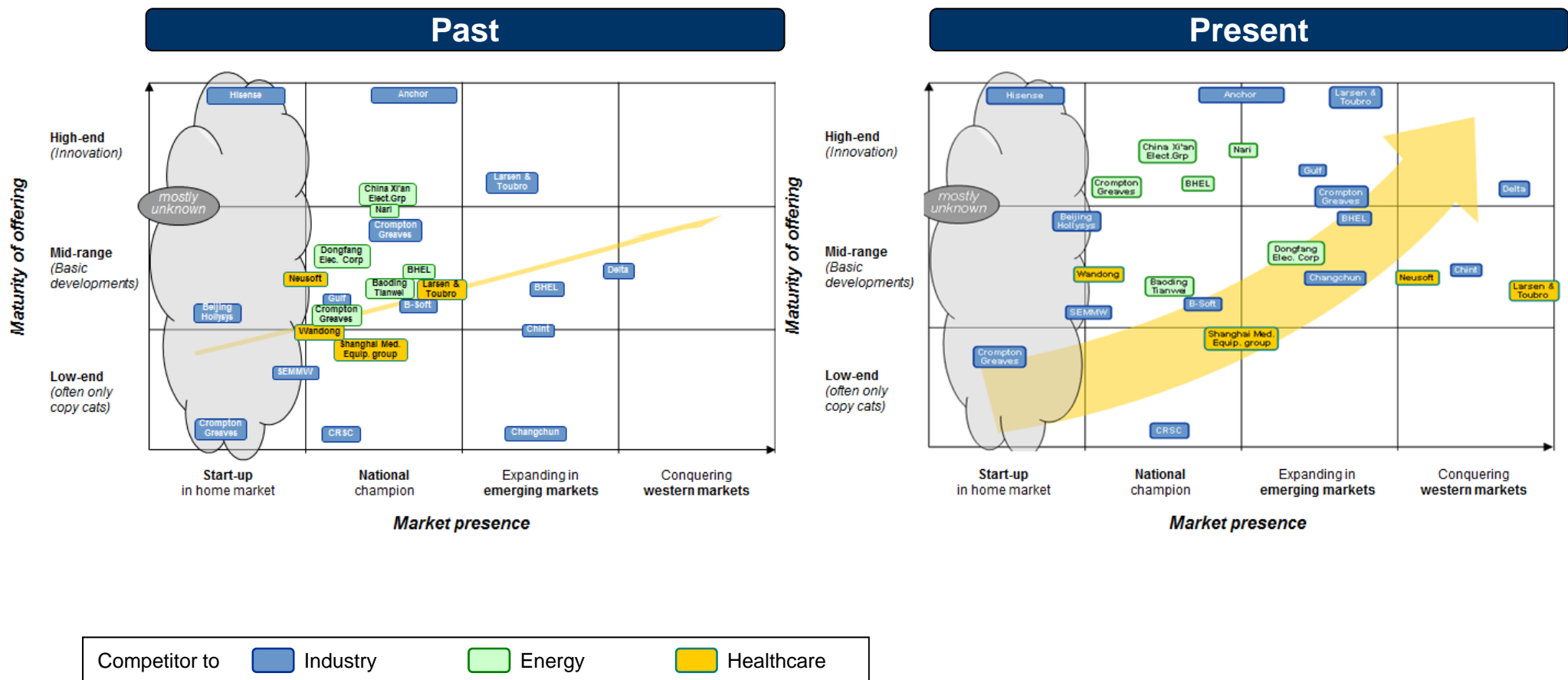
Challenge 6

Optimizing **local sourcing** and embedding this into globally distributed value chains and SCM concepts

Example increasing competition: Several years ago few innovative competitors in Asia – meanwhile numerous competing also in our home markets

Challenge 1

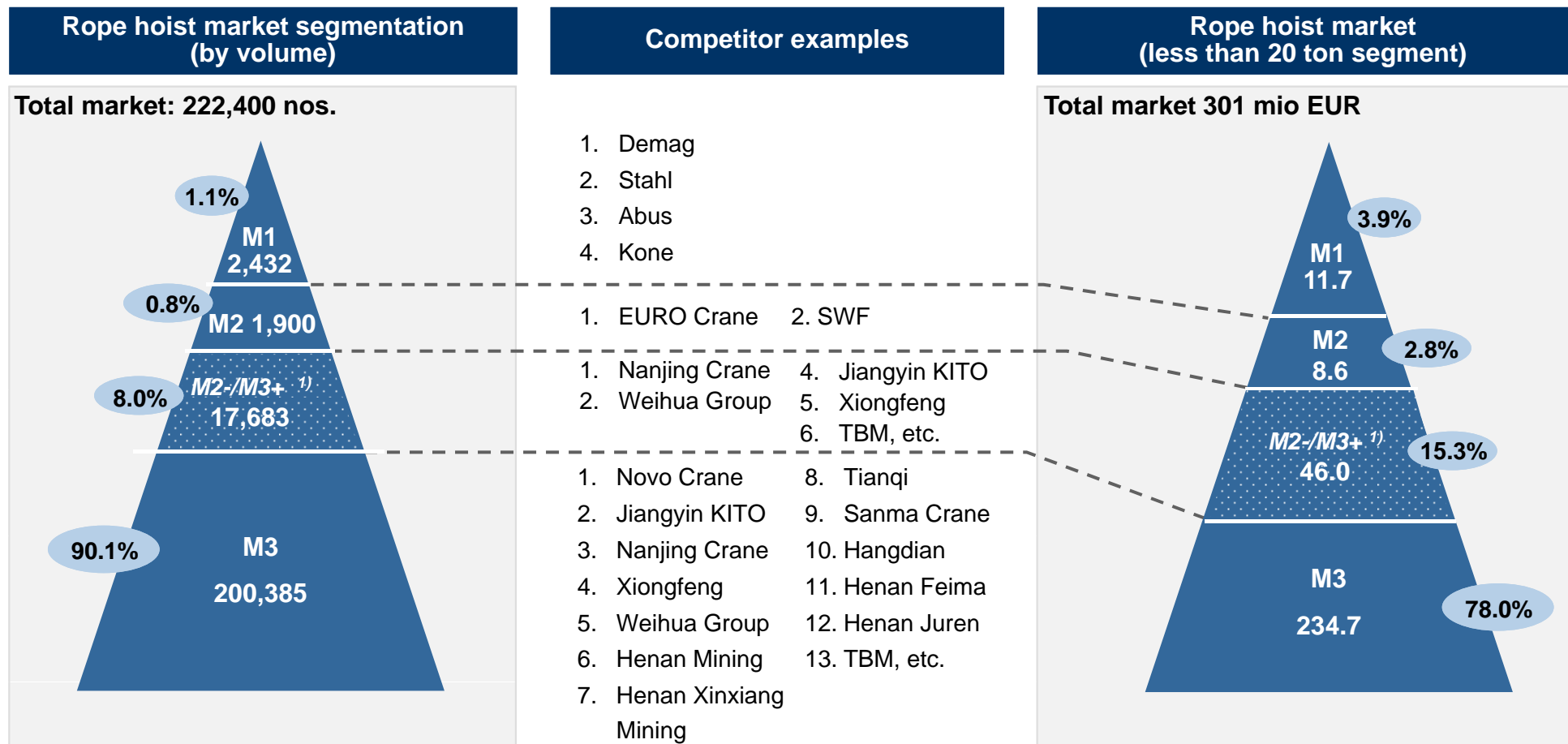
Competitiveness:
Local competitors are moving up the value chain



Example Crane industry: International players dominate the high end of the market however volume segments are more in M2 and M3 markets

Challenge 2

Products for mid market and low end:
Required to address largest market segments



Remarks: Total market size excluding functional rope hoist

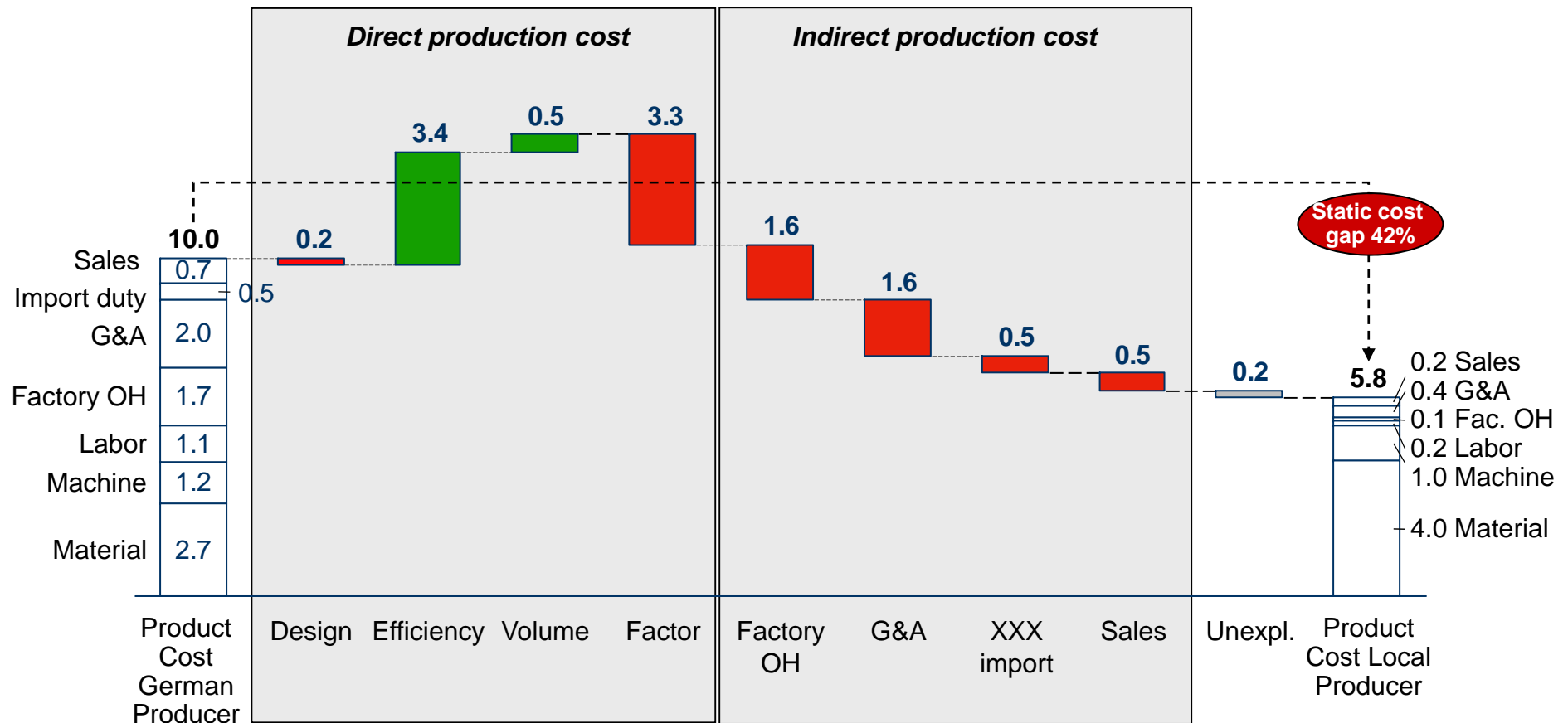
1) Actual product performance of this products are not M2 comparable. However, players in such segment target M2 market in future

Example Consumer product: Major disadvantages compared to international player: factor cost, OH, G&A – but also a small disadvantage in design

Challenge 3

**Cost gaps:
Typical cost gaps range from 30-50%, dynamic view required
Cost Gap Comparison (in RMB)**

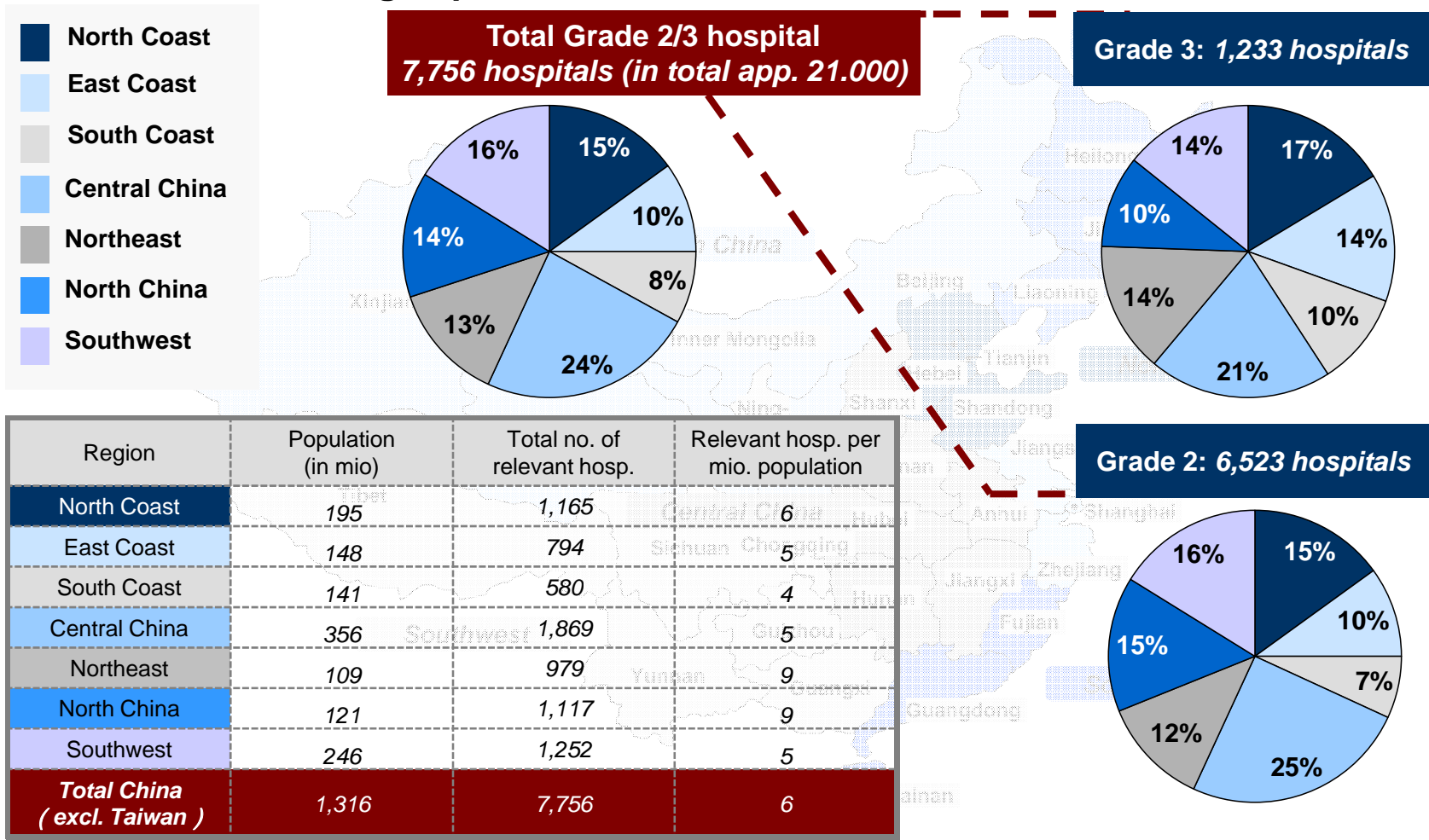
Case study



Example Healthcare industry: Even by looking at only Grade 2 and 3, 24% of potential customers are located in rural areas in Central China

Challenge 4

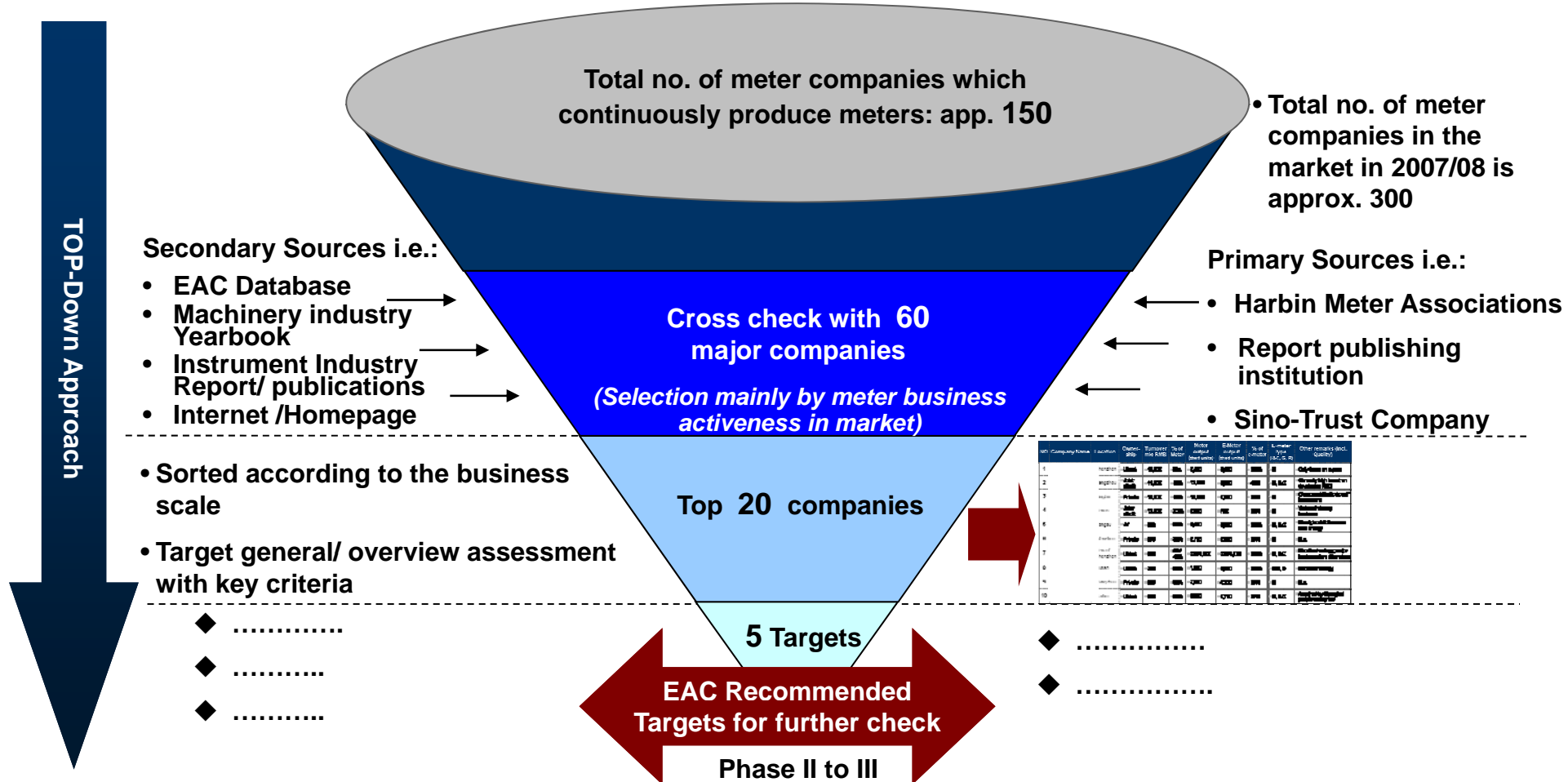
Tier II/III cities:
Increasing importance of rural areas in almost all industries



Example Meter industry: Most industries in China are still quite fragmented – proper target screening to identify strategically and financially viable targets

Challenge 5

Target screening:
Required to increase success of subsequent M&A transactions



Example Healthcare: BrainNet EAC analysis showed that based on ex-works plus logistics considerations, clients can realize savings of up to 11% on pilot order

Challenge 6

**Global sourcing and SCM:
Assessment of cost savings on TCO basis**

Sr. No.	BU / Product name	Volume per year	Average savings % on ex works	Savings on (Ex-works + Logistics)
1	Higher Assembly 1	185	33%	23%
2	Smaller assembly 1	163	36%	26%
3	Smaller assembly 2	170	46%	36%
4	Fabrication 1	24,000	20%	8%
5	Fabrication 2	24,000	0%	0%
6	Fabrication 3	7,000	0%	0%
7	Higher Assembly 2	800	14%	4%
8	Higher Assembly 3	124	18%	8%
9	Fabrication 4 with teflon coat	40	74%	62%
10	Fabrication 5 with anodizing	40	62%	50%
11	Fabrication 6 with anodizing	40	31%	19%



Total cost based on Client prices in EUR	8,4 mio EUR	
Total savings based on ex works	1,8 mio EUR	22%
Total savings based on ex works + logistic	0,9 mio EUR	11%

Logistics factor assumed		
India to Europe	10%	Based on BrainNet EAC experience
CEE to Europe	7%	
China to Europe	12%	

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According to EAC experiences we would recommend to consider the following points when assessing any China engagement

Summary: China UP or OUT

Challenge 1

- **Strategy: Clear aspirations towards addressing Chinese market with clear competitive advantages – “old” export driven models are out, defensible advantages required**

Challenge 2

- **Products: must meet specific requirements of the Chinese (and other emerging) market, right product approach is essential addressing mid market and low end (or defensible niche)**

Challenge 3

- **Cost gap: Meeting cost levels of comparable Chinese competitors – use all levers (design, factor cost, volume, processes) to improve cost position**

Challenge 4

- **Distribution: Concentration on western provinces are not sufficient anymore to capture the market potential – rural areas to be approached (however with the right products)**

Challenge 5

- **Target screening: In case market position can not be build up stand alone basis, M&A might be a viable path – however careful target screening essential – M&A track record still low**

Challenge 6

- **Sourcing/SCM: Only if the product is localized (incl. R&D) full sourcing potentials can be leveraged and might also offer global sourcing opportunities if carefully managed**

Created for Success



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