

# **A Businessman Eye - Made in China: three ways Chinese business has evolved from imitation to innovation**

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Businesses and governments around the world are watching as China grows, innovates and extends its influence. We explore how the country got to where it is and what might be in store for its future in our series Understanding China's Influence.

Most of us use products made in China every day and are aware of its growing economic power as a factory to the world. But China intends to become a developed nation by mid-century and integral to this ambition is its intense focus on innovation.

In a very few decades, Chinese companies had evolved from imitators to imaginative and effective innovators.

As part of my research with my colleague George Yip on this issue [[1](#)], we identified three key phases in China's development:

1. From Copying to Fit for Purpose
2. From Followers to World Standard
3. From Seeking New Resources to Seeking New Knowledge

Chinese companies now pose a challenge to established multinationals, as they enter the markets of the developed world to become insiders.

Since China's former leader, Deng Xiaoping, implemented market-oriented economic reforms to China in 1979-80, the driving forces of this transformation have been the customer and the culture. Chinese customers have an insatiable and rapidly growing demand for products, as the large, diverse population seeks better lives. This has stimulated many companies to develop affordable products for those needs. And a culture of entrepreneurship in the business sector has been facilitated by a far-sighted government with a strong drive for independence and economic development.

The Chinese government has fostered an innovation ecosystem across the country, consisting of some 100 science and technology parks, universities and government research institutions, which

provide support for new enterprises. The Chinese government and business invested some US\$190 billion in research and development in 2013 [2], which is around 40% of the annual R&D investment in the United States.

China's research and development expenditure represents just over 2% of its GDP, which is slightly more as a share of GDP than that of Western Europe. The government's priority for technological development is matched by the entrepreneurial spirit and drive of Chinese entrepreneurs.

### **From copying to fit for purpose**

In the first phase of development, Chinese companies started by copying products and processes from Western firms or producing components for the supply chains of multinational corporations. Chinese suppliers to multinationals were forced by their business partners to achieve high standards of quality at low cost [3].

While demand from domestic consumers was initially for very cheap products, Chinese producers quickly learned to develop products that were "good enough", combining fitness for purpose with low cost. For example, an enterprising start-up created the "Apple Peel", a component which the customer could combine with an iPod Touch, turning it into a mobile phone, very much like an iPhone.

Contrary to the low level of competition in China's state-owned sector, private companies operated in sectors that were more open and competitive. Chinese firms' better understanding of local customers enabled them over time to compete effectively with multinationals in the Chinese market.

Although local firms lacked the research and development capabilities of foreign companies, they were helped to innovate by the extensive technology network and innovation ecosystem developed by the Chinese government. With the experience they gained in satisfying customer demands and dealing with intense competition, Chinese firms were also able to diversify into other markets and more advanced products.

An example of this is Joyoung, a Hangzhou-based domestic appliance company, which began as the inventor of an appliance that makes soy milk, later copied by many others (including foreign firms). Joyoung built on its success with its soy milk appliance to become a large diversified maker of small household appliances.

This competitive experience in the fast-growing markets of China led Chinese firms to the second phase in their evolution.

### **From followers to world standard**

In this phase, Chinese firms ambitiously set their sights on achieving global standards, particularly those companies active in export markets, such as the domestic appliance firm Haier.

Haier from the beginning was focused on innovation and is now the biggest company by sale revenue in the appliance sector. A legendary innovation of Haier's is a washing machine that washes potatoes as well as clothes, which was in response to a need from farmers.

Many of China's companies have now reached global standards of quality. However, very few have strong brands that are recognised outside China. This is one of the reasons for the third phase in

their evolution.

## **From seeking new resources to seeking new knowledge**

Building on the capabilities they developed in the domestic market, coupled with the cash generated by their successes, Chinese businesses are now moving outside China.

In contrast to the earlier expansion of Chinese firms investing abroad in petroleum and other natural resources, this third phase is very much about exploiting innovation developed at home and applying it to the consumer and industrial markets of the West.

Chinese businesses are seeking brands, market access and technologies that may be missing from their home-developed portfolios. Their entries into foreign markets are often by acquisition, and European firms (particularly German middle-sized companies) have been popular targets.

Others have set up research and development centres in the United States and Europe, located in centres of innovation such as Silicon Valley. A good example is the telecoms equipment and smartphone maker Huawei.

Over many years of international expansion, Huawei has developed a global network of 16 research and development institutes and 36 joint customer innovation centres. Huawei and the other major Chinese telecoms company ZTE are consistently among the top 10 patent filers each year in the international patent system (PCT) application process [\[4\]](#).

## **Chinese lessons in business management**

Chinese firms have also adopted a number of management practices that are less common in the West. Our research identified ten of these, ranging from deep understanding of their customers, rapid decision-making, rapid prototyping and learning from mistakes, to a ready willingness to deploy extensive resources to innovate.

While these are not of themselves particularly new, they are a source of competitive advantage in the Chinese environment, where foreign companies have not applied them consistently.

Foreign companies have much to learn from China, as it is becoming a leading market for the world. They can develop in China capabilities that they may have neglected, including bold experimentation, speedy implementation, new product category creation, focus on “lean value” and developing mixed teams and global leaders.

There is a tidal wave of competition approaching the developed world from China. The best way multinationals can prepare themselves for this is by participating directly in the Chinese innovation ecosystem.

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## **P.S.**

\* The Conversation. October 26, 2016 8.10pm BST:

<https://theconversation.com/made-in-china-three-ways-chinese-business-has-evolved-from-imitation-to-innovation-67236>

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## **Footnotes**

[1] <https://mitpress.mit.edu/books/china's-next-strategic-advantage>

[2] Idem

[3] <http://fiid.org/wp-content/uploads/2012/11/China's-Run-of-the-Red-Queen---Government-Innovation-Globalization-and-Economic-Growth.pdf>

[4] <http://www.wipo.int/pct/en/activity/>