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# CHINA'S FAST CLIMB UP THE VALUE CHAIN

From high-tech unicorns to specialty chemicals, the country's economy is moving swiftly beyond its lower-margin roots.

**The Chinese are now** the world's most avid online purchasers of goods and services, which they are likely to pay for with a mobile device. The deepening digital ethos reflects a broader consumerization of the Chinese economy. These trends are creating fertile grounds for digital start-ups while also transforming traditional industries such as specialty chemicals as they supply materials for advanced industries and higher-margin consumer goods. Global companies in China should ensure that they're not competing for yesterday's markets.

## CHINA'S BREAKNECK PACE OF DIGITIZATION

The consumer economy is now among the world's most digitized, and business transformation is accelerating with an explosion of start-ups and new business models.

by Jeongmin Seong, Kevin Wei Wang, and Jonathan Woetzel

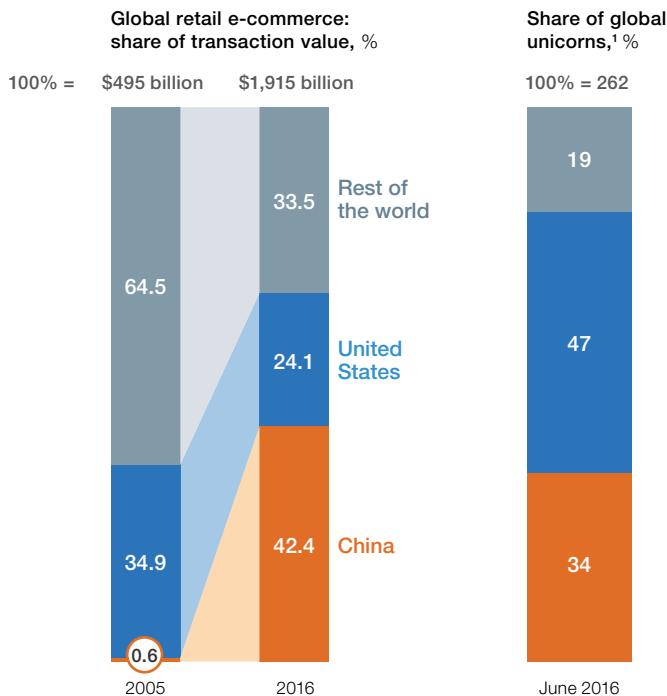
Everything speeds up in the digital economy, and nowhere is that more evident than in China. In little more than a decade, China has come from almost nowhere to become the largest e-commerce market in the world, accounting for more than 40 percent of global e-commerce transactions (exhibit). China's mobile payments are 11 times the value of those in the United States thanks to consumers' early embrace of the technology. This flourishing digital culture is paying

innovation dividends, as China is home to one in three of the world's start-up "unicorns," those with more than \$1 billion in market cap. And China now places in the top ranks of global venture-capital investment in virtual reality, autonomous vehicles, 3-D printing, robotics, drones, and artificial intelligence.

That innovation base is leading to a host of new business models based on emerging technologies that might soon

## Exhibit

China's digital economy has jumped from almost nowhere to lead in e-commerce and seed many successful start-ups.



<sup>1</sup> Defined as a privately held start-up valued at more than \$1 billion.

Source: Dealogic; eMarketer; iResearch Consulting Group; PitchBook Data; TechCrunch Crunchbase Unicorn Leaderboard; McKinsey Global Institute analysis

revitalize other, previously lagging sectors of China's economy. According to a recent report from the McKinsey Global Institute, these new approaches include directly linking business buyers and suppliers in disintermediation plays, disaggregating incumbent value chains as digital attackers move in, and creating a raft of new digitally "dematerialized" products and services.<sup>1</sup> Creative destruction on a grand scale, which would boost productivity and the international competitiveness of China's economy, might be next. Between 10 and 45 percent of revenue in China's industries could shift from old business models to new ones enabled by digital

by 2030. The transformation is picking up steam: in 2013, industries in the United States were 4.9 times more digitized than ones in China; in 2016, that figure had fallen to 3.7 times.<sup>2</sup> 

<sup>1</sup> For more information, see "Digital China: Powering the economy to global competitiveness," McKinsey Global Institute, December 2017, McKinsey.com.

<sup>2</sup> Based on the McKinsey Global Institute Industry Digitization Index, which measures the degree of digitization in 22 industries by analyzing more than 20 indicators on digital asset, usage, and labor.

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# HOW CHINA'S SHIFT TO CONSUMER-LED GROWTH IS CHANGING INDUSTRY DYNAMICS

The experience of the specialty-chemical sector shows the ground-level impact.

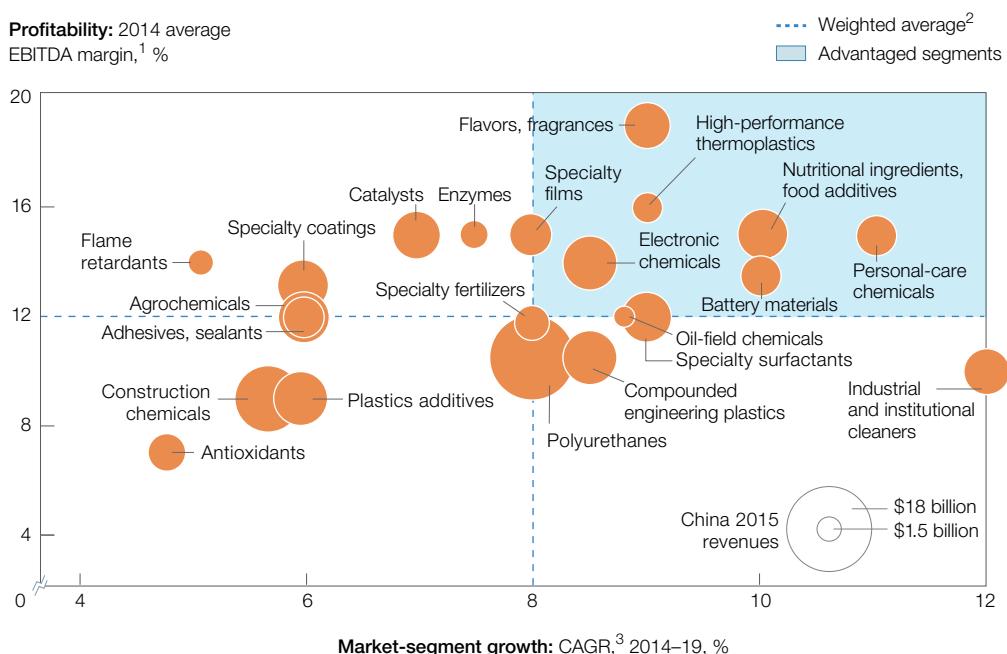
by Elisabeth Hirschbichler, Nathan Liu, and Ulrich Weihe

China's move from an investment-led to a consumption-led economy is a familiar theme. But the momentous shift is changing the fortunes of manufacturing industries in less visible ways as demand

for higher-value products expands. The specialty-chemical industry is a case in point (exhibit). In line with wider economic trends, the fastest growers (and those with higher earnings before interest, taxes,

## Exhibit

Many of the **specialty-chemical** industry's advantaged segments are related to the manufacture of consumer goods.



<sup>1</sup> For selected specialty-chemical sectors. EBITDA = earnings before interest, taxes, depreciation, and amortization; margins estimated based on EBIT margin + 5 percentage points; correlation derived from 50 publicly listed Chinese specialty-chemical companies.

<sup>2</sup> Excludes construction chemicals and polyurethanes.

<sup>3</sup> Compound annual growth rate.

depreciation, and amortization) include the specialty chemicals used in the manufacture of consumer goods such as personal-care ingredients and fragrances. Similarly, growth in advanced industries such as autos, aerospace, and electronics is supporting higher demand for the likes of electronic chemicals and high-performance plastics. On the flip side, products used in traditional industries are growing more slowly, their margins squeezed as these markets become more commoditized.

There may be lessons for other industries in the way the changes are reshaping the specialty-chemical sector. Chinese players will benefit, to be sure, but the new playing field should also allow international players—which have been losing share on their earlier, older-line investments—scope to reposition themselves to their advantage. The demand for more sophisticated products, after all, plays to the strengths of foreign companies in specialty chemicals and elsewhere.

With China's economic turn likely to affect the prospects for individual specialty chemicals in different ways, executives will need to carefully adapt product strategies to fit these evolving patterns of demand. 

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For a more complete set of findings, see "A game plan for international specialty-chemical companies in China," on McKinsey.com.

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