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INTRODUCTION

Welcome to the Center for the Future of China's 1st annual *Five-Year Forecast!*

For nearly a decade we have been probing the edges of China's business landscape for our pioneering members, providing a strategic window on their long-term interests and an early warning system about emerging opportunities and threats. With the encouragement of these early supporters of the Center for the Future of China, and other friends and colleagues on both sides of the Pacific who found our "fresh window of understanding" about China's future useful, we have launched the *Five-Year Forecast*.

There is no more uncertain future business environment than China. Its complexity and pace of change is dizzying. Churning 24 hours a day and seven days a week, China is an economic "badlands" where navigation is not for the faint of heart. Although a lot of information about China exists, there is precious little sense-making. Every day, executives in both Chinese and multinational corporations make wrong turns and backslide in their quest to create China's new marketplace. Often these mistakes are costly—sometimes costing their firm's very existence.

Some people may question the importance of studying the future of business in China. After all, who has time to think about the future when surviving day to day in the very busy present consumes every ounce of energy and focus? But the basic business challenge of balancing short-term tactics with long-term strategies especially pertains to China. So much of its future will sharply contrast its past that anticipating the future will become a competitive advantage. Successful business leaders in China will force themselves to look at their organizations carefully—from an objective distance and up close and personal. Their business processes and quagmire of carefully crafted

guanxi, confusing and shifting consumer behaviors, fragmented business infrastructures, and undecipherable regulations—all will need to be examined and understood.

In nearly a decade of forecasting and providing foresights about China, we have learned that understanding the direction and pace of change of the environment—what we call the "driving forces"—is critical. An extensive view of the whole—the big picture—is crucial to forging the new strategies that fuel long-term successful businesses. This, then, is the purpose of the *China Five-Year Forecast*. It takes a longer view, one with enough distance to reduce the distractions of the noisy chaos of the day-to-day business world to provide a calmer context for anticipating the future.

Each year's *Five-Year Forecast* will focus on trends and issues that are important to incorporate into business thinking today because of their big impacts over the next five years. The forecasts will provide a wealth of evidence-based insights, and over the years this accumulation of strategic windows and forecasts will bring the future business landscape into sharper focus for program members, enabling them to make better informed decisions about the future.

Welcome to our first *Five-Year Forecast!* We hope this strategic tool becomes a key to unlock your successful business future in China.

—Mary O'Hara-Devereaux, Ph.D, President, CFC
Chen Zhangliang, Ph.D, Vice President, Peking University

THE CHINA FIVE-YEAR FORECAST AT A GLANCE

This inaugural year, we focus our key forecasts on China's shifting economic context, its dynamic society, the rise of the new consumer, and technology innovations and applications in key industries. We have a special section on business issues, which includes case studies of nine companies that we think provide strategic models for the future. We wrote this *Five-Year Forecast* in a period marked by far-reaching worldwide events—at the tail end of what seems to be a mild global recession, shortly after the admission of China to the World Trade Organization (WTO), and after the tragic events of September 11, 2001. All of these events have increased the uncertainty in China's future.

The Economic Context

Economy in Transformation: Core Economic Forecast.

We begin the report with a concise presentation of our longer-term economic assumptions and forecasts, providing a set of filters for making sense of the pace and direction of China's changing economy. China will likely continue to benefit from "the advantages of backwardness"—the ability to maintain growth by successively eliminating long-standing structural and institutional barriers over the next five years. But challenges and uncertainties abound. Will China's consumers be a new engine of growth? Or will they maintain high levels of savings equal to those in the mid-1990s? We explore and forecast several key trends and issues.

Post-World Trade Organization China: Speeding the Juggernaut Along.

China's accession to the WTO will set off a number of external and internal shocks resulting in many uncertainties. The actual pace of change for key shifts—such as when the banks will clean up their balance sheets, how fast an insurance industry will grow, the true extent of actual control joint-venture partners will be able to exert, and the impact on farmers—is unknown. We explore the possible impacts of joining the WTO over the next five years. Overall, it will be a long, slow, painstaking process with many surprises.

The Networked Economy: The Illusion of Connection.

The Internet is still an elite phenomenon in China and the four pathways to diffusion—people, the market, technology, and the government—all have major obstacles. Chinese firms and the government need to accept that adoption of modern business best practices is the precursor to networked economy success.

The Northwest: Exploring Opportunities Along the Silk Road.

Next, we take a business journey on the old Silk Road, exploring some business opportunities in the far western frontier. The development of the western regions will not resemble that on the coast for two inherent reasons: they are remote from markets, and most provinces and autonomous regions have scattered populations. However, there are pockets of opportunities, like Shaanxi's Guan Zhong Corridor, tourism, and infrastructure projects. All opportunities are only for those companies with the capacity for long-term thinking.

A Dynamic Society

China's Generation: Diverging Lifestyles.

Behind the massive, ongoing changes in China are the people. And a key question for each person is: "Who will I become in the new China?" Based on our consumer and lifestyle research, we present a generations framework and analysis of China's people—who they are, what events shaped them, and what lifestyle innovations are appearing as China moves from a mass to a class society. Without a deep understanding of the people, business won't be able to decipher them as consumers.

Employment Conundrum: Closing the Skills Gap.

The labor force will pass through many growing pains on its way to becoming more market driven, from legacy policies that fragment labor to poor job-seeking skills throughout the workforce. Unemployment, particularly rural unemployment, is a serious problem in China today, and one of the solutions will be to close the skills gap.

Cultural Innovation: Making Connections That Matter. China must make many changes to prosper in the next few decades, including some cultural innovation. Neither China nor the United States is "other" oriented, and both have deeply held values of cultural superiority. How can the deep connections and understandings needed for long-term successful business partnerships be developed?

The New Consumer

Aging China: New Older Consumer. Chinese new consumers act differently than traditional consumers in the marketplace. These innovators in consumption are cutting new ground across the generations. How can businesses tell which early innovative behaviors will catch on with the rest? This year we look at the older new consumers, a surprisingly large group of people who are becoming consumers for the first time late in life and are experiencing rising disposable incomes.

The Sandwich Generation: The Knowledge-Worker Pioneers of China's Changing Workplace. There is a new knowledge worker on the rise in the Sandwich Generation, the first generation of workers who will have to make their way without an "iron rice bowl." The concept of career is new to them, and given their historical influences, they are a cautious and wary group who will give only limited loyalty. They know they must learn on the job to survive their whole career, and so they will demand education from their companies.

Business Issues

China Reaches Global Markets: The Need for "Business Middleware." All global businesses know that an important part of their future is being able to connect with Chinese companies to form joint ventures, partnerships, supply chains, and distribution channels. But that's not as easy as in their own countries. What are the tools and understandings—the missing middleware—to make those connections work in the long term?

Chinese High-Tech Diaspora: Innovation Flows Across the Pacific. Next, we open the window to China's high-tech diaspora and its specific linkages among California's Silicon Valley, Taiwan, and mainland China. We focus on Shanghai's emerging role in chip manufacturing.

Business Strategies for the Future: Nine Case Studies. New business models and best practices will emerge across all industries in China, particularly with its entry into the WTO. We present nine cases that offer interesting models for future business in China.

Technology Innovations and Applications

The Future of Chinese Banks: On the Bumpy Road to Integration. The transformation and productivity of the Chinese economy can be speeded up with the strategic application of innovations in science and technology specific to China's needs. Yet, how ready are the Chinese to apply and generate them? We explore the implications of centralization and present our view of nonperforming loans to forecast the future of e-banking.

High-Tech Manufacturing: Moving Fast Up the Production Value Chain. The application of information technology in high-tech manufacturing is critical to keeping China's development moving fast in this important area for the economy. We look at both the substantial drivers and brakes to new information technology strategies and forecast readiness to use them effectively. China will continue to grow into a major player in high-tech manufacturing but will struggle to upgrade all the technology and human component parts.

The Future of China's Software Industry: Global Aspirations, Local Success. The development of China's software sector will be much more complex and multidimensional than India's rise as a software export giant, and one big differentiator is China's growing domestic market. China's strengths, such as its large pool of programmers, and weaknesses, such as its relatively poorly run and poorly funded software companies, will need to offset each other as the soft-

ware sector develops. The future holds both promise and uncertainty. Yet there are four steps that will lead to successful development. China can take the first step when the government acts as a facilitator and enabler by revamping its purchasing policies and practices to level the playing field.

Wildcards for the Future

What is the most destabilizing trend or event that China could experience? The wilder it is, the bigger the potential threat. Wildcards are trends or events that have a low (less than 10%) or uncertain (simply unquantifiable) probability of occurring, but if they do happen, they will have a very big impact. Wildcards help decision makers think more creatively and strategically about the future of very uncertain places.