Don’t belittle China’s innovation potential

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Western competitors would be wrong to write Chinese companies off as copycats, warns **Edward Tse**

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Is China a breeding ground for innovation? Most people wouldn't say so, as China is so often associated with copycats, restricted freedom of speech, poor protection of intellectual property rights (IPR), rote-learning education and an overbearing state sector. For some or all of these reasons, outsiders tend to see China as lacking the fundamentals for successful innovation.

But this view is simplistic and superficial. Let's look at two of these so-called reasons in more detail. Lack of IPR protection is a real issue, but it hasn't stopped innovation from taking place. Over the past decade, there have been many examples of innovation originating from China, both product and technology innovations as well as business model innovations. One can argue that change is still at a snail's pace, but China's IPR protection is improving and in recent years there have been cases where foreign companies successfully sued Chinese companies for IPR infringements.

The dominance of the state economy is another often-cited reason inhibiting innovation in China. Yet even the state sector can create innovations. Large scale examples include China's space programme, its expanding high-speed rail network, the world's highest-elevation railway (to Tibet), and the world's fastest supercomputer. The list goes on and is lengthening. These were all developed under the auspices of the state sector. Regardless of what many people say about the Chinese copying or even stealing technology from others, for projects as complex as these, real innovations clearly do exist, and the dominance of the state economy was able to provide ample funding for these advances.

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China's market economy is still developing, and is now slightly over two decades old. This fundamental transformation away from the fully planned economy so deeply ingrained during the Chinese People's Republic's first 30 years is still just a small blip in China's long history, and nothing that we have seen during the last 20 years is by any means perfect. But the forces shaping the future change need to be fully understood, and the direction and speed of their change recognised and appreciated.

Despite the state sector's role so far, most of China's innovation will not be coming from there. It will come from the companies or even individuals who compete in China's increasingly open economy. And that includes both Chinese and foreign private companies as well as state companies. And as more mixed equity enterprises are formed in response to the needs of a competitive market, the lines separating these different kinds of companies will become more blurred than ever. China is undergoing a measured but definite process of deregulation, sector by sector. Not all sectors of the economy will ever be fully deregulated, but the trend is clear.

The size of China's market and the potential for profits mean that when the government opens up a sector it becomes an arena for some of the world's most intense competition. This forces companies to be innovative and to create the best products, services and business models to achieve success. There's also a strong "why not me?" mentality among Chinese entrepreneurs, so when an opportunity arises they tend to give it a try. Some – maybe even most – may fail, but with a population of 1.4bn, even a small percentage of successes is noteworthy and these are going to encourage many others to try their luck. In short, waves of new entrepreneurs in China will be pushing for greater experimentation and more innovation.

Xiaomi, one of China's leading smartphone players, is an excellent example of an innovative company in a highly competitive industry. Xiaomi's leader, Lei Jun, understood the power of the Internet and built his company's business model by "listening to customers" through social media – the concept known as "crowd-sourcing". Its strategy is working so well that Xiaomi's revenues grew from zero in 2010 to $5bn in 2013, with the company now reportedly valued at $10bn. The late Steve Jobs at Xiaomi's U.S. counterpart, Apple, didn't believe in focus groups because he felt he knew best, but Lei Jun takes the opposite approach, and is convinced that customers will be the best ones to tell him how his products should be designed and how its service model developed. With millions of fans, Lei Jun claims his business model is not to make money from the hardware, but from services.

At a more basic level of innovation, Haier, a leading Chinese white goods manufacturer, quickly gained market awareness and share by introducing a washer capable not only of cleaning clothes but also potatoes. This sprang from a customer claim and is an example of Haier's "customer centric" management philosophy. Not every Chinese company will be like this, but the market is changing so rapidly that there are major incentives for Chinese companies to be agile, nimble and innovative.

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To successfully breed innovation, a country must be tolerant of mistakes and failures. These failures will include short-lived innovations, but they are part of the process and in fact often further examples of how innovation will be sustained in China. Tencent’s QQ, for example, was a precursor to WeChat, a fast-growing Twitter/WhatsApp type of platform very popular not only in China but internationally too. Although only two years old, WeChat already has over 600m registered subscribers and over 270m active users and the numbers are growing fast. It introduced voice capability before WhatsApp, along with a more recent payment capability that is undercutting China’s dominant incumbent, Alipay of Alibaba.

Telecom operators see WeChat and Sina’s Weibo as competitors because they eat into their own text messaging businesses and the prevalence of the Internet, in particular wireless internet, is fast cutting out traditional distribution methods. Only a few years ago, Gome and Sunning were the dominant retailers through their “bricks-and-mortar” retail stores and today, Sunning is having to quickly transform itself into an “O2O” (Offline to Online) retailer. The same goes for companies like Haier, while many retailers, especially state-owned ones, are looking at how they must revamp their business strategies to remain competitive.

As China’s economic transformation continues, more and more monopolies will be broken down. It’s unlikely that China will become completely deregulated in the near future, but it’s heading in the right direction, and the new government re-affirmed this trajectory at its recent Third Plenum when it was emphasised that market forces will play a “decisive role” in China’s economic development and non-state capital will gain access to more sectors. State-owned enterprises (SOEs) are set to remain important, but non-state companies were for the first time put on an equal footing with the SOEs. Experimental free trade zones like that of Shanghai are to be established in more cities across China, and an effort will be made to create economic conditions that are conductive to innovation by entrepreneurial companies, both foreign and state-owned.

China's unique qualities are its complexity and size. Even a small percentage of successes can be significant in the context of global commerce. Europe and the rest of the world will need to keep a close eye on China's innovations because as well as threats they will bring with them opportunities.

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