

What China's five-year plan means for business

McKinsey analyzed the potential impact on 33 industries. Two dimensions stood out: the plan's effect on profit pools and on the competitive landscape.

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China's recently announced 12th five-year plan aims to transform the world's second-largest economy from an investment-driven dynamo into a global powerhouse with a steadier and more stable trajectory. The plan affects domestic and foreign companies in all industries. To help senior managers decode and understand its provisions, we analyzed the potential impact on 33 industries. Two dimensions stood out: the effect on their profit pools and competitive landscapes. (For a detailed look at this analysis, see the interactive exhibit, "The economic impact of China's 12th five-year plan.")

The plan's likely impact on profit pools was categorized as either favorable (for example, sensitive to an increase in domestic demand or specifically targeted for special treatment), unfavorable (subject to restrictive policies), or neutral. For the effect on the competitive landscape, we looked at the intensity of regulation.

Five groups emerged from the analysis. New strategic industries are singled out for global leadership. Domestic-consumption engines drive consumer growth in the homeland. Restructurers are under government mandate to change. Reinventors are mature industries that must innovate and reinvest to close the gap with global leaders. Social utilities are large state-owned enterprises managing significant components of the national infrastructure.



The economic impact of China's 12th five-year plan

This interactive charts the effects of China's new plan on 33 industries, grouped by their common exposure to its potential impact.

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New strategic industries

The plan characterizes a handful of industries as emerging battlegrounds where countries will be competing for technological leadership during the next wave of development. These industries, including new energy sources and biotechnology, are distinguished by their high profit growth potential and moderate state oversight. In these areas, the government has dedicated itself to incubating national and global champions by helping them gain leading technologies and expanding their commercial capabilities.

China's government aspires to increase the share of GDP these industries contribute from about 1 percent today to 8 percent by 2015 and to 15 percent by 2020, presenting a huge market potential for domestic and foreign businesses alike. Although significant uncertainties remain in such young markets, companies that compete in them should focus on building core competitiveness in technological and commercial capabilities, as well as on gaining recognition as local innovators. Domestic players should concentrate on acquiring leading technologies and building relationships with local governments. Foreign companies must bring advanced technology and be seen as trusted partners for local innovation.

Competition, its texture defined largely by regulatory decisions, will be fierce. The central government could further shape the competitive

landscape by specifically identifying technology paths, industry standards, market entry criteria, and partnership models. Given the fragmented markets that developed around early favorites such as wind and solar power, the government will become increasingly selective in its policies, looking for avenues to expedite consolidation and to identify national champions quickly.

Domestic-consumption engines

The industries that will benefit most from the government's efforts to retool the Chinese economy and to boost domestic consumption are consumer-facing ones such as airlines, fast-moving consumer goods, food, pharmaceuticals, shipping, and tourism. These domestic-consumption engines, which have a favorable environment for profit growth and reasonably free markets, also benefit from the government's attention to social harmony and "green" development.

To capture the greatest growth opportunities, companies must increase their market penetration and offer tailored products for core customer segments. They should also closely monitor the development of specific consumption-enhancing government policies, such as encouraging urbanization, optimizing the investment structure, strengthening the social safety net, increasing household income, and developing the retail infrastructure. Opportunities in newly urbanized areas and the countryside should be explored vigorously. In addition, the government's push to assure higher product safety and quality and to encourage environmentally friendly consumption habits will present further openings for quick movers.

While government efforts to increase household incomes and wages will help spur private spending, they also present companies with the challenge of keeping expenses at bay amid rising labor costs. The plan targets a 13 percent increase in minimum wages each year, along with a more modest annual increase in household income (about 7 percent). Construction, consumer electronics, logistics, retailing, and other industries will feel the pinch. Further, costs will probably increase as a result of new policies for pricing energy, raw materials, and water; tighter environmental regulations; and enhanced consumer protection. Intense concern over inflation means that the government is unlikely to favor moves fully passing these cost increases on to consumers.

The government is also shaping the competitive environment in other ways. Industries such as education, financial services, health care, and logistics are being deregulated, further opening the market to foreign companies. Increased attention to food and drug safety and to quality gives companies with a solid reputation for high standards an opportunity.

Restructurers

Real estate and commercial banking, two industries fundamental to the country's economic and social well-being, face significant structural risks and follow shaky business models. The government has given these structural reformists a clear mandate to clean up their act.

China's real-estate industry has enjoyed rapid growth during the past five years, contributing strongly to overall GDP and local-government budgets. But the overheated market has raised fears of speculative bubbles and social instability linked to rising housing costs. In the plan, the government sets a target of 36 million affordable living units and promises strict oversight of housing loans and the residential market.

For fundamental reform, however, the industry must create a profitable and sustainable business model—for instance, in real estate for retailing or affordable-housing projects. Meantime, the central government must find new income sources for municipalities that have used the proceeds from lucrative property sales to finance local-industry development projects, as well as establish alternative investment channels.

Commercial banks also expanded rapidly in the wake of the surging real-estate market, primarily by lending to developers, and face their own obligation to reform. To maintain profit growth rates, banks must identify the plan's new revenue streams—for example, in support for small- and medium-sized businesses, digital banking, and wealth management—and build capabilities in managing risk and talent and in other value-added roles. They must also become adept at interpreting and balancing contradictory government policies, such as the drive to control inflation while at the same time financing small- and medium-sized enterprises and stimulating private consumption.

After much-needed reform, Chinese banks would be free to offer more sophisticated and diversified services, and the broader industry may enter a new era of competition. These developments will require know-how, talent, well-structured processes, and management. At present, Chinese banks suffer from a capability gap, opening opportunities for leading foreign institutions. Of course, the size of the opportunity depends on the direction and depth of reform. Foreign banks might also be able to give regulators assistance in defining that direction.

Reinventors

Many mature manufacturers lag behind their global competitors in technology and suffer from overcapacity, low efficiency, and high pollution. These companies account for most of the reinventors. The

government aims to transform their industries through innovation and upgrades.

This group generally benefits from the drive to stimulate domestic demand. The plan reserves the best opportunities for producers that use advanced technology, add greater value, boast higher energy efficiency, and offer more protection for the environment. Fiscal and tax policies, as well capacity and export regulations, collectively encourage these players to improve their businesses and consolidate. The plan encourages local innovation to develop domestic brand equity and intellectual property.

China's mature industries are particularly vulnerable to the new focus on green development: that policy will probably drive up costs related to environmental protection, energy conservation, reduced pollution, and even raw materials, in addition to pressures linked to rising labor costs. Energy efficiency and carbon dioxide—emission targets, for example, will add to the demands on industries such as nonferrous metals, power, and steel. Success will rest on a company's ability to maintain a healthy margin while accumulating green equity.

For this group, the government is taking a direct approach to shaping industry landscapes. In a drive to create national champions, it has set clear guidelines encouraging accelerated industry consolidation, especially in automotive, industrial machinery (such as construction equipment), nonferrous metals, and steel. Prominent domestic players can use the plan's support for M&A to acquire high-quality assets, strengthen leadership positions, and build credentials as national champions. Foreign companies can also take advantage of this drive by completing strategic mergers and acquisitions and becoming more competitive in the local market. Domestic and foreign players alike must watch developments on policies to push innovation, which will probably further define the country's aspirations in technology, product portfolios, and partnership models.

Social utilities

State-owned enterprises that manage national infrastructure networks—including the power grid, railways, and telecommunications—will grow steadily thanks to urbanization and strong support from the government. With no real competition, the main responsibility of these social utilities will be to use their scale and procurement power to deliver successful planned domestic projects at global standards of quality and cost.

Improved infrastructure is critical to the country's urban-development program, and the central government has laid out clear plans for

expanding the penetration and capacity of China's rail, power, and communications networks. These expansion plans will enjoy significant government investment, ensuring that state-owned enterprises and their suppliers (in industries such as construction, equipment, and steel) have secure revenue streams.

However, China's natural monopolies must work to contain rising construction and operational costs stemming from new energy and environmental regulations and from rising wages. State-owned enterprises will also feel pressure to innovate with and improve their business models for the sake of profitability and high quality. Because these companies have enormous procurement power, they can expect to receive help in their efforts from global technology leaders and, ultimately, to set worldwide industry standards. Foreign companies are quite interested in selling to the national infrastructure networks, which clearly offer big opportunities as their expansion continues.

China's ambitious 12th five-year plan builds on decades of unprecedented economic growth. It seeks to transform the economy from an investment-led powerhouse focused exclusively on GDP growth to a sustainable model that balances growth with social harmony, and innovation with environmental protection. Whether or not the full slate of aspirations can be achieved, the direction in which China's leaders hope to move the country is clear. Domestic and foreign companies need to understand the plan's implications for their industries so they can identify the opportunities and risks ahead.



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