Asia Business 3.0 – Chance and Challenge for German Mittelstand Companies

German-Indian Round Table, Berlin
Prof. Dr. Gert Bruche, December 5, 201

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Gert Bruche: About me

- Founding Partner, BGM Associates GmbH
  Strategy and Transaction Advisors for Life Sciences (Berlin-Seoul)
- Chairman of the Board, Asia-Pacific Forum Berlin e.V.
- Professor of International Management
  Berlin School of Economics and Law (HWR Berlin)

Business/Industry:
- Schering AG: Director Global Marketing SBU Diagnostics; MD of Schering China Ltd. (5 yrs); Corp. Strategy Advisor
- Consultant: in Asia to Corporates (KOR, PRC, HKG, SP), Exec trainings in SP (NTU)

University/Research
- HWR Berlin: Dean & VP, India Coordinator, MBA w. Chinese and Indian universities; Guest Prof (e.g. SIU Pune, India); WZB: Head of Policy Research Group (5yrs).
- Research/publications: Asian 'Emerging MNCs' and 'Innovation in Asia', Medical markets

United Nations
- UNDP: Programme Officer in Ankara, Turkey (3yrs)

Dipl. Ing. (TU Berlin), Dr. rer pol, FU Berlin
Content

'Asia Business 3.0': an emerging multipolar market

The 'mid-market' challenge

The new players

Asia: 'second home' for German Mittelstand?
Asia Business 3.0 should increasingly be seen as multipolar with four Business Regions:

- **Asia Business 1.0**: Japan
  - Post WW II – 1980s
- **Asia Business 2.0**: China – the 100 Pound Gorilla
  - 1990s – 2015/20s
- **Asia Business 3.0**: ASEAN, Greater China, India, Japan, Korea
  - 2015/20s – 2025+
The four Asian Business Regions are all important, but different in size and dynamics

<table>
<thead>
<tr>
<th></th>
<th>Emerging Asia</th>
<th>Established East Asia (Jap / Kor)</th>
<th>EU</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>China</strong></td>
<td>1,379</td>
<td>178</td>
<td>509</td>
<td>324</td>
</tr>
<tr>
<td><strong>India</strong></td>
<td>1,310</td>
<td>556</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ASEAN 5</strong>*</td>
<td>556</td>
<td>178</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Population</strong></td>
<td><strong>1,379</strong></td>
<td>1,310</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(2016e)</strong></td>
<td></td>
<td>556</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>GDP per capita</strong> ($, PPP) (2015)**</td>
<td>12,880</td>
<td>5,855</td>
<td>10,381</td>
<td>37,718</td>
</tr>
<tr>
<td><strong>GDP (Tr $, PPP)</strong> (2015)**</td>
<td>19.7</td>
<td>8.0</td>
<td>6.1</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Average GDP growth</strong> (2010-2015)**</td>
<td>8.3</td>
<td>7.3</td>
<td>4.4</td>
<td>JAP KOR 1.4 3.6</td>
</tr>
<tr>
<td><strong>Source, IMF: World Economic Outlook Database, October 2016, own calculations</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Indonesia, Thailand, Malaysia, Phillippines, Vietnam
50% of global growth will come from Asia

Source: IMF: World Economic Outlook Database, October 2016, own calculations
There are five ‘change drivers’ of Asia Business 3.0

# 1 Rising Cost in China

# 2 Growing consumer class and urbanization

# 3 Mid markets and ‘good enough products’

# 4 Chinese and other challengers in Asia and worldwide

# 5 Shift of innovation to Emerging Asia

In addressing growth opportunities country/regional risk should be considered

### Ease of Doing Business Index

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank 2016</th>
<th>Progress/setback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>2</td>
<td>▲</td>
</tr>
<tr>
<td>Hongkong</td>
<td>4</td>
<td>▲</td>
</tr>
<tr>
<td>Korea (Rep.)</td>
<td>5</td>
<td>▲</td>
</tr>
<tr>
<td>Taiwan</td>
<td>11</td>
<td>▲</td>
</tr>
<tr>
<td>Malaysia</td>
<td>23</td>
<td>▼</td>
</tr>
<tr>
<td>Japan</td>
<td>34</td>
<td>▲</td>
</tr>
<tr>
<td>Thailand</td>
<td>46</td>
<td>▲</td>
</tr>
<tr>
<td>China</td>
<td>78</td>
<td>▲</td>
</tr>
<tr>
<td>Vietnam</td>
<td>82</td>
<td>▲</td>
</tr>
<tr>
<td>Indonesia</td>
<td>91</td>
<td>▲</td>
</tr>
<tr>
<td>Philippines</td>
<td>99</td>
<td>▲</td>
</tr>
<tr>
<td>India</td>
<td>130</td>
<td>▲ (from 131)</td>
</tr>
</tbody>
</table>

Worst performance

- Getting Credit: 44
- Starting Business: 89
- Construction permits: 177
- Construction permits: 185

Modi’s target: Breaking into top 50 by 2018

World Bank: Ease-of-Doing-Business Index, June 2016 (www.doingbusiness.org/rankings)
Implications for 'Mittelstand‘s strategies': # 1

- "(Emerging) Asia" is 'must be' market for German Mittelstand in the next decade
- China remains key, but cost will and protectionism may rise so that overdependence on China may become a risk which could be addressed through intra-Asian diversification
- ASEAN strategies must address single countries AND a future AEC at the same time
- Larger Mittelstand companies‘ strategy should be based on 'multipolar Asia‘, with localisation AND intra-Asian integration elements
- Small Mittelstand companies should have a strategy of how to cover Asia (and in which sequence to enter/penetrate single countries)
Implikationen für die 'Mittelstand-Strategie‘: # 1

- Die Asiatischen Wachstumsmärkte sind (weiterhin) ein 'muss‘ für Deutsche Mittelständler im nächsten Jahrzehnt

- China bleibt wichtig, aber Kostensteigerungen und das Risiko von Protektionismus nehmen zu. Eine zu große Abhängigkeit vom chinesischen Markt kann durch intra-asiatische Diversifikation verringert werden (Asia Business 3.0)

- Strategien in und für ASEAN Länder sollten sowohl die Einzellandebene anzielen, aber auch bereits die Entwicklung hin zur AEC strategisch berücksichtigen

- Größere Mittelständler sollten eine kongruente 'multipolare’ Asienstrategie haben, mit Lokalisierung in einzelnen Märkten UND intraasiatischer Integration

- Sehr kleine Mittelständler sollten ein klare Länderstrategie entwickeln (hinsichtlich der Sequenz des Markteintritts bzw. der Marktdurchdringung)
Asia Business 3.0: Chance and Challenge for German Mittelstand Co‘s

'Asia Business 3.0': an emerging multipolar market

The 'mid-market' challenge

The new players

Asia: 'second home' for German Mittelstand?
What do we mean by ‘mid-market segment’ in emerging markets?

**Premium segment**
- Market share ~10-30% (of tot. market value)
- Complex machines, long life span, tailor-made single machines or lines, 24/7 service
- Dominated by foreign premium manufacturers

**Mid-market segment**
- Market share ~30-40%
- Basic features, reduced flexibility, lower automation level, standard or slightly customized single machines or lines, 24/7 service. Prices 30-50% below premium segment
- Dominated by local manufacturers (or imports from Taiwan or Korea)

**Low end segment**
- Market share ~30-60%
- Minimal features for simple tasks, limited life span, less precision, fewer safety features, limited flexibility and process stability, standard single machines, less than 24/7 service
- Prices 30-50% under mid-market segment
- Completely dominated by locals

Growth opportunity in mid-market segment in next 5-10 years

Mature markets (e.g. EU)    Emerging Markets (e.g. China, India, ASEAN)

Technological level and price $^{EU}$

Premium-segment $^{EU}$

Mid-market segment $^{EU}$

Lower segment $^{EU}$

Today

Today $\rightarrow$ Tomorrow

Technological level and price $^{CN}$

Premium-segment $^{CN}$

Mid-market segment $^{CN}$

Lower segment $^{CN}$

Lowest price market segment does not exist in mature markets

Possible scenario: loss of the mid-market segment – pushing German companies into a 'super niche'

![Market segments diagram](image)

## Mid-markets in India: already lost for German Mittelstand?

In 2015, Imports to India, USD billion

<table>
<thead>
<tr>
<th>Category</th>
<th>China</th>
<th>Germany</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery imports</td>
<td>10.6</td>
<td>3.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Electronic imports</td>
<td>19.3</td>
<td>1.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Medical equipment</td>
<td>1.3</td>
<td>0.9</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: www.worldsrichestcountries.com/top-india-imports.html
The mid-market challenge affects various industrial segments where Germany is strong, and can be addressed in various ways:

- Machine tools
- Construction machinery
- Building technologies
- Medical devices
- Chemicals (industrial, speciality)
- Transport (trucks, small utility vehicles)
- Others...

Approaches:
- Defeaturing
- Value chain localisation
- Supplier localisation
- Old technology
- Frugal engineering
- Reverse glocalization
Active mid-market strategy in B2B: the example of Trumpf

- Trumpf – one of the world’s biggest providers of machine tools (machine tools, power tools, laser technology, electronics). Rev. 2.8 bn EUR
- 2004: Start of manufacturing in China (Taicang)
- 2013: Acquires Chinese machine tool company JFY (Yangzhou)
- Trumpf China covers premium segment, JFY covers mid-market segment

“\textit{In order to succeed in mid-market segments one needs the courage for a ‘good-enough approach’. That means one has to omit features and accept larger tolerances…We see no big risk for us as we go for a clear ‘dual-brand strategy. The strict separation is important, technologically, in service and sales.}”

\textit{Mathias Kammüller, MD of Trumpf GmbH & Co KG}

Implications for Mittelstand‘s strategies # 2

- The 'mid-market segment‘ (in relevant fields for German industry) grows faster than premium or low end
- As a result, in emerging economies, German companies are gradually loosing share in important segments
- Mid-market segments provide a 'springboard‘ for the new players from emerging markets for later 'trading-up into premium‘
- In order to maintain a leading position the 'mid-market challenge‘ needs to be addressed by German Mittelstand
- There are already good examples of 'dual strategies‘ by Mittelstand and by large German companies

[NB: Industry 4.0 is no substitute for action in mid-market segments in the next 5-10 years, maybe partially complementary]
Implikationen für die 'Mittelstand-Strategie': # 2

- Das 'mittlere Marktsegment' (in für die deutsche Industrie relevanten Sektoren) wächst auch im nächsten Jahrzehnt rascher als das Premiumsegment (oder das 'low end' Segment)

- Als unmittelbare Folge können deutsche (B2B) Firmen mehr und mehr Anteile in den neuen Märkten verlieren

- Die Expansion im Mittelsegment ist ein 'Sprungbrett' für Wettbewerber aus Emerging Markets zum späteren Vorstoß in Premiumsegmente

- Um ihre weltweiten Führungspositionen zu sichern müssen die deutschen Mittelständler die 'Mittelmarkt-Herausforderung' strategisch adressieren

- Es gibt bereits vielfältige Beispiele für 'Mittelsegment-Strategien durch deutsche Großunternehmen und Mittelstands-Champions

- [NB: Industrie 4.0 ist kein Ersatz für das Handeln in Mittelmarktsegmenten in den nächsten 5-10 Jahren, es könnte eher komplementär sein]
The new kids on the block

Asia Business 3.0: Chance and Challenge for German Mittelstand Co‘s

'Asia Business 3.0': an emerging multipolar market

The 'mid-market' challenge

The new players

Asia: 'second home' for German Mittelstand?
Three waves from Asia: arrival of a Tsunami?

1970s +

Japanese Multinationals

1990s +

Korean, Taiwanese Multinationals

2000s +

New multinationals from Asia (China, India)

Source: own illustration
How many of these companies do you know ... already?
China’s outward FDI has grown very fast, India’s has not yet recovered.

Sources: UNCTAD 2016, MOFCOM 2016
There is a typical path for the new players from emerging countries to become global champions.

- **Fight for survival in China a.o.e.m.*
- **National Champion**
- **Emerging Market Champion**
- **Global Champion**

Competences
- International footprint

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>30-100 Firms</td>
<td>30-100 Firms</td>
</tr>
<tr>
<td>5-10 Firms</td>
<td>5-10 Firms</td>
</tr>
<tr>
<td>3-5 Firms</td>
<td>3-5 Firms</td>
</tr>
<tr>
<td>1-3 Firms</td>
<td>1-3 Firms</td>
</tr>
</tbody>
</table>

*Transition to premium market*

- Primarily mid-market players
- 10 – 15 years

Source: Adjusted and extended from: BCG (2011) Duelling with Dragons

* and other emerging markets
‘Made in China’ 2025 formulates ambitious goals for local firms

Target market shares for local firms in the Chinese market:

<table>
<thead>
<tr>
<th>Until...</th>
<th>2020</th>
<th>2025</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical devices</td>
<td>50%</td>
<td>70%</td>
</tr>
<tr>
<td>Autonomous driving</td>
<td>50%</td>
<td>60%</td>
</tr>
<tr>
<td>E-vehicles (et al.)</td>
<td>70%</td>
<td>80%</td>
</tr>
<tr>
<td>Cars w. CBE</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td>Energy technologies</td>
<td></td>
<td>90%</td>
</tr>
<tr>
<td>Industrial robots</td>
<td>50%</td>
<td>70%</td>
</tr>
<tr>
<td>Long-range jets</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Chips for mobile</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Smartphones</td>
<td>25%</td>
<td>45%</td>
</tr>
</tbody>
</table>


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With M&A in Germany the new players from China acquire premium assets

<table>
<thead>
<tr>
<th>Year</th>
<th>Target</th>
<th>Acquirer/Co-Owner</th>
<th>Field</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>Osram</td>
<td>IDG Capital, MLS, Yiwu State-Owned Assets Center</td>
<td>Leading position: High end LED</td>
</tr>
<tr>
<td>2016</td>
<td>Aixtron</td>
<td>Fujian Grand Chip Investment Fund</td>
<td>L. pos.: Special semiconductor machinery</td>
</tr>
<tr>
<td>2016</td>
<td>Krauss-Maffei</td>
<td>Chem China (SOE)</td>
<td>L. pos: Pl./ rubber machinery</td>
</tr>
<tr>
<td>2016</td>
<td>Kuka</td>
<td>Midea</td>
<td># 2-3 Robotics</td>
</tr>
<tr>
<td>2016</td>
<td>Bochumer Ver.</td>
<td>China Railway Stock Corp. (SOE)</td>
<td># 1 Wheelset systems</td>
</tr>
<tr>
<td>2012</td>
<td>Schwing</td>
<td>XCMG (SOE)</td>
<td>L. pos. Concrete pumps</td>
</tr>
<tr>
<td>2012</td>
<td>Putzmeister</td>
<td>Sany</td>
<td># 1 Concrete pumps</td>
</tr>
<tr>
<td>2012</td>
<td>Kion</td>
<td>Weichai P.</td>
<td># 2 Forklifts</td>
</tr>
<tr>
<td>2012</td>
<td>Kiekert</td>
<td>CNGC Hebei (SOE)</td>
<td># 1 Car closure systems</td>
</tr>
<tr>
<td>2008</td>
<td>Vensys</td>
<td>Goldwind (SOE)</td>
<td># 1 Gearless w. turbines</td>
</tr>
<tr>
<td>2005</td>
<td>Waldrich Coburg</td>
<td>BJ No 1 M. Tools (SOE)</td>
<td>L. pos: Large mach. tools</td>
</tr>
<tr>
<td>2004</td>
<td>Dürrkopp Adler</td>
<td>SGSB Shangong (SOE)</td>
<td>Strong brand in ind. sewing machines</td>
</tr>
</tbody>
</table>

Source: various

= currently under review by Government authorities

SOE: State owned, partially or fully

India
Largest: RePower / Suzlon: resold at discount 2015 to PE. Indian M&A went down after peak in 2006-11
Implikationen for Mittelstand‘s strategies # 3

- The new players can rely on their position in the mid-market segments and often on the support of their government

- ‘Made in China 2025‘ aims to strengthen local companies in important high-tech markets for them (often important for German companies too)

- Through M&A they acquire technology, distribution and brand assets as a catch-up and trading up strategy

- [Indian companies, after some earlier initial impressive moves, have so far not come back in strategic asset seeking acquisitions]

- German Mittelstand companies must develop a strategic answer to the challenge which may include cooperation and competition at the same time
Implikationen für die 'Mittelstand-Strategie‘: # 3

- Die neuen Spieler haben Reserven basierend auf ihren Erfolgen in den Mittelmarkt-Segmenten und genießen oft staatliche Unterstützung.

- 'Made in China 2025‘ unterstützt sie zusätzlich bei der Gewinnung von Führungspositionen in High-Tech-Zukunftsmärkten (häufig wichtige Märkte auch für deutsche Firmen).

- Durch M&A (u.a. in Deutschland) erwerben sie Technologien und Marken, die den Aufholprozess beschleunigen und den Vorstoß ins Premiumsegment ermöglichen.

- [Indische Herausforderer-Firmen haben nach zwischenzeitlich starken Bewegungen noch nicht in den 'Akquisitionsmodus‘ zurückgefunden]

- Deutsche Mittelständler in wichtigen Sektoren müssen sich der Herausforderung stellen und Kooperations- wie auch Wettbewerbsstrategien entwickeln.
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The premium vs. 'mid-market‘ challenge

The new players

Asia: 'second home‘ for German Mittelstand?
We studied German Mittelstand Champions‘ (GMCs) strategies in Asia

- Surveyed 100 companies
  - 22 personal interviews (Owner or C-Suite)
  - 80 firms in online-survey (Senior Execs w responsibility for Asia)

- Participating companies (selection)

  ![Company Logos]

Published in October 2015, jointly with Prof. Bernd Venohr
German Mittelstand Champions are already very active in Asia

Share of revenue from Asia (2014)

- Mittelstand-Champions: 20%
- Dax-Unternehmen: 16%

German companies with own subsidiaries

- China: 5200
- India: 1000
- Singapore: 1480

Source: Survey, Statista, AHK China, AHK India, ACRA SG
GMCs have ambitious sales growth targets for Asia

GMCs plan for strong revenue growth in Asia...

Expected annual revenue growth for the next three years

<table>
<thead>
<tr>
<th>Share of surveyed firms</th>
<th>0-5%</th>
<th>6-10%</th>
<th>&gt;10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>8%</td>
<td>36%</td>
<td>56%</td>
</tr>
</tbody>
</table>

... which is above projected annual GDP growth

GDP Growth 2015e-2020e

- India: 7.6%
- China: 6.2%
- ASEAN 5*: 5.5%

Source: Survey
In order to compete with the new players GMCs have to become 'insiders' (and also address mid-markets)

<table>
<thead>
<tr>
<th>Value chain (foreign subsidiary)</th>
<th>Decision rights headquarter/subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export</td>
<td>Alle major decisions taken in headquarter</td>
</tr>
<tr>
<td>Distribution/Service</td>
<td>Selective delegation</td>
</tr>
<tr>
<td></td>
<td>Subs.: tactical distribution decisions</td>
</tr>
<tr>
<td>Distribution/Service/Manufacturing</td>
<td>Selective delegation</td>
</tr>
<tr>
<td></td>
<td>Subs.: tactical distribution and manufacturing decisions</td>
</tr>
<tr>
<td>Distribution/Service/Manufacturing+Local F&amp;E</td>
<td>Second home (&quot;Home country clone&quot;);</td>
</tr>
<tr>
<td></td>
<td>Regional and global mandates (for part. product areas)</td>
</tr>
<tr>
<td>Globally integrated network with &quot;Centers of Excellence&quot;</td>
<td>Globally decentralizes management (MDs/Bus. CEOs distributed to varios locations)</td>
</tr>
</tbody>
</table>
The focus of GMCs’ Asian subsidiaries is often still on 'sales & service' (except in China)

Source: Survey
Many GMCs have already a 'regional structure'

<table>
<thead>
<tr>
<th>Locations</th>
<th>Roles of Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore: 45</td>
<td><strong>Asia Headquarter</strong></td>
</tr>
<tr>
<td>China: 12</td>
<td><strong>ASEAN Headquarter</strong></td>
</tr>
<tr>
<td>Japan: 3</td>
<td><strong>Second home base:</strong> R&amp;D / Infrastructure / High Value Manufacturing; Integrated value chain with surrounding Asean countries</td>
</tr>
<tr>
<td>Thailand: 2</td>
<td><strong>R&amp;D:</strong> No 3 location after China and India for German companies</td>
</tr>
<tr>
<td>India: 1</td>
<td><strong>Global Headquarter:</strong> Specific industries, e.g. logistics, water etc.</td>
</tr>
<tr>
<td>Korea: 1</td>
<td></td>
</tr>
<tr>
<td>Malaysia: 1</td>
<td></td>
</tr>
</tbody>
</table>
Implications for Mittelstand companies # 4

- German Mittelstand Champions generate a significant sales share from Asia, and they have ambitious growth target for the next years in Asia.

- Except for China, localising of the value chain beyond sales & service is still in its infancy (and even more so for smaller Mittelstand firms).

- In order to maintain their strong global position (also in view of the new players) they need to become insiders in multipolar Asia through value chain localisation.

- This will also facilitate a better approach to the 'mid-market challenge'.

- Eventually, 'Asia' should become a 'second home' for many larger Mittelstand companies (and maybe also for smaller ones).

- As part of a 'second home' strategy Mittelstand companies must decide on their regional organization structure in Asia.
Deutsche Mittelstand Champions generieren bereits wesentliche Umsatzanteile in Asien und haben ehrgeizige Umsatzziele für die Region

Mit der Ausnahme von China ist die 'Lokalisierung‘ der Wertschöpfung (und Produkte) noch in den Anfängen – Kernfunktionen vor Ort sind Vertrieb und Service

Um ihre oft weltweiten Führungspositionen zu verteidigen müssen sie durch Wertschöpfungslokalisierung Insider in einem zunehmend multipolaren Asien werden

Dadurch können sie auch der Herausforderung der 'Mittelmärkte‘ begegnen

Am Ende kann 'Asien‘ zum 'zweiten Heimatmarkt‘ für größere (aber auch für mittlere und kleinere) Mittelständler werden

Im Rahmen der 'second home‘ Strategie ist die Frage der regionalen Organisation zu entscheiden (Regionales Headquarter?)
Asia Business 3.0: General recommendations

Prepare for and address multipolar market with adapted strategies

Adress the mid-market challenge

Address challenge from new players through cooperation and competition

Localize your value chain with a view to establish 'second home' in Asia