China’s innovation is going global

2014 China innovation survey
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Executive summary

Innovation is the wellspring of success in the China market. There is no other path forward — only fierce innovators will thrive. The China Innovation survey, now in its third year, shows that Chinese companies and multinationals alike continuously and rapidly innovate as they jockey for position.

In this year’s study, we see for the first time how important innovation is to senior executives in Chinese companies. Their personal commitment is not simply an indicator of government initiatives or regulation. Senior executives’ involvement speaks more significantly to how engrained innovation is in their approach to business. Innovation — not only in products but also in services, supply chains, and business models — is truly a matter of table stakes in China.

Companies continue to adapt their innovation strategies in China. Chinese companies are increasingly turning to technology to deliver first-to-market innovations, building on their historic strength in understanding and defining customer needs. Multinational corporations (MNCs) are internalizing the need for constant customer-based innovations in China.

The most surprising insights from this year’s survey pertain to the important role that innovation plays in Chinese companies’ globalization strategies. Many MNC executives outside the country expect Chinese companies to simply target developing markets with existing cheap and low-quality products. This misperception lingers despite the many visible examples of the opposite approach — witness Haier’s central billboard in Tokyo’s Ginza district and Xiaomi’s high-tech and trendy smartphone ambitions for Brazil and Indonesia.

Chinese executives are using innovation to drive globalization. In the process, they are adapting their products and services to new markets and customers. They will challenge well-established companies in developed markets as they build their global positions with innovative and localized products.
Chinese companies use new and tailored approaches to expand their worldwide innovation capabilities. Technology and people, rather than market insights, are the engines of expansion. Chinese companies are more open and, in general, able to integrate better with partners in their value chain than are MNCs in China. In other words, Chinese companies are using a very modern and networked approach to building their global innovation capabilities.

As was the case last year, respondents cast votes for the most innovative Chinese companies (see “The Most Innovative Chinese Companies,” page 25). These 10 companies epitomize the modern, charismatic, and global nature of innovation in China today. Eight are high-tech companies that have introduced significant business model innovations. Every one of these companies is pursuing worldwide ambitions, and they leverage innovation to globalize their companies. At least half have founders or chief executives who take an active and public role in innovation.
2014 survey confirms China is a global innovation engine

Each year the survey has been undertaken, Chinese companies have gained ground against their MNC competitors. In 2014, two-thirds of MNC executive respondents said their companies face Chinese competitors that are just as innovative as or more innovative than they are. (See Exhibit 1, next page.) That number will likely astound MNC executives outside China.

We see the ultracompetitive Chinese market engendering this razor-sharp focus on innovation. Although MNCs rated Chinese companies’ product innovation highly, they recognized even stronger competition in service, supply chain, and business model innovations. (See Exhibit 2, page 8.) There is no doubt: Chinese companies’ innovation is a force to be reckoned with — for now in China, but likely soon in the rest of the world.

Chinese companies are more likely than others to adopt a Need Seekers innovation strategy, which means they innovate ahead of customers and competitors. There is little truth to the Western image of Chinese companies as followers of others, focusing on low-value-add activities such as copying technologies and products already available on the market. In fact, Chinese companies in mainland China outpace MNCs in high-value-add activities such as advanced and applied research, as well as emerging technologies and trend analyses. Furthermore, we see MNCs in China shifting innovation strategies to align with the Chinese model.

As far as the vibrant innovation ecosystem in China is concerned, the rest of the world is its playground. Both MNCs (91 percent) and Chinese companies (84 percent) use China as a base to innovate products for other markets. (See Exhibit 3, page 8.) We see Chinese companies targeting developed markets in Asia (e.g., Japan, Korea, and Singapore) as well as in Europe and the United States.

Not surprisingly, limits in attracting, training, and retaining talent are identified as the greatest threat to continued innovation excellence. (See Exhibit 4, page 9.) Talent gaps have been top of mind for three years now. In the rapidly changing sector of innovation, we see demand for talent continuing to outstrip supply.
Exhibit 1
Chinese companies have arrived as innovators

Please rate your company’s innovation performance in Mainland China.
(Note: The respondents were from MNCs.)

- **2012**: 47% Chinese less innovative, 53% Chinese equally or more innovative
- **2013**: 64% Chinese less innovative, 36% Chinese equally or more innovative
- **2014**: 65% Chinese less innovative, 35% Chinese equally or more innovative

**Exhibit 2**
Chinese firms eclipse MNCs on supply chain, service, and business model innovation

Please rate your company’s innovation performance in Mainland China.
(Note: The respondents were from MNCs.)

<table>
<thead>
<tr>
<th>Product innovation</th>
<th>Supply chain innovation</th>
<th>Service innovation</th>
<th>Business model innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>41%</td>
<td>30%</td>
<td>35%</td>
<td>28%</td>
</tr>
<tr>
<td>30%</td>
<td>29%</td>
<td>35%</td>
<td>28%</td>
</tr>
<tr>
<td>29%</td>
<td>38%</td>
<td>40%</td>
<td>43%</td>
</tr>
</tbody>
</table>

Chinese equally innovative
Chinese more innovative
Chinese less innovative

Note: Sums may not total 100 due to rounding.
Source: 2014 China Innovation Survey

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**Exhibit 3**
Both Chinese companies and MNCs are developing innovation in China for the world

Do your company’s innovation efforts in Mainland China contribute to developing products/services for foreign markets?
(Note: The results are percentages of respondents from MNCs saying “yes.”)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chinese company</td>
<td>85%</td>
<td>81%</td>
<td>84%</td>
</tr>
<tr>
<td>MNC</td>
<td>89%</td>
<td>84%</td>
<td>91%</td>
</tr>
</tbody>
</table>

Exhibit 4
Talent remains the key innovation challenge for both Chinese companies and MNCs

In the process of conducting innovation in mainland China, is your company facing the following challenges?

<table>
<thead>
<tr>
<th></th>
<th>Chinese companies</th>
<th>MNCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Talent access</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>Talent retention</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>Inadequate intellectual property protection</td>
<td>3.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Rapid cost increases</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Inadequate infrastructure and innovation ecosystem</td>
<td>3.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Difficulties in understanding market needs</td>
<td>3.2</td>
<td>3.2</td>
</tr>
</tbody>
</table>

Source: 2014 China Innovation Survey
Concerns about intellectual property (IP) also continue to surface — with the interesting twist that Chinese companies are more worried about IP than their MNC counterparts are. Chinese companies are investing more heavily in IP; their concerns may be due to a relative lack of expertise in managing IP in China.

Three fundamental innovation strategies

- **Need seekers**: First movers that proactively discover their customers’ needs and then use this understanding to shape new products and services.

- **Market readers**: Second movers who focus on incremental improvement in existing products and services.

- **Technology drivers**: Deliverers of new technological achievements that realize both breakthrough and incremental change but have less direct contact with customers.

*Source: Strategy& Global Innovation 1000 study*
In China, innovation is the number one priority for 42 percent of Chinese companies, compared with 21 percent of MNCs. (See Exhibit 5.) Faced with the stark truth of “innovate or perish,” Chinese leaders show more personal involvement in and responsibility for innovation than their MNC counterparts. (See Exhibit 6, next page.)

Alibaba’s Jack Ma, Tencent’s Pony Ma, and Xiaomi’s Jun Lei have become the highly public face of entrepreneurial innovation in China with their continued media appearances and social media presence. Their personal public commitment will likely further fuel the zeal for innovation in China. Which young technologist or business graduate in China does not dream of becoming the next innovative entrepreneur?

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Exhibit 5
Chinese companies place a high priority on innovation

How does innovation rank among your organization’s strategic priorities in China?

<table>
<thead>
<tr>
<th></th>
<th>Chinese companies in China</th>
<th>MNCs in China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top priority</td>
<td>23%</td>
<td>28%</td>
</tr>
<tr>
<td>Among top three priorities</td>
<td>35%</td>
<td>51%</td>
</tr>
<tr>
<td>Don’t know or not a priority</td>
<td>42%</td>
<td>21%</td>
</tr>
<tr>
<td></td>
<td>21%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: 2014 China Innovation Survey
**Exhibit 6**

Chinese companies’ leaders are taking direct leadership of innovation

Who is responsible for your company’s innovation?

<table>
<thead>
<tr>
<th></th>
<th>Chinese companies in China</th>
<th>MNCs in China</th>
</tr>
</thead>
<tbody>
<tr>
<td>No one</td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td>Directors or below</td>
<td>18%</td>
<td>11%</td>
</tr>
<tr>
<td>Head of R&amp;D</td>
<td>19%</td>
<td>29%</td>
</tr>
<tr>
<td>General manager or vice president</td>
<td>54%</td>
<td>32%</td>
</tr>
<tr>
<td>C-Suite</td>
<td>36%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Note: Sums may not total 100 due to rounding.

Source: 2014 China Innovation Survey
Innovation strategies are different and evolving

The Need Seekers innovation strategy adopted by many Chinese companies creates the greatest value. The percentage of Chinese companies employing the Need Seekers strategy is well ahead of the global average and is easy to understand given the ultracompetitive nature of the Chinese market.

In 2014, however, for the first time, we saw the Technology Drivers strategy as a more frequent choice among Chinese companies (43 percent compared with 21 percent for Market Readers and 37 percent for Need Seekers). (See Exhibit 7, next page.) We won’t know until next year’s survey whether this is a temporary blip or a meaningful trend. The choice may demonstrate that Chinese companies are investing in advanced technology — and then using that technological foundation in addition to customer proximity and propensity to take the risks that have historically defined the Chinese model of innovation.

The innovation strategies of MNCs in China are also evolving. We see more MNCs adopting Need Seekers strategies today than in the past. (See Exhibit 8, page 15.) Interestingly, MNCs are more likely to adopt Need Seekers strategies in China than in their home markets. “Innovate or perish” is likely driving this choice, as MNCs attempt to survive and differentiate themselves in the Chinese market.

Chinese companies are investing in advanced technology.
Exhibit 7
Chinese companies are embracing technology

Profile your company’s innovation strategy.
(Note: The respondents were from Chinese companies.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Need seekers</th>
<th>Market readers</th>
<th>Technology drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>38%</td>
<td>28%</td>
<td>33%</td>
</tr>
<tr>
<td>2013</td>
<td>44%</td>
<td>25%</td>
<td>32%</td>
</tr>
<tr>
<td>2014</td>
<td>37%</td>
<td>21%</td>
<td>43%</td>
</tr>
<tr>
<td>Average of Global Innovation 1000</td>
<td>27%</td>
<td>26%</td>
<td>47%</td>
</tr>
</tbody>
</table>

Note: Sums may not total 100 due to rounding.

Exhibit 8
MNCs are moving away from following competitors’ innovation in China

Profile your company’s innovation strategy.
(Note: The respondents were from MNCs.)

<table>
<thead>
<tr>
<th></th>
<th>Average of Global Innovation 1000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>Need seekers: 30% Market readers: 50% Technology drivers: 20%</td>
</tr>
<tr>
<td>2013</td>
<td>Need seekers: 29% Market readers: 34% Technology drivers: 37%</td>
</tr>
<tr>
<td>2014</td>
<td>Need seekers: 35% Market readers: 30% Technology drivers: 34%</td>
</tr>
</tbody>
</table>

Note: Sums may not total 100 due to rounding
The extent to which Chinese companies use innovation as a tool in globalization is surprising. Indeed, they prioritize innovation in globalization more than MNCs prioritize innovation in China. (We used survey questions about the extent to which MNCs prioritize innovation in China as a proxy for their propensity to innovate while globalizing in general). (See Exhibit 9, next page.) This strategic choice likely reflects the deep and well-trained reflexes of Chinese executives to innovate to succeed, regardless of the geography.

As Chinese companies globalize, they will push the innovation bar higher. We see Chinese companies using innovation to demonstrate relevance for new customer segments, particularly in niche markets. They are hungry to build their global innovation capabilities, given that many Chinese companies still perceive themselves as lagging on a worldwide basis. Soon, the level of innovation intensity that MNCs face in China will appear elsewhere — including in their home markets.
**Exhibit 9**

Chinese companies prioritize innovation when going global

How does innovation rank among your organization’s strategic priorities?

![Bar chart showing innovation priorities](chart.png)

Source: 2014 China Innovation Survey
Chinese companies globalize innovation differently

Waves of globalization have originated in the past from the United States, from Europe, from Japan, and more recently from Korea. Each wave has been accompanied by companies extending their innovation capabilities through the spread of innovation resources, processes, and systems around the world. Similarly, as China drives another wave of globalization, Chinese companies will globalize their innovation systems. Their efforts will be grounded in their Chinese roots and today’s realities.

The 2014 survey helps us begin to define the distinctive Chinese approach to globalizing innovation.

1. Chinese companies are more likely to globalize their innovation in order to access talent and technologies. (See Exhibit 10, next page.) In other words, they seek capabilities rather than simple facts or even knowledge. The top driver (chosen by 68 percent of respondents) for a Chinese company setting up an innovation center is to acquire or monitor a leading technology. For MNCs, the top driver (chosen by 90 percent of respondents) is to capture customer trends and insights.

2. Chinese companies tend to rely less on in-house expansion than do their MNC counterparts. They are more likely to partner with or even acquire other organizations. (See Exhibit 11, page 20.)

3. Chinese companies are more likely to partner with organizations outside their regular value chains (e.g., universities, research institutes) as well as with those within their regular value chains (primarily suppliers but even competitors). (See Exhibit 12, page 21.) As an example, 77 percent of Chinese companies partner with universities, versus 45 percent of MNCs; and 68 percent partner with suppliers, versus 46 percent of MNCs. Of note: 48 percent of MNCs partner with customers, versus 27 percent of Chinese companies. Chinese companies are also hesitant to partner with companies in other industries because of the risk of those companies crossing industry lines and taking market share.
**Exhibit 10**

Chinese firms seek technology and talent when globalizing innovation while MNCs emphasize customer insights

Why does your company set up innovation centers outside mainland China or in mainland China?

<table>
<thead>
<tr>
<th>Why set up innovation centers</th>
<th>Chinese companies</th>
<th>MNCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquire/monitor leading technology</td>
<td>68%</td>
<td>46%</td>
</tr>
<tr>
<td>Access to innovation talent</td>
<td>59%</td>
<td>58%</td>
</tr>
<tr>
<td>Capture customer trends/insights</td>
<td>45%</td>
<td>46%</td>
</tr>
<tr>
<td>Lower the innovation costs (labor, infrastructure, etc.)</td>
<td>32%</td>
<td>63%</td>
</tr>
<tr>
<td>Innovation centers are legacies from acquisitions</td>
<td>14%</td>
<td>16%</td>
</tr>
</tbody>
</table>

**Source:** 2014 China Innovation Survey
Exhibit 11
Chinese companies rely more on external resources to build global innovation capabilities

How does your company build innovation capabilities outside of its home market, and which approaches has your company applied?

![Bar chart showing the comparison between Chinese companies and MNCs in China in terms of self-development, partnership, and acquisition for building innovation capabilities outside their home market. The chart indicates that MNCs in China rely more on external resources compared to Chinese companies.]

Source: 2014 China Innovation Survey
Chinese companies rely more on third parties outside their business value chain to build global innovation capabilities

What types of innovation partners does your company have outside your home country?

<table>
<thead>
<tr>
<th>Partners outside of business value chain</th>
<th>Chinese companies</th>
<th>MNCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Universities or other higher education institutions</td>
<td>77%</td>
<td>45%</td>
</tr>
<tr>
<td>Consultants, commercial laboratories, or private innovation</td>
<td>23%</td>
<td>55%</td>
</tr>
<tr>
<td>Government or public research institutes</td>
<td>22%</td>
<td>45%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Partners within business value chain</th>
<th>Chinese companies</th>
<th>MNCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suppliers</td>
<td>68%</td>
<td>46%</td>
</tr>
<tr>
<td>Competitors or other business in your industry</td>
<td>36%</td>
<td>13%</td>
</tr>
<tr>
<td>Other business units within your enterprise group</td>
<td>32%</td>
<td>39%</td>
</tr>
<tr>
<td>Clients or customers</td>
<td>27%</td>
<td>48%</td>
</tr>
</tbody>
</table>

Source: 2014 China Innovation Survey
In sum, we are beginning to recognize a uniquely Chinese approach to globalizing innovation — an approach that is very much “of our times.” Chinese companies expanding worldwide are open, seek collaboration, build capabilities, create networks, and are acquisitive, when necessary. In contrast, previous waves of globalizing innovation have been more focused on building in-house capabilities and creating self-standing assets.
Now what? Challenges for Chinese companies and MNCs

Chinese companies that want to globalize and MNCs seeking to be successful in China face challenges that are two sides of the same coin. Chinese companies will need to carefully systematize, whereas MNCs will need to make their comparatively rigid global innovation “machines” more nimble and modern.

The historically successful Chinese model of innovation is customer-centric (the Need Seekers model). It is led from the top down, featuring fast decisions and implementation (super-fast in comparison with Western models). Companies have a high propensity to take risk grounded in various market realities.

But the original Chinese company leadership (in many cases, the owner–operator) is aging, and the next generation is usually not so close to markets and operations. Customer preferences are diversifying and evolving very rapidly, making it difficult to stay ahead of the game. As companies grow in size, reach, and complexity, the cadence of decision making naturally slows. Chinese brands and reputations are growing more prominent — and as they do, their leaders’ willingness to risk it all again will decline.

All of these factors will put pressure on the traditional Chinese innovation model. Chinese companies will need to learn how to systematize their innovation more — for example, by involving their entire organization in the process, absorbing an ever-increasing volume of customer insights, and managing a wide portfolio of current and future products — without losing the speed and decisiveness that are so important in China.

Likewise, challenges stand in the way of the Chinese approach to globalizing innovation. Worldwide innovation capabilities create value only if companies operate as networks with a free flow of ideas, information, and skills across locations.

Chinese companies will need to successfully integrate the disparate innovation capabilities that they are buying and building around
the world. Furthermore, as more companies seek to partner or acquire assets, demand may exceed supply, driving up the costs of these choices. At some point, building capabilities in-house may become necessary.

MNCs will continue to face a familiar set of challenges in the Chinese market. They need to adapt their innovation model to China’s ultracompetitive and super-rapid innovation context. Although more MNCs are adopting Need Seekers strategies within China, their global innovation strategy is different in most cases. Aligning the innovation models between China and the rest of the world is challenging for many companies.

Our survey findings imply that more than two-thirds of MNCs may face a Chinese competitor in their home market that is as innovative as they are, or even more so, in the near future. To compete, MNCs will need to rapidly bring the lessons from China back to their home markets.
Our survey asked respondents to name the most innovative Chinese companies. The prominence of high-tech companies on the resulting list is striking. Although today many people recognize how innovative these companies are, as recently as five years ago very few people predicted that the high-tech sector would be leading innovation in China. In those days, the bets were still on the heavier industries, such as automotive, industrials, and machinery.

Experts were predicting that Chinese companies would swamp the world with so-called midmarket products aimed at developing new markets and eventually adding customers in developed markets who were looking for simple and cost-effective products. This strategy is still apparent, but at the same time, a new wave of Chinese high-tech companies is now taking the world by storm. The triggers for the high-tech momentum are multiple and complex, but the highly open and ultracompetitive nature of these sectors in China is key. This environment breeds innovation writ large.

Notice the new and somewhat surprising names on the MNC list. L’Oréal, for instance, is not usually included in lists of innovative companies on such a scale. Clearly, the company has created a dominant position in China with its innovative and tailored cosmetics products. This success speaks to the power of seamlessly combining a globally integrated innovation network with local insights. (See Exhibit A.)

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**Exhibit A**

**Top 10 Chinese and MNC innovators:**

**Eight of Chinese are tech or Internet companies**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company name</th>
<th>Rank</th>
<th>Company name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Huawei Investment &amp; Holding</td>
<td>1.</td>
<td>Apple</td>
</tr>
<tr>
<td>2.</td>
<td>Tencent Holdings Ltd</td>
<td>2.</td>
<td>Samsung Electronics</td>
</tr>
<tr>
<td>3.</td>
<td>Alibaba Group</td>
<td>3.</td>
<td>Volkswagen</td>
</tr>
<tr>
<td>4.</td>
<td>Xiao Mi Technology Co., Ltd*</td>
<td>4.</td>
<td>Google</td>
</tr>
<tr>
<td>5.</td>
<td>Lenovo Group</td>
<td>5.</td>
<td>3M</td>
</tr>
<tr>
<td>7.</td>
<td>Baidu Inc.</td>
<td>7.</td>
<td>Procter &amp; Gamble</td>
</tr>
<tr>
<td>8.</td>
<td>Byd Auto Co.*</td>
<td>8.</td>
<td>L’Oréal*</td>
</tr>
<tr>
<td>10.</td>
<td>China Merchants Bank</td>
<td>10.</td>
<td>Coca-Cola*</td>
</tr>
</tbody>
</table>

Note: *new in 2014

Source: 2014 China Innovation Survey
The demographics of the survey

This annual longitudinal survey is in its third year. More than 60 percent of the MNC and joint venture respondents live and work in China — and have been in China for more than 10 years. They have seen the evolution of innovation in China firsthand. (See Exhibit B, below, and Exhibit C, next page.)

Exhibit B
386 companies participated in 2014 survey, up 46 percent from 2013

<table>
<thead>
<tr>
<th>Total respondents</th>
<th>Respondents by industry</th>
<th>Respondents by position</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>110</td>
<td>C-Suite</td>
</tr>
<tr>
<td>2013</td>
<td>264</td>
<td>Director / general manager</td>
</tr>
<tr>
<td>2014</td>
<td>386</td>
<td>Vice president (incl. SVP &amp; EVP)</td>
</tr>
</tbody>
</table>

Note: Sums may not total 100 due to rounding.

Exhibit C

The 2014 survey had a good mix of respondents

**Total respondents by company type**

*Total = 386*

- Chinese company: 52%
- Sino-foreign joint venture: 23%
- Wholly foreign owned enterprise: 14%
- Other and not disclosed: 11%

**Total respondents by company size***

*Total = 386*

- Don’t know / not disclosed: 13%
- $0–249 million: 4%
- $250 million–499 million: 6%
- $500 million–999 million: 10%
- $1 billion and above: 29%

Note: Annual revenue; sums may not total 100 based on rounding.

Source: 2014 China Innovation Survey
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