

CHINA'S NEW NORMAL

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CHINA'S NEW NORMAL

HOW CHINA SETS THE STANDARD FOR INNOVATION

Pelckmans Pro

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BY PETER HINSSEN

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THANK YOU!

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谢谢!

I dedicate this book to the two most important people in my life.

My wife, Annelies, who has shown alternating patience and enthusiasm throughout the 27 years of my wild China adventures. Being an entrepreneur is hard, both mentally and physically. You were my daily support and the only constant in a rich and often eventful life. Without you, I could never have gathered together the knowledge, experience and insights that have resulted in this book.

Our daughter, Amelie, who came into our lives on 11 June 2002, when she was nine months old. During the next sixteen years it was your smile and your joy that gave us the energy to try new things and to keep on moving forward. Although you are a citizen of the world, you now feel fine here in Belgium. You are the most wonderful gift that China ever gave to us.

My heartfelt thanks go to all the people who have inspired, stimulated and supported me. There are too many to name them all and I hope that those who are not among the following list will forgive my forgetfulness.

Peter Hinssen. Thank you for showing me a completely new way and for taking me along on your own journey. Since 2018, I have no longer been active as technology entrepreneur, but I have never regretted a single moment of the road we followed together. Today, in part thanks to your network, I can reach more people than ever and feel like a phoenix reborn! Your inspirational foreword to this book was, for me, the icing on the cake.

Luc De Cleir. Thank you for encouraging me to write. You were the first person to believe in me as an author. Your pen is so powerful that you continue to inspire me, time after time. After eight months of writing, your final feedback was: 'That was really not bad at all!' Thank you for your sincerity. Without you, this book would never have been written.

Elisabeth Torfs. You convinced me that Pelckmans Pro was the right choice for *China's New Normal*. It was mainly because I trusted you that I believed you, because for me all business is based on personal trust. Your team produced what you promised me they would, and for that I am enormously grateful, both to you and to them.

I would also like to thank the China experts who read through the earliest version of my manuscript: Thierry Raymaekers, Jan Van den Bergh, Jan Van Der Borgh and Jan Jonckheere.

A special thanks to my friend David G. Brooks for all the long hours you spent to help me edit and improve the English version of my book. I hope, in the process, I somehow triggered you to write a book about China, as your unique China experiences and insights should be revealed to the world.

Last but not least, I would like to express my gratitude to everyone who helped me, directly or indirectly, with the realisation of this book: Jason Breen, Kurt Wang Lin, Wim Rombaut, Felix Garriau, Inge Van Damme and the whole nexxworks team. Julie Vens-De Vos, Laurence Van Elegem, Cathy Boesmans and Stephanie De Kesel deserve a special mention for continuing to give me a new podium, as do Rik Vera, Steven Van Belleghem and Nancy Rademaker-Gysbrechts for allowing me to surf on their wave of inspiration.

FOREWORD

by Peter Hinssen

Leesvoorbeeld

A GUIDE FOR ANYONE WHO WANTS TO UNDERSTAND THE FUTURE

'The Yellow Peril'. That must have been my earliest image of China, as I grew up during the Cold War. The combination of a general fear of advancing Communism and the horror stories emerging about the Cultural Revolution had seriously coloured the West's perception of China — and that's putting it mildly! Reading the Tintin comic book entitled *The Blue Lotus* did little to set my young mind at rest!

As the young boy became a young man, I found myself living in a Europe that was trying to reinvent itself after the terror and tragedy of two world wars, out of which there had only really been one winner: The United States. Western Europe was being flooded by the commercial marketing violence of the 'greatest nation on Earth' and baby boomers bathed in the wondrous luxuries of capitalism. The United States had taken over Europe's role as the 'engine of the world', while Asia as a whole was widely regarded as a region where true innovation was dead and cheap imitation was the main way of working.

Gradually, this image was overtaken by reality. I saw 'Made in Hong Kong' on many of the cheap toys I played with as a child. For adults, this confirmed the stereotypical image of the Far East as a huge factory with dirt-cheap labour that was capable of nothing more than copying things, albeit really well. However, first Japan and then Korea slowly began to bring about a change in perception. Japan evolved from a copycat nation to a nation where world-class innovation thrived, both in technology and design. The Japanese 'miracle' saw the emergence of companies like Canon, which made the most advanced cameras in the world, or Sony, the most creative and inventive player in the field of personal electronics. In the automobile industry, Toyota and Lexus set the bar for comfort and safety higher than ever before, certainly much higher than any comparable brand in Stuttgart or Detroit.

'The Era of Asia' had begun, led by the powerhouses of Japan, Korea and Singapore, each of which excelled as world centres of innovation and growth. But China? For me, as for many others, the country remained a closed 'black box', shrouded in mystery and secrecy. Unknown and unloved.

When I started working in the 90s as a young engineer at Alcatel in Antwerp, a first wave of Belgian managers and technologists had already set off for China. When Deng Xiaoping introduced his 'open door' policy in 1978, in an effort to close the gap with the West's level of (technological) development, numerous companies were encouraged to set up operations in Shanghai. Pioneers like Julien De Wilde (later the CEO of Alcatel in Belgium) and Bert De Graeve (later the CEO of the VRT and Bekaert) seized this chance with both hands and went off to establish 'Shanghai-Bell'. They returned home with stories of huge markets and huge opportunities, but also huge challenges, huge thresholds, huge cultural differences and, most of all, huge frustrations.

For the next twenty years, I concentrated my own professional gaze almost exclusively on the West. In particular, I focused with increasing intensity on the internet revolution that was taking place in Silicon Valley and the resulting digital tsunami that soon flooded the world. For me, the epicentre was Palo Alto and it soon became clear that Europe was finding it hard to keep up with the pace of American technological development.

Over the past ten years, however, the Far East has slowly been edging its way back into the picture. The early rumours about the rapid rise of digital in Asia increasingly found confirmation in world markets. Japan was the first Asian country to fully embrace the mobile revolution, with players like NTT DoCoMo's i-mode. Korea soon followed suit, quickly becoming the world leader in broadband. Stories even began to emerge about Chinese companies enjoying previously unseen spectacular rates of growth, with Alibaba as one of the first.

For some time it had been a common sight to see Asian technologists employed in Silicon Valley. Even back then, these developers with Eastern roots were among the very best in the business. For the past few years, I have been lecturing at MIT in Boston, one of the finest technological universities in the world. It is fantastic to be part of this educational Mecca of the technological revolution and to see how the MIT continues to attract the best students from every country and continent. But a decade ago, it was a clear sign of things to come that the most brilliant students — the very best of the best — systematically began to come from China. They also began to speak English increasingly well, so that they could achieve the ambition that most of them held: to graduate from MIT, make their way *subito presto* to Silicon Valley and make lots and lots of money.

But in recent years this has all changed. Once they have completed their studies, these Chinese whizz-kids can now hardly wait to pack their bags and return home to China. If you ask them “why”, the answer is nearly always the same: “Because that’s where the action is.” Companies like Huawei, Tencent, Alibaba and Baidu have shown that it is now possible to develop technological players of world standing in China. Entrepreneurs like Jack Ma (Alibaba) and Pony Ma (Tencent) have demonstrated to the new generation of tech superstars that you don’t need to go to Palo Alto to make your fortune. Jack Ma, in particular, is now the role model par excellence for my students. He is a perfect cross between Steve Jobs and Elon Musk: larger than life, and above all, very Chinese.

In just a few years, the general perception of Chinese (digital) technology has undergone a metamorphosis. The initial idea that the Chinese players were no more than the copiers of American examples may have been correct. Alibaba, for example, was first seen as a ‘Chinese knock-off of Amazon’. But it is now clear that Alibaba is moving much further and much faster than its American rival and is, above all, much more innovative.

When, not so long ago, I first went to China with my company, nexxworks, to visit Chinese start-ups and experts, just like we used to do in Silicon Valley, my eyes were opened to a whole new world. The omnipresence of digital technology, the unbelievable richness of apps and the versatility of services like WeChat were truly fascinating. But through it all shone a clear common theme: the massive innovative drive of a country in full transformation.

If you travel to China nowadays, you have the feeling that you are travelling to the future. It is very much a ‘hard landing’ when you return to Europe. It is perhaps an even harder landing for the American tech-gurus returning to Palo Alto. Once they led the world, but now they are increasingly being left behind. Last year, I went on a seven-day tour to Shanghai and Shenzhen, two of the absolute hotspots in terms of digital innovation. After a week’s immersion in the new China, I flew directly to Silicon Valley, where I also planned

a further week's stay. It was like stepping back in time. In Shenzhen, everyone uses their smartphone to pay for everything via WeChat or AliPay. Even the beggars on the streets have their own QR-code to receive money! It's a bit of a techno-shock when you then arrive back in the USA to see people still paying with paper cheques for their weekly shopping in Walmart. The contrast is huge; the difference between day and night.

Much the same is true about the respective spirit of the countries. Michael Moritz is one of my favourite risk capitalists in Silicon Valley. Today he is a partner in Sequoia Capital, but he was originally a journalist. Back in the 80s, after he wrote a portrait piece for *Time Magazine* about Steve Jobs, he decided to switch careers and try his hand in the world of venture capital. He soon worked his way up to become one of the most important financiers for Silicon Valley. Some time ago, Moritz wrote an outstanding editorial article for the *Financial Times*, in which he argued: "Silicon Valley would be wise to follow China's lead." He described the work mentality of the start-ups he had seen in China: how these companies and their hungry young lions have an aggressive drive to change the world. He compared this with the pampered nerds of Silicon Valley, who are picked up each day for work by the Google bus and treated to all the privileges of stardom, such as sushi lunches from Michelin-rated chefs. Moritz is convinced that Silicon Valley is history unless it "cottons on" — and quickly — to what is happening in China. Needless to say, the nerds were less than impressed by this prophecy.

Since time immemorial, China has been an important hub in world trade. Academic studies have confirmed that throughout the course of recorded history China has accounted for roughly one-third of the world's entire economic activity. Indeed, China's position was so crucial and so unassailable that the country came to see itself as the centre of the earth: the 'Middle Kingdom' or *Zhōngguó*.

In other words, throughout much of human history China has been the pivotal point for the global economy. There have only been relatively short periods when this was not the case. The most fascinating and most recent of these periods spans the years between 1800 and 1900, when China lost the dominant position it had held for centuries. The 19th century was Europe's century. Above all, it was the century of the Industrial Revolution, which initiated worldwide change based on new technology that was largely in European hands. This led first to the steam revolution in Great Britain, followed by the electrical and chemical revolution in Germany. Later, the United States would capitalise on these developments and scale them up to gigantic industrial proportions. While all this was happening, China stood still. The Chinese people still refer to this period as the '100 Years of Humiliation', during which they not only failed to jump on board the new technological train, but also found themselves increasingly dominated and humiliated by new world powers, such as England and Japan.

Today's China is working to erase the memory of the 'Century of Humiliation' at lightning speed. Following the death of Mao in 1976, Deng Xiaoping set his country on a new and accelerated path of transformation. The nation's new leader was not only the architect of major reform in the economic field, but also had an equally important impact on social and ideological matters. For me, the greatest monument to Deng Xiaoping is Shenzhen, my

absolute favourite city in China. When Deng came to power, Shenzhen was little more than a rural village, the last railway station on the Chinese side of the border with economically prosperous Hong Kong. Deng immediately designated it as a 'Special Economic Zone', with the ambition to build a new city, alongside which Hong Kong would pale into insignificance. Shenzhen became the Silicon Valley of China, achieving amazing rates of growth based on the newly emerging electronics industry. Today, the city is the headquarters of companies such as Huawei (the telecom giant), Tencent (the owners of WeChat) and Ping An (the largest insurance company in the world).

China opened the door slightly to the West at the end of the Mao era, with the legendary visit to the country in 1972 by the American president, Richard Nixon. The US Director of National Security at the time, Henry Kissinger, has left us a brilliant description of this visit in his autobiography. At the first meeting between Nixon and Mao, it soon became clear that the Chinese Premier, Zhou Enlai, shared a passion for history with Kissinger. In his book, the American diplomat describes a later scene that took place over a glass of cognac around an open fire somewhere in the heart of Beijing. The two men were discussing their favourite subject, when Kissinger suddenly asked his Chinese host: 'What is your opinion on the French Revolution'. Zhou Enlai thought for a while, gently swirling his liquor around his glass, before answering: 'It is too early to tell.'

Perhaps this story is true; perhaps it is not. Even so, it brilliantly encapsulates the Chinese capacity for long-term thinking. The old stereotypical monolithism associated with Communist China has long since disappeared. In the meantime, China has developed with startling speed into what is now perhaps the most capitalist system in the world. That being said, the Chinese people and their leaders have not lost their ability to think and plan with something more than the immediate future in mind. The country still has a remarkable clear vision of where it wants to go and a remarkably effective way of persuading everyone to move in that same direction.

The latest evolution in Chinese thinking is the idea of China as the hub of the 'New Silk Road', an idea that finds its best expression in the famous 'One Belt One Road' (OBOR) initiative. This is perhaps the largest economic project the world has seen in the past hundred years. The Chinese government has committed itself "lock, stock and barrel" to this project, in the hope of making China the most (technologically) innovative nation in the world. The direction, planning and leadership associated with the project are fascinating to watch, although the methods can sometimes seem a little strange to Western eyes. Consider, for example, the discussion about social credit scoring: the three-figure code or score that will be given to every Chinese citizen by the year 2020 and will be correlated with, for example, their WeChat-account. This 'Big Brother' approach is frowned on or even openly reviled by many commentators in the West. But if you discuss the matter in China, people just shrug their shoulders. They regard it as the most natural way in the world to run a sprawling and complex country of 1.4 billion inhabitants.

China has become a long-term thinking machine, with a visionary 'day after tomorrow' focus and, above all, a 'ruthless power of execution'. This makes it an ideal machine for times when things are changing at a rapid pace. That is why, in this book, Pascal focuses

less on China's past and more on its present and its exciting future, which is certain to have an impact on us all, the scale of which is still worryingly unknown.

At the time of writing, tension is growing between the world's two great economic superpowers, China and the United States. It is perhaps even possible to speak of a new Cold War. Concurrently, we are also living in a world increasingly dominated by a 'G-Zero' mentality, to use the phrase coined by the American Professor Ian Bremmer. Bremmer, who teaches at NYU, argues that the original function of the United Nations — thinking collectively about the future of our planet — has been devalued to the point of meaninglessness. The UN is now nothing more than a ceremonial 'talking shop' with no real power. In similar vein, the G20 has shown itself to be toothless and the G8 is equally impotent. As a result, we are evolving towards GO or G-Zero: a situation in which no group of countries has the power to impose its will on the international agenda, so that each individual country is now required to fend for itself.

It is within the context of this economic and political free-for-all that China wishes to reassert its leadership in the world. It wants to re-establish its position as the 'Middle Kingdom'. It remains to be seen, of course, how this new Cold War will develop and what role Europe will play within it. Yet for all the uncertainty, one thing is crystal clear: this is a crucial moment for the West.

For this reason, it is vital to do everything possible to learn and understand all we can about China, about how and why it is developing so quickly and what, ultimately, it hopes to achieve. I recently led a Chinese management team from a large multinational on a tour through Silicon Valley. I was surprised by how irritated they were by the attitudes and behaviour of their former compatriots in San Francisco's Chinatown. "These are the old Chinese," they said, with a clear note of contempt in their voice, "trapped in the old way of thinking about China. They no longer know what China stands for in our modern world. This field of tension between the 'new' and the 'old' in Chinese thinking is something we need to be aware of — and learn from.

It is less than ten years since I wrote my book *The New Normal* (2010), in which I predicted that digital would soon become a normal part of our everyday lives. At the time, this idea sounded 'exotic', perhaps even a little fanciful. Surely, I was exaggerating? As a result, many people hugely underestimated the speed of the change and its impact on life, work and society as a whole. Exactly the same thing is now happening with China. Whereas the centre for digital development in the past clearly resided in Silicon Valley, the centre for the next phase, the 'Fourth Industrial Revolution' as Klaus Schwab calls it, the new cognitive era fed by AI, will unquestionably be in China. In the near future, China will become the focal point of our New Normal. This idea still sounds 'odd' to our Western ears, perhaps even a little hard to stomach or believe. As a result, and as with the digital revolution a decade ago, almost everyone is seriously underestimating the likely impact.

For this reason, this book is a must-read for everyone who is an entrepreneur, or runs a company, or is engaged in innovation, or wishes to provide his customers with a better experience, or wants to be inspired, or simply hopes to better comprehend the world in which his or her children will live. In other words, it is a must-read for all of us! After twenty

years of living and working in China, Pascal knows better than anyone precisely what makes the Chinese people tick. In his own irresistible style, this makes it possible for him not only to confront us with harsh facts that we can no longer ignore, but also to show us what we can learn from China's New Normal, before it is too late.

In recent years, I have come to know Pascal as the very best of guides for everything relating to China and I am proud to regard him as my partner in this fascinating and inspirational voyage of discovery. His book is a brilliantly written manual for anyone who wants to get a grip on our uncertain future. Just forget that China is a country: it is becoming a standard.

Peter Hinssen

The Future of Go



柯洁 KE JIE
00:46:57

ALPHAGO
02:08:18

<

China's Go player Ke Jie loses
on 25 May 2017 to Google's artificial
intelligence machine, Alpha Go.

INTRODUCTION

**CHINA'S NEW
NORMAL**

CHINA'S NEW NORMAL IS VERY SPECIAL

Two hundred years ago, my native city of Ghent was the very first city on the European mainland to witness the Industrial Revolution. The man responsible was Lieven Bouwens, who in 1798 managed to smuggle important parts of the spinning mule into Ghent hidden inside sacks of coffee. Much the same kind of thing happened in the United States, where the English-born Samuel Slater, known forever after as 'Slater the Traitor', kick-started the Industrial Revolution in America with the stolen designs of British cotton-making machines. In the 1960s it was Japan's turn to copy America's leading technology, although few observers at the time believed that Japan would ever develop into the world leader in the automotive industry. Similarly, 20 years later few could imagine that Korean companies like LG and Samsung would become so dominant in their sectors, largely through their imitation of and improvement upon successful Japanese methods. Throughout modern history it seems that the title of 'the most innovative place on Earth' is one that is regularly passed on from country to country. And now it is China's turn.

Xi Jinping (习近平) became President of the People's Republic of China in 2013. This event coincided with the country's first deceleration in the rate of economic growth after a nearly unbroken 35-year period of average annual GDP growth of more than 10 percent. This high-speed economic growth was the result of the 'Open Door Policy' adopted by Deng Xiaoping (邓小平) after his rise to power in 1978. Deng became the most important Chinese leader following the death of Mao Zedong in 1976 and he remained in office until 1987. The Chinese growth miracle appeared to come to a stuttering halt just as Xi Jinping assumed the reins of power. Since becoming President, Xi has had to confront an annual growth rate of less than 7 percent. In May 2014, Xi declared that China had entered a new era he called the New Normal (xīnchángtài 新常态). In doing so, he made clear to his own citizens and to the wider world that his country had entered a new phase of economic 'normalcy', during which its economic growth would be more or less in the same range as the growth rates in the rest of the world. By this he meant a more modest growth rate, linked to an improved and more balanced economic structure with growth coming increasingly from domestic innovation, rather than from exports and state subsidies.

However, China's New Normal is anything but normal! Even with a slower growth rate, China's economy is still generating around a third of the world's total economic growth each year. And there are two other important new growth normalities. China's purchasing power parity (a widely used parameter to compare the purchasing power of different countries) from 2015 onwards exceeds that of America and Europe, and by 2050 will be as great as America and Europe combined. The Chinese already have much more money at their disposal than the 'rich' West. Moreover, in recent years up to 78% of the GDP growth has been driven by domestic consumption, an increase of 45 percentage points since the advent of Xi Jinping.¹ It is remarkable that Chinese reported GDP growth in 2017 still amounted to nearly 7%, given that a large part of the economy still consists of loss-making state-run companies that are now being systematically written off, one by one.

In my opinion, China's New Normal is about much more than classical economic growth analysis, as the economy is still highly reliant on state intervention and other legacies from the past. For a future-focused analysis, I believe it to be more meaningful today to look at the exponential growth of innovation in China as the best indicator of the country's huge economic potential. If we want to view China's New Normal in its proper perspective, we need to look at the spectacular rise of innovation over the past five years. In 2018, this rise in innovation reached a tipping point, with China apparently overtaking the innovative capacity of the United States. Some key developments signal this tipping point:

- ✦ The list of the world's 20 most valuable internet companies (by market valuation) already contains nine Chinese enterprises.²
- ✦ China already has 149 unicorns³, private companies that are worth more than 1 billion dollars. This is three more than the United States.
- ✦ China now spends as much on research and development (R&D) as Europe or America, whereas just eight years ago they only spent half as much.⁴
- ✦ China accounts for 40% of all the world's patent applications and is now approaching the total number of patents granted to American and Japanese companies.⁵
- ✦ Trump's firm actions against Huawei and other Chinese high-tech companies reveal new concerns for America towards the real capabilities of Chinese technology firms.
- ✦ If a comparison is made between the growth of similar technology companies in China and the West, those in China are growing nearly twice as fast, even though they are still almost exclusively active on their domestic market.

This handful of facts and figures is enough to show that the standard image of China held by most people in the West is outdated or even totally wrong. This is the image projected in 2014 by Joe Biden, the former American Vice-President, in a broadcast to the American people on national television: "I challenge you. Name me one innovative project, one innovative change, one innovative product that has come out of China." Donald Trump played on much the same theme in 2018, when he tweeted that China had already stolen 300 billion U.S. Dollars in intellectual property rights, a situation that could not be allowed to continue. The assumption remains that China needs to copy because it is not capable of generating innovation on its own. This is the stereotypical 'story' that many politicians, business leaders and journalists in the West love to tell about China. It reassures their populations that 'we' are still more innovative than 'them'. Yet while this might be a reassuring story, it is also a dangerous one, since it feeds a self-fulfilling prophecy that the West has nothing to fear from China and its dramatic economic renaissance. Nothing could be further from the truth. In this book I will highlight the trends, phenomena and examples that will shatter this outdated image of China and of the Chinese people, in the hope that this will prepare us better to remain competitive as individuals and companies in a world where

New Normal China will be a major force. I will look past the hackneyed clichés by describing the trends that stimulate innovation in China. I will explain why and how this innovation is not predominantly directed by Alibaba (China's biggest e-commerce giant) or Tencent (the country's largest social media platform) or even by Xi Jinping, but by the urgent desire of 1.4 billion Chinese to live a better life. This desire – the wish to enjoy a standard of living comparable to people in Western Europe – is unquestionably the most powerful driving force behind the Chinese innovation revolution.

My personal experience suggests that China entered the new age of innovation in 2013. This was the turning point year: the year in which the switch was made from quantity to quality; the year in which young entrepreneurs suddenly started to believe that they could become the next Jack Ma, the founder of Alibaba; the year in which consumers first recognized the huge power they possess and in which Ferrari was unable to keep up with unprecedented demand from the new class of Chinese super-rich. It was also the year in which the first major wave of Chinese experts returned from America and Europe to set up and run new companies in their homeland. The mobile digital era was their playground, and they had the ambition and self-confidence to make this playground their own. In 2013, a new and more innovative China awoke.

Was this perhaps the result of the impulse that Chinese entrepreneurs had received five years earlier when the Olympic Games were hosted in Beijing? Or was it the influence of the new standards in communication set by Tencent's WeChat product – mistakenly referred to as the Chinese Facebook? Or was it because China suddenly found itself with the largest middle class in the world? Or because the corruption trial of Bo Xilai (the Communist Party Secretary in Chongqing, the most densely populated city in China, and a member of the Chinese Politburo, the most senior political organ in China, containing the country's 25 most influential leaders) signalled the end of the era of extravagant and unprincipled self-enrichment? Or was it the appointment of Xi Jinping as President and Communist Party Secretary that provided the decisive impetus? Or was it simply because 2013 was the Year of the Snake in the Chinese zodiac, a year associated with wisdom, intelligence and intuition?

Whatever the reason, there now seems little doubt that in 2013 China turned a corner and entered a new age of innovation of a type never seen before. As a result, this book about China's New Normal also starts in that same year. Although it took Japan and Korea many decades to make the transformation from innovation copycat to innovation leader, China will achieve this in less than 20 years. These Asian countries all started by picking the low-hanging fruit that dangled tantalisingly from the tree of Western innovation. China, in particular, turned this culture of copying into its trademark by replicating almost everything that was capable of making a profit. In contrast to the experience in Japan and Korea, in China this led to the development of a production industry with millions of factories and experts: an infrastructure and a source of knowledge that the country can now exploit to its advantage as it seeks to become an innovation powerhouse in its own right. This does not mean that China will not continue to copy in the future, but the Chinese companies that are currently redefining global standards are all supremely innovative and the majority were founded less than six years ago (or else are older companies that have totally reinvented themselves over the past six years). I call these the Chinese phoenixes, in contrast to the unicorns of the West.

Unicorns, like phoenixes, are mythical creatures. But unicorns are much rarer. The desire to become the next unicorn is rooted in a Western culture that emphasises individuality and uniqueness, a dream that remains out of reach for the vast majority of entrepreneurs. In contrast, Chinese entrepreneurs want to become phoenixes. In China, the phoenix (凤凰 fènghuáng) is not only associated with the strongest virtue, strength and prosperity, but also represents yin (阴) and yang (阳), the duality of existence that gives the universe its shape and form. The phoenix also has the ability to reinvent itself, to rise from the ashes of its former self, to be reborn as a new entity. If, as an entrepreneur, you wish to be a phoenix, you need to have the mentality of a start-up and the courage to take risks (yang), combined with the wisdom that will allow you to search for the necessary resources and security that can be offered by collaboration with a larger organisation as an investor or partner (yin). Chinese phoenix-start-ups or the phoenix departments in major Chinese companies are all less than six years old. In fact, it is probably more accurate to refer to them all as start-ups. And this is what this book is about: these remarkable Chinese start-ups. But these are not start-ups as we know them in the West. They are all young companies with an enormous growth potential allied to an equally great resilience. Their race to the top is breathtakingly fast and is the result of a uniquely Chinese investment and innovation strategy.

THE S-CURVE OF WESTERN INNOVATION

In the West, innovation has been the secret to commercial success for more than 100 years. In Belgium, Ernest Solvay invented the ammonia-soda process to produce soda ash. Henry Ford developed a brilliant method for the mass production of cars. The list is almost endless.

Figure 1

