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The ‘world’s toughest gym’: how global companies fight to survive in China

Innovation, speed, and entrepreneurial agility are needed in China; foreign firms must adapt or lose ground, says McKinsey’s Joe Ngai

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Joe Ngai, Greater China chairman at McKinsey & Company. Photo: Edmond So

Foreign executives used to come to China to study shoppers. Today, many come to study their future competitors. That shift, according to Joe Ngai, chairman of Greater China at McKinsey & Company, says almost everything about how China’s role in the global economy has changed.

For much of the past two decades, China was the market multinationals could not afford to miss. The formula was often straightforward: enter the market, ride the growth of a rapidly expanding middle class and capture a share of the world’s largest consumer base.

However, that playbook is now becoming harder to execute. Economic growth has slowed while consumers have become more selective about how they spend. From electric vehicles to coffee, many foreign companies that once enjoyed comfortable positions are seeing their market share shrink and profits come under pressure.

“The market has become harder,” Ngai said in an interview with the South China Morning Post. “Twenty years ago, if the tide was rising, everybody got a share of it. Today it’s different.”

“In the past, many companies came to China with a product and a business model that had already worked elsewhere,” he added. “Today, that’s not enough.”

Another factor is that the business environment became tougher amid Covid and rising geopolitical tensions.

During the past few years, global supply chain strategies have lurched from “China Plus One” – searching for alternative manufacturing hubs across Asia or India as a hedge – to something more drastic: “ABC,” or Anything But China. Geopolitical tensions, tariffs, and pandemic disruptions accelerated the search for alternatives by many foreign firms.

But now, some companies have discovered that leaving China is easier said than done because finding a replacement is challenging.

Many of the CEOs who explored alternatives in India, Indonesia and the Philippines eventually found how difficult China’s industrial ecosystem was to replicate, said Ngai.

Ngai, who leads the global consultancy firm’s Greater China business and recently co-authored “The Next China Is Still China” with fellow senior partner Nick Leung, has spent much of the past few years fielding a question that once dominated boardrooms from New York to Frankfurt: if companies need an alternative to China, where should they go?

People visit the terrace of a shopping centre overlooking Beijing's central business district. Photo: Reuters

"The next China is still China" was the answer Ngai eventually arrived at. "But it's a different China," he added, noting that when many foreign firms returned to the country, they realised they had taken the country for granted.

China's competitive advantage, Ngai argues, is no longer cheap labour or even market size. Rather, it is the density of its industrial ecosystem – suppliers, engineers, logistics networks, manufacturers and entrepreneurs operating at a speed that remains difficult to replicate elsewhere.

However, that speed comes at a cost. China's business world has become defined by what locals call "neijuan", or involution – relentless competition that squeezes margins and leaves companies fighting for their survival.

Many executives, as well as the authorities, see it as a warning sign, while Ngai described it as "the world's toughest gym".

"You are fighting 24 hours a day. Even when you become the best fighter, you can't rest because there is always somebody lining up to challenge you."

The casualties are real as companies burn through capital, price wars destroy profits and entire sectors become overcrowded. "There is a lot of blood spilled in that gym," Ngai said.

Yet it is these very same forces that have helped produce some of China's most formidable and successful companies.

Luckin Coffee challenged Starbucks through relentless experimentation and aggressive pricing. BYD has overtaken established global carmakers. And Chinese AI and robotics firms are advancing at a pace that is drawing foreign executives to Shenzhen and Hangzhou as often as Silicon Valley.

The result is that many foreign executives now visit China for very different reasons than a decade ago. Instead of touring shopping malls, they ask to visit factories, robotics companies and research labs.

"They want to understand why these companies are so competitive," Ngai said.

For multinationals already operating in China, the challenge is becoming even more urgent. The keyword is innovation," he said. "Your response to the market has to be much faster …[and] if you believe technology will drive the next 10 years, then you can't ignore China," he said.

Beyond manufacturing, foreign companies are also increasingly tapping into what Ngai calls China's "engineer dividend" – a vast pool of researchers, engineers and scientists that has emerged as the country's demographic dividend fades.

China's role in global innovation is becoming particularly visible in sectors such as pharmaceuticals. Ngai said many multinational drug makers now license compounds developed by Chinese biotech firms, while research and development can often be conducted more quickly and at lower cost than in Western markets.

Another reason Ngai believes many foreign companies struggle in China is that they have become too bureaucratic. "Many multinational companies have become too corporate," he said. The question is how to compete against entrepreneurs who, as Ngai puts it, "wake up every day thinking about how to beat you."

That often requires abandoning traditional multinational playbooks. Companies such as McDonald's and Starbucks have given local operations greater autonomy, allowing them to move faster and respond more quickly to Chinese rivals.

The pressure is also pushing Chinese companies overseas. Brands such as BYD, Xiaomi and Pop Mart are becoming increasingly visible abroad, but Ngai cautions that success at home does not guarantee success elsewhere.

"In some ways, Chinese companies overseas are still in kindergarten," he said.

China’s business culture rewards disruption, speed and aggression. Overseas markets often demand patience, partnerships and trust.

“You can’t assume you can disrupt everything,” Ngai said. “You have to learn how to play other people’s games too.”

That, he argues, may be the defining challenge of China’s next chapter: foreign companies learning to become more entrepreneurial in China, while Chinese companies learn how to become global citizens outside it.

“If you survive in China, you win in the rest of the world,” Ngai added.