Internet connectivity to boost Chinese productivity

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The internet is driving big changes in the productive capacity of China's economy.

When market commentators talk about the internet in China, the first examples that are rolled out are the increasing penetration rate or areas such as the phenomenal rise of e-commerce and how this is changing consumer behaviour. Alibaba's recent mega-IPO in New York has reinforced this excitement surrounding the potential of online business in the world's second-largest economy. However, what is less discussed, but which may have far more wide-reaching consequences on the direction of China's growth, is the effect the internet will have on how businesses are operated – both big and small.

Chinese businesses and the internet

Individual connected users in China number 632 million, amounting to a penetration rate of just 46%, according to the McKinsey Global Institute (MGI). China's internet economy is also having an impact on the country's growth. The internet could contribute up to 22% of incremental GDP growth through 2025 in China, albeit in the best case scenario of speed and breadth of industry adoption. Although GDP growth does not necessarily translate into stock market returns, the benefits of this contribution will be seen in other areas of the economy – where businesses will utilise online connectivity to boost productivity. This could include areas from tapping into 'big data' to managing supply chains better and collaborating on research.

This dearth of business connectivity is an area that presents a plethora of potential opportunities. Just 20-25% of small businesses in China are internet-connected, a small number as compared to the US where 75% of small firms are, according to the MGI. Relatively low connectivity also helps to partially explain why labour productivity of small and medium enterprises (SMEs) in China is roughly two-thirds the average for all firms in the country. This compares to 90% in Britain and 95% in fellow BRIC Brazil.

Online change for the better

These changes will benefit not only smaller businesses but also the wider economy, as internet connectivity will allow small firms to scale up rapidly and at low costs while the nascent rise of cloud computing also reduces the need for hefty capital investments in IT systems. Online marketing can now be purchased in small increments and target specific customers. In China, limited access to capital is a common obstacle to the growth of SMEs but the internet is also changing this. Online lenders and finance providers are using new tools to evaluate risk and lower transaction costs and this changing landscape has been further exemplified by the entry of the big two tech giants – Alibaba and Tencent – into the world of financial services. Alibaba, for instance, provides micro-loans to its e-merchants while JD. Com (in which Tencent has a stake) offers supply chain financing to its merchants.

Furthermore, the benefits of internet connectivity go beyond the obvious. The healthcare sector is an example in case. As China's population ages and medical spending increases, the shift from paper records to a more streamlined electronic health record system will dramatically improve the country's healthcare infrastructure. Online platforms that allow patients to rate and review hospitals and doctors will inject an element of transparency and competition into the process.

Industries where manufacturing makes up a large component of the business can also benefit from increased connectivity. In 2010, China overtook the US to become the largest single-country market for new cars. The opportunities for manufacturers to form a collaborative approach towards product development in this vast industry are enormous. For example, deploying real-time supply chain data to help optimise inventory levels and transportation routes could deliver huge savings to car makers. Although many of the largest carmakers have already adopted this, there remains space for substantial incremental gains from smaller competitors. In the chemicals sector, better utilisation of connectivity can also reap rewards. Manufacturers in the sector have traditionally relied on demand forecasting and production planning to address fluctuations and improve operational efficiency. However, the internet can further improve these by supplying real-time data on areas that range from suppliers' inventory to shipments in transit to downstream customer demand. All these initiatives will allow for further gains in transparency, inventory control and production capacity.

Opportunities to connect

More than anything, increased use of the internet allows companies to more efficiently allocate working capital to where it is needed and, in the process, realise significant cost savings. As with all changes, what does this impending online revolution in the Chinese economy mean for investors? All of the above shows that attractive investment opportunities can potentially be found in a number of sectors, where companies have successfully leveraged changes and improvements in the technology landscape to add value in the operation and management of their businesses.

Healthcare and auto manufacturers are just two areas likely to see changes for the better by utilising connectivity. Banks, real estate developers and retailers are also likely to be the beneficiaries from increased online interaction. Companies that are deploying technology to lower operating costs or those that are embedding connectivity into core processes will likely be the beneficiaries of this shift to the online world.

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