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HOW THE CLOUD WILL BECOME THE GREAT ENABLER FOR INDUSTRY

SaaS (Software as a Service) and other cloud tools offer a golden opportunity for industrial leaders to rethink and redesign their growth strategies, says Simon Zhang.

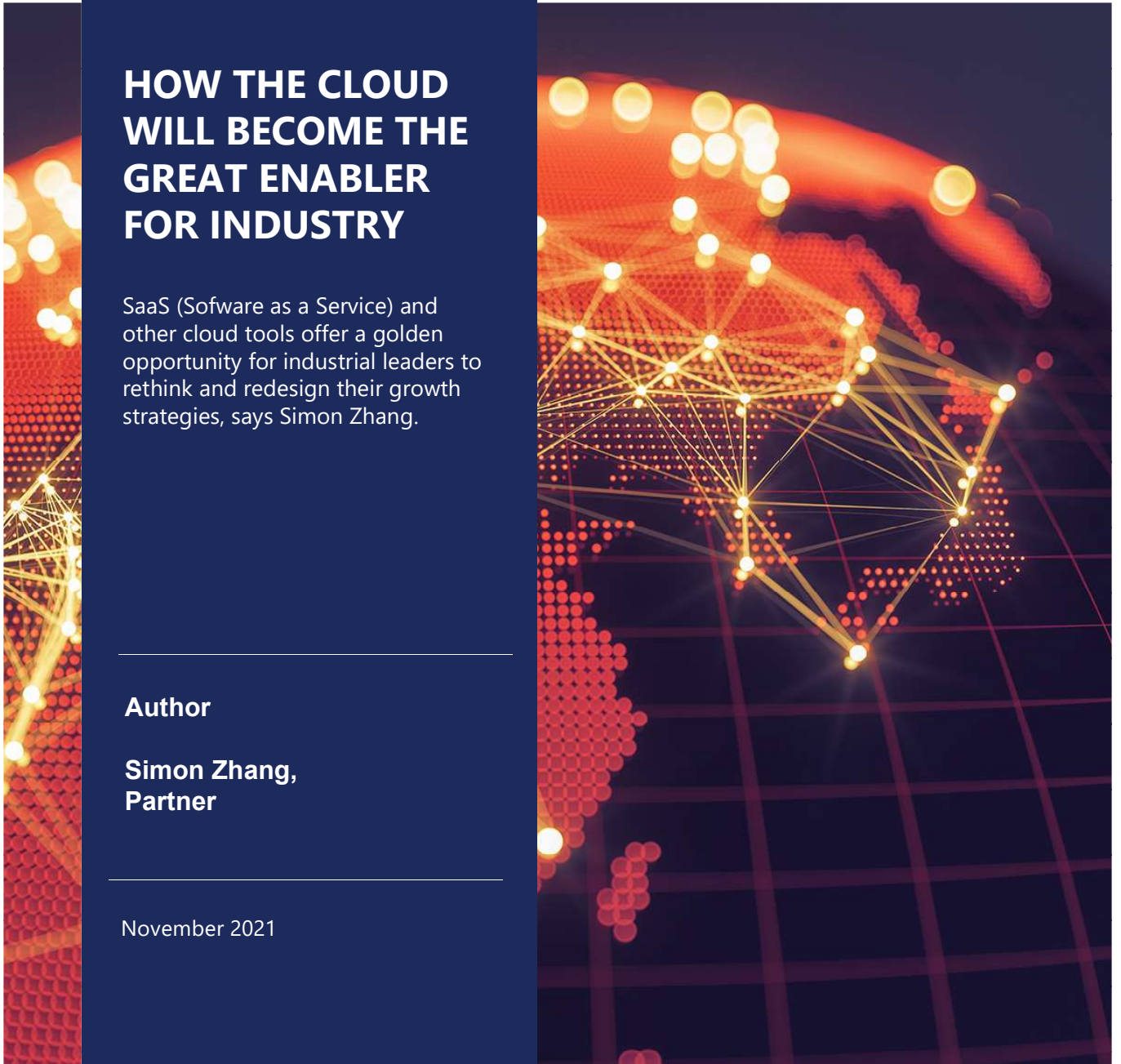
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SaaS (Software as a Service) and other cloud tools offer a golden opportunity for industrial leaders to rethink and redesign their growth strategies, says Simon Zhang.

Overview

The adoption of cloud services – the on-demand delivery of computing services over the internet – is a huge strategic opportunity to disrupt and create value. As such it needs to be part of the thinking process of every leader of a manufacturing business in China today.

This is not purely an IT infrastructure issue for the CTO. This is as much a market development issue for the CEO and it's relevant to international companies in materials, food & beverage, automotive parts, healthcare, fashion and most other sectors. Furthermore, China is on the cusp of a rapid acceleration in its cloud computing capability, and international companies need to take a proactive approach to ensure they reap the benefits.

This article aims to trigger new thinking among manufacturing companies and will argue that cloud models, especially SaaS, have the potential to be a great enabler for industrial leaders in both their own sectors and across different sectors. Indeed, given the lower GDP growth currently being witnessed in China, the need to rethink and redesign growth

models has become even more pressing.

So what is the cloud?

The delivery of computing services – such as servers, storage, databases, analytics and intelligence – over the cloud contrasts with the traditional approach whereby companies invest in their own computing infrastructure and services. Using cloud services not only reduces capex requirements, but also creates an opportunity for lower opex from economies of scale, as well giving managers more flexibility to adapt to changing business needs.

The chart below and on the next page illustrate the range of cloud services options that can be considered.

Chart #1

Cloud Services Options

Infrastructure (as a Service)

The company rents IT infrastructure (such as servers and virtual machines, storage, networks and operating systems) from a cloud provider on a pay-as-you-go basis.

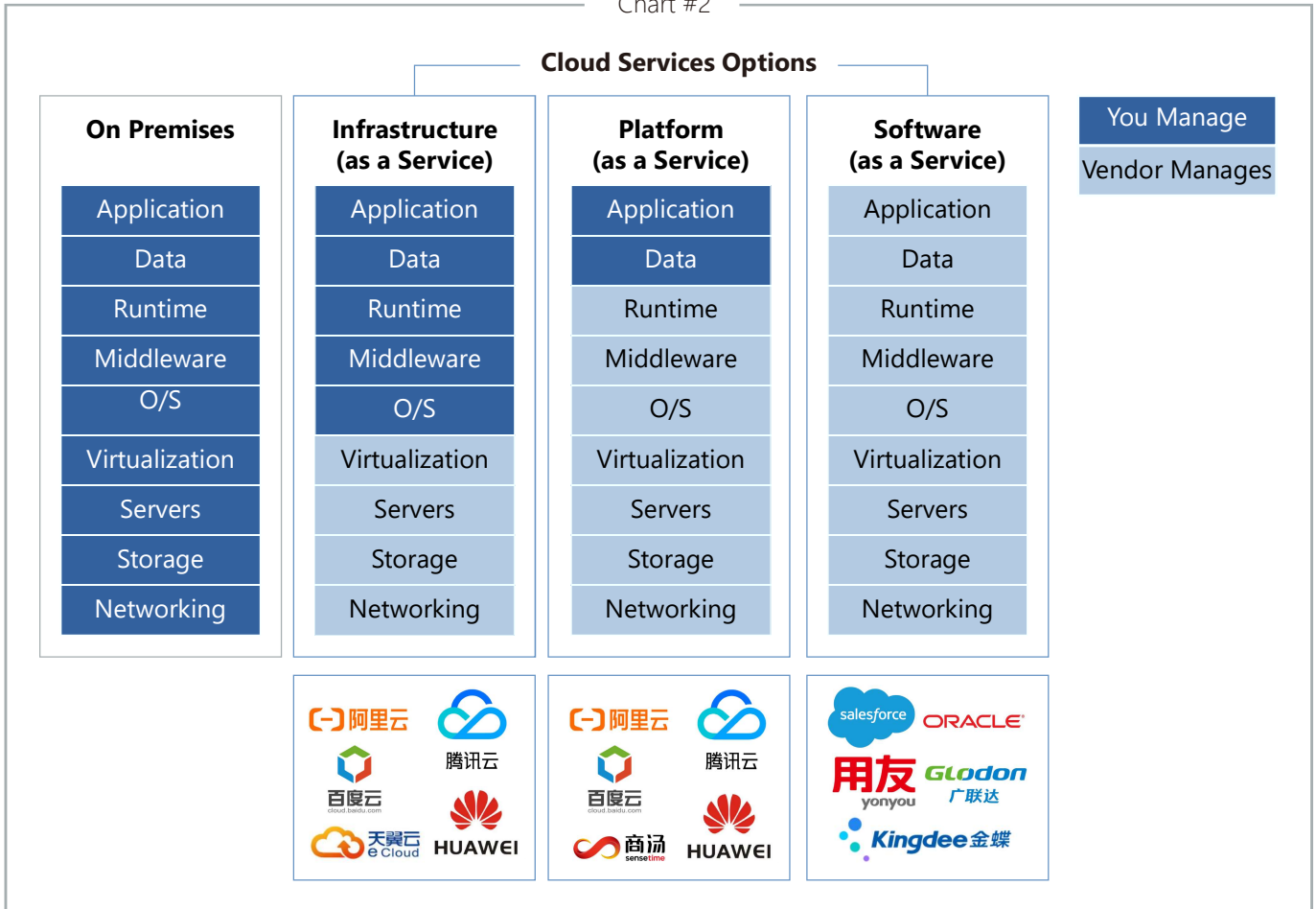
Platform (as a Service)

Cloud services supplied in an on-demand environment for developing, testing, delivering and managing software applications, such as web or mobile apps for instance.

Software (as a Service)

A method for delivering software applications over the internet, typically on a subscription basis (cloud providers host and manage the software application and underlying infrastructure).

Chart #2



In this article we will mainly discuss the benefits of the SaaS model, but that doesn't mean that China's PaaS and IaaS models don't have significant benefits too. Indeed it is clear that the tide has truly started to turn as manufacturers begin to realise the full potential of using cloud services, especially SaaS and PaaS models, within their business.

China and the cloud

Earlier this year the World Economic Forum published statistics¹ showing that the Chinese e-commerce market now represented more than half of all global e-commerce retail value. Yet despite this astonishing figure, China still only accounts for a marginal share of the global market in cloud computing.

Indeed, according to IDC², China's SaaS market is still only worth \$5bn out of a global market of \$210bn. So what is going on? Why is China still

playing catch-up with its cloud service market development?

One major reason is that so far only the Chinese e-commerce market has begun to truly embrace cloud models. By contrast, take-up in industrial sectors remains low. Another big reason has been China's relatively poor record of enterprise IT spending. For instance, according to IResearch, in 2019 China's GDP accounted for 16.4% of global GDP but its enterprise IT spending accounted for just 5.5% of global spending.

One of the main reasons has been China's relatively low labour costs (compared to Western markets) which represent a draw on IT spending from a cost-saving perspective. Another is the pressure on businesses to drive investment via short-term revenue gains initiatives such as market channel expansion, rather than on those with longer payback periods such as IT investment. Aligned to this are the pressures of dealing with such a fast-moving market as China which makes it difficult for companies to standardize processes.

Another reason is that, unlike say in the US market, demand for SaaS services in China still mostly comes from large companies rather than the SME market. And then there are also concerns over data safety too. Whereas use of the public cloud is mainstream in the US, the private cloud solution remains far more common in China such that many companies end up running both private and public cloud solutions simultaneously.

However cloud service providers have become used to these challenges and customize options appropriately. For instance the real estate industry, as shown in the table below, is a good example of how SaaS players have adapted their models to suit the unique features of the Chinese market.

Chart #3

Customization Of Cloud Services In China: Example Of The Real Estate Market

		Deployment Model		Private cloud option
		SaaS	License (on-premise)	
Huawei	Cloud provider/ platform	√	√	√
Tencent	Cloud provider/ platform	√	√	√
Persagy	Energy mgmt. software		√	
ARTISAN	Asset mgmt.	√		√
Mingyuan	ERP & SaaS / Asset mgmt.	√		√
SpaceUp	Subsidiary of Vanke / platform	√	√	√
Ideal Life	Subsidiary of Greentown / platform	√	√	√

Future prospects

Despite these challenges we strongly feel that China's cloud market, and especially its SaaS market, has a promising future. We are not alone in our thinking. For instance IResearch forecast that China's SaaS market will see nearly 40% annual growth to 135.8bn RMB in 2023.

In particular demographic and economic factors will drive IT spending in the future as labour cost inflation and increased market awareness should lead to much stronger spending. At the same time value creation by SaaS players

focus heavily on the 'technical' aspect of their services as they simply move traditional software functions to the cloud. But in the future they will develop far greater and deeper insights into particular customer challenges.

The improvement of both cloud and other digital infrastructure coverage capabilities will also expand the scope of SaaS services and bring better user experiences. For instance the development of IoT (Internet of Things) technologies and mobile internet will significantly facilitate digitalization and help move business processes online, enhancing the interconnection of

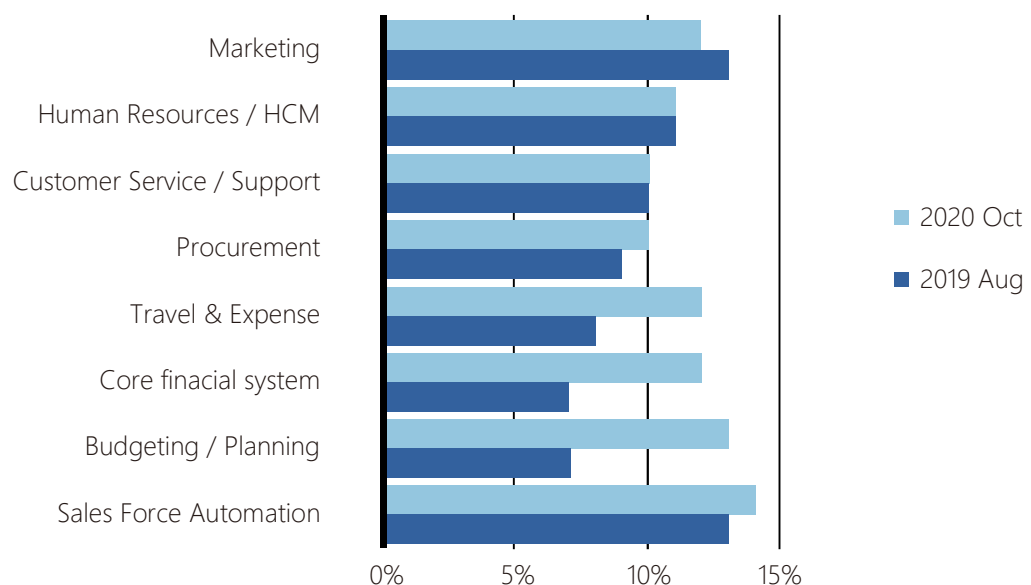
various products and devices. This will not only increase the necessity to adopt SaaS from a technical perspective, but also facilitate the complete rethinking of business models with SaaS.

The impact of COVID-19 should also not be underestimated as the pandemic drives ever more business functions online. As the chart below shows, the SaaS adoption rate in many business functions increased from 5-10% to 10-15% during 2020, and we believe that this momentum will continue.

Chart #4

China's SaaS Adoption Rate

While overall SaaS adoption is low in China, survey data shows adoption increase in 2020.



Note: Surveys conducted in Oct-20 and Aug-19, survey sample 101 and 106 respectively. Source: UBS Evidence Lab

Value creation in manufacturing

As we have stressed, we believe SaaS – and other technologies such as IoT and mobile technology – can now be a great enabler for industrial leaders to rethink and redesign their growth models. However for SaaS to be an enabler we have to move away from thinking just in terms of its ‘technical’ definition, namely standardizing an application based on cloud computing with on-demand usage.

Instead these technologies now provide an excellent opportunity for business leaders to both integrate existing data and explore new data and metadata to solve business problems throughout their supply chains and among stakeholders.

A good way of illustrating the significance and importance of this value creation mindset is to point out the differences among those SaaS players which provide mainly functional software, and those which are designing different models for customers, as we show in the chart right.

At the moment most SaaS players still come under the ‘Traditional SaaS’ heading, but most are also thinking about moving across to the ‘SaaS of Tomorrow’ column. As such, the boundaries between the two columns are becoming more blurred.

	Traditional SaaS	SaaS of Tomorrow
Examples	Functional software (e.g. CRM, sales management software, ERP, OA).	LinkedCare, Smart Fabric, RootCloud, Uptake.
Scope	To move ‘traditional’ software to the cloud without changing the customer’s business model too much.	Together with other enabling tech (like IoT and mobile tech) to integrate existing or explore new data (either from the data or metadata from their own equipment or from that generated via the value chain) to solve the business problems of value chain stakeholders.
Features and benefits	The customer enjoys the benefits of the SaaS model (e.g. fast deployment, lower upfront investment, more user-friendly etc.), but the essence of the software doesn’t change too much. Perceived benefits for customers are efficiency gains and compliance.	The customer enjoys the benefits of the traditional SaaS model but also enjoys benefits not previously available. The aim is to provide measurable gains to value chain partners, like revenue-up (one example refers to Smart Fabric next page), cost-down (e.g. the synergy on collective purchase, supply chain synergy etc.), and sometimes efficiency gains and compliance.
Big Data involved	Data of in-house operation (e.g. accounting, production etc.).	Focused data of in-house operation and selected data from related value chain stakeholders.
Typical players	Software companies (incumbents and newcomers).	Industrial leaders, start-ups, software companies (often partnered with parties with industrial expertise).

Case study: Smart Fabric

A company sitting firmly in the right hand column former page is Smart Fabric, a disruptive SaaS player in China's huge textile sector, an industry worth around 5tn RMB a year.

The industry's value chain is inefficient, beset by a highly fragmented landscape dominated by SMEs with low IT sophistication. Yet at the same time the industry needs to be able to respond much more quickly to fast-changing fashions.

Smart Fabric, founded in 2014, initially focused on ERP (Enterprise Resource Planning) and MES (Manufacturing Execution Systems) for textile companies. But this approach was not particularly successful because of low take-up and fierce competition in the

market. As such it revamped its business model to focus on value creation around a specific eco-system of weaving, dyeing, and printing plants.

Having come up with its cloud proposition it then took its model to both textile companies and clothing manufacturers, and has since developed a framework whereby it collects orders from both and then runs a smart planning process to allocate the sub-orders to customers within the eco-system (as illustrated below).

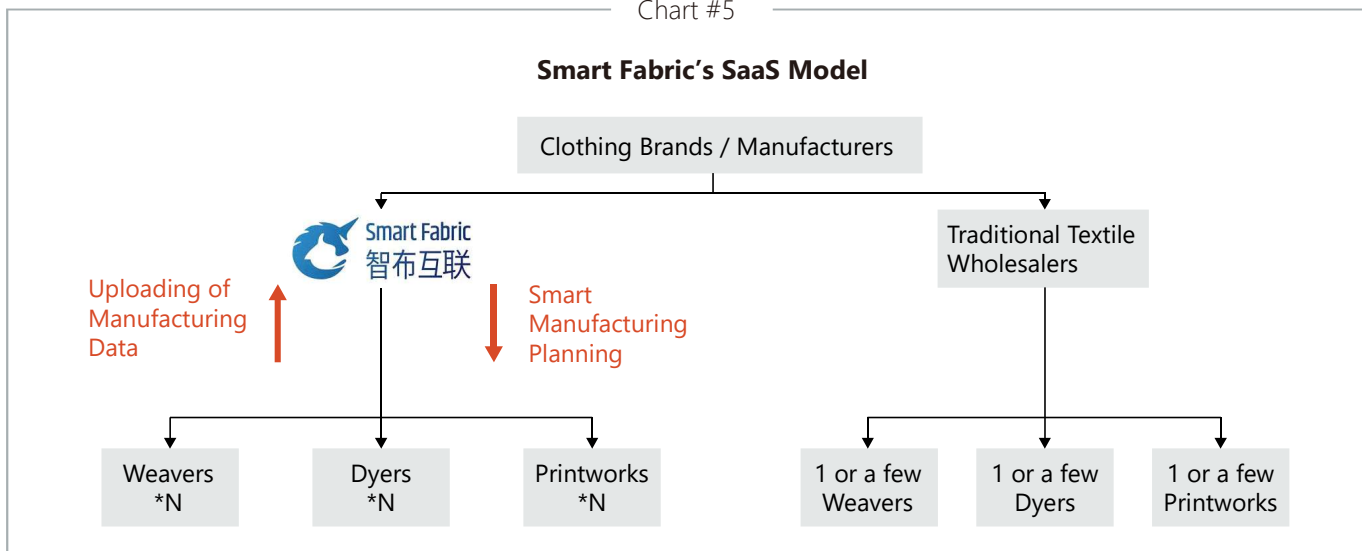
The key point is that Smart Fabric is always aiming to stay one step ahead of its customer and think about potential headaches that might be just around the corner.

The model offers a win-win for all parties involved. Clothing brands and

manufacturers have a trusted textile product supplier, and some report that the delivery times have been shortened from 45 days to 25 days with 10% cost saving. And textile companies such as weavers, dyers and printing players experience revenue gains which were difficult to achieve as individual players. Indeed some report that the effective production days of weaving plants has increased from 200 days a year to more than 300 days.

And of course it's a win-win for Smart Fabric itself in terms of both revenues from SaaS sales and textile product sales. Today Smart Fabric's clients include 70% of the global top 200 clothing players including the likes of H&M, Target, Walmart, Calvin Klein, and Tommy Hilfiger.

Chart #5



Value creation

When you look at the success of Smart Fabric the key point is that value creation lies at its very core and it goes far beyond the technical aspect (i.e. simply moving ERP functions to the cloud). That said, it is not so straightforward or easy for a SaaS player to figure out this kind of disruptive model. It requires extraordinary customer insights and out-of-box thinking to stand in the shoes of the value chain, or at least beyond the immediate scope of your products.

The value creation of Smart Fabric is also further driven by the network effect. The more textile plants that use Smart Fabric services, the more bargaining power Smart Fabric has when negotiating with clothing players, and the more successful it becomes.

Meanwhile concerns over data safety, and willingness to share data, are also overcome thanks to advanced data safety tools. Indeed Smart Fabric has a saying that 'when the benefits are more than the concern, then the concern is not necessarily a big deal'.

Summary

There is no doubt that SaaS is a great tool, but simply moving a business function from offline to the cloud won't succeed by itself. The real breakthrough that the technology creates is the potential to revamp the business model.

As such SaaS offers a golden opportunity for manufacturing companies to create the next growth curve on their service-driven business model. It also provides an excellent opportunity to relentlessly analyse customer behaviour and assets, and unlock hidden potential via the data reviewing and re-reviewing process, in a truly customer-centric approach.

However it is important that companies take a proactive approach and don't just wait for third party SaaS players to solve their problems. As such a good starting point is for companies to first check the status-quo of disruptive activities along their value chains, and then try to steer change either by building their own SaaS propositions or through strategic partnerships with SaaS players.

Sources

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