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## The Efficiency Dividend

### Navigating China's Transition from Volume to Value

Source: JFU  
2 January 2026

#### Contacts Us

Shanghai Office: [Lynn Dou | Manager \(China Operation\)](#)

Beijing Office: [Lucy Liu | Manager \(China Operation\)](#)

Market sentiment regarding China is currently dominated by the rising Incremental Capital-Output Ratio (ICOR), which has significantly increased from **3.4 in 2010 to 9.5 in 2024**, indicating a decline in investment efficiency. Analysts interpret this as a stalling engine—evidence that investing \$1 in China no longer yields the growth it once did.

This Note challenges that narrative. Based on the latest 2024 data, China is not stalling; it is aggressively restructuring. The economy has stabilized at a **5% growth rate**, driven by a massive reallocation of capital from Real Estate (-10.6%) to High-Tech Manufacturing (+7.0%).

It is our view, as explained below, that China is entering the era of the "**Efficiency Dividend**." As the economy pivots from "Volume Growth" (building factories or simply building buildings) to "Quality Growth" (operational excellence), investment efficiency will speed up again. For foreign investors, value is no longer found in China's broad market beta, but in the specific structural efficiency of operations.

#### Outline

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## 1. Addressing the ICOR Fallacy: The Cost of Maturity

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It is true that capital efficiency has decreased. Our internal research confirms that China's latest ICOR is **9.5** for 2024.

However, interpreting this solely as failure ignores economic physics. China is following the standard trajectory of a maturing economy:

### 1. The Stabilization of Growth

The era of double-digit expansion is over. Between 2022 and 2024, China transitioned into a "High-Quality Development" phase, maintaining a stable growth range of around **5.0%**. This is not a stall; it is the hallmark of a complex economy finding its equilibrium.

### 2. The Efficiency Dividend Forecast

The current high ICOR represents the "friction cost" of shifting gears. The 15th Five-Year Plan has provided policy response to China's rising ICOR problem, ensuring that capital spending will generate real economic return. This projected improvement is the **Efficiency Dividend**: the point where the new, high-tech industrial base begins to generate returns that outweigh the initial setup costs.

## 2. The Structural Pivot: Where the Capital is Going

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To understand why efficiency will improve, we must look at *where* the capital is flowing. While China's investment rate remains globally high at around **40% of GDP (2024)**, the allocation of that capital has undergone a radical structural change.

We are witnessing a "Great Divergence" between the old engines of growth and the new:

Sector	2024 Investment Growth	The Strategic Signal
<b>Real Estate</b>	<b>-10.6%</b>	The era of volume-based asset inflation is being actively deflated.
<b>Manufacturing</b>	<b>+9.2%</b>	Capital is returning to the real economy to build industrial depth.

Sector	2024 Investment Growth	The Strategic Signal
<b>High-Tech Industries (Manufacturing +Services)</b>	<b>+8.0%</b>	Innovation is replacing construction as the primary driver.

**The Takeaway:** The decline in investment efficiency (rising ICOR) is largely driven by the painful but necessary correction in the Real Estate sector. Meanwhile, the "New Economy" sectors—specifically High-Tech Manufacturing—are absorbing capital at a rate outpacing total investment growth. The efficiency dividend is not found in the aggregate average; it is found in these specific, high-growth sectors, and factors positioned to enjoy the cascading effects.

### 3. Strategic Case Study: The Jardine Matheson Signal

Recent market movements confirm the "Efficiency Dividend" thesis. Jardine Matheson's Mannings announced on Dec 16, 2025 the strategic withdrawal of its physical chain from the mainland. As we see it, this is not a retreat but a disciplined execution of their strategy revealed in the Group's 2024 Annual Report.

#### 1. The Strategic Shift: "Engaged Investor" vs. "Owner-Operator"

Jardines Matheson is explicitly pivoting its corporate identity. In the past, the "Owner-Operator" model justified holding assets for scale. Today, as an "Engaged Investor," the Group prioritizes **Total Shareholder Return (TSR)**. This requires the agility to excise operations that suffer from the "ICOR Trap"—regardless of sunk costs.

#### 2. The Precedent: Yonghui Superstores

The Mannings exit follows the strategic logic of the earlier divestment of the Yonghui Superstores interest. Both moves demonstrate a refusal to bleed value in hyper-competitive, lower-margin sectors dominated by local digital ecosystems.

#### 3. The Allocation Pivot

Crucially, capital is being reallocated, not abandoned. While withdrawing the lower-efficiency Mannings operation, the Group continues to expand **7-Eleven in South China** with over 100 net new openings, also mentioned in the Group's 2024 Annual Report. They are moving capital from a friction-heavy vehicle to a high-efficiency, high-turnover one, primarily through a capex-light franchise model.

#### The Lesson for Operators:

Foreign investors must stop viewing China as a broad "beta" capture. You cannot simply "be in China"; you must be in the *efficient* parts of China. Success requires the agility to reallocate resources from "Volume" assets to "Value" assets where structural efficiency can be realised.

#### 4. The Risk Landscape: Why Efficiency is the Only Hedge

The Jardine Matheson case analysis highlights three principal risks that necessitate the shift to an efficiency-based strategy. You must use these as a lens for your operations:

Principal Risk	The Threat	The Efficiency Mitigation
<b>Geopolitical &amp; Economic Instability</b>	Weak sentiment and slower growth directly impact consumer spending and macro stability.	<b>Agile Adjustments:</b> Move from rigid plans to dynamic resource allocation. If a sector stalls, capital must be liquid enough to move.
<b>Competitive &amp; Market Change</b>	Local competitors leverage digital platforms and instant delivery (e.g., Meituan/Ele.me) to undercut traditional models.	<b>Portfolio Optimization:</b> Divest assets that cannot achieve market leadership or digital integration. "Footprint" is a liability if it lacks digital velocity.
<b>Operational Performance</b>	Rising costs and compliance burdens erode margins in traditional sectors.	<b>Regular Monitoring:</b> Ruthlessly evaluate ROIC. If a business unit cannot generate a return above the cost of capital, it is a candidate for "Deduction."

#### 5. The New Engine: Rule-Based Governance & Motivation

Private investment data also confirm the efficiency dividend thesis. **Private investment in 2024 fell by 0.1% but rose by 6% after adjustment for the downside effect of investment in real estate.** This signals that capital is moving away from the real estate sector which was driven by the broken old engine, **Relationship-Based Administration**. In line with the latest five-year-plan, the state is pivoting to **Rule-Based Governance** to restore confidence and lower transaction costs that drives modern economies.

##### From "Who You Know" to "What You Follow"

For decades, success depended on expensive networks to navigate opacity. Today, that opacity is a liability. The government is remodeling governance on the Rule of Law to bring private capital back. You do not need to pay a premium for access; you need to pay attention to compliance.

##### The Anti-Corruption Dividend: An Economic Observation

Addressing corruption shifts the incentive structure for business leaders:

- **Old Incentive:** Rent-Seeking. Profit was generated by manipulating connections often leading to the blind, repetitive or unproductive construction and development.
- **New Incentive:** Productivity-Seeking. With the removal of shortcuts, the only path to profit is genuine strategic and operational excellence, counting more on vision, skill, and technical knowhow.

This environment forces efficiency. The "power" for future growth now comes from legitimate administrative efficiency and the unleashing of proper economic motivation.

**Related Insight:** We explore the economic theory behind this motivation shift (replacing rent-seeking with productivity) in our newsletter: "[Tax for Growth](#)."

## 6. Micro-Strategy: Structuring to Shape Reality

In this new rule-based, efficiency-driven environment, you cannot rely on side-deals. You must rely on soundly derived **Strategy** and properly devised efficient **Structure** and **Modus Operandi**.

Business is an abstract entity. How you define its "abstraction"—its legal form, governance, and value chain—shapes its financial reality. The profit and value functions for the new era can now be clarified according to usual business logics as:

- Profit = Revenue - Cost - Risk - Tax
- Performance = Commitment + Strategy + System + Capability
- Value = Profit Performance + Risk Management

**Related Insight:** For a deep dive into the Profit Function, Abstraction, and designing your Modus Operandi, refer to our newsletters: "[Value-focused Growth](#)" and "[Shaping Reality: Structuring a Business Firm](#)".

An efficient structure brings together the above components minimizing Cost (through system), Risk (through compliance) and Tax (through policy alignment). The government is actively rewarding this efficiency with specific policy incentives, but you can only capture them if your system including *corporate structure and modus operandi* is arranged to do so.

### The Rewards for Efficiency from Innovation and Method of Organization

Opportunity	The Policy	The Structural Requirement
<b>Innovation</b>	<b>Extra 100% R&amp;D Super Deduction</b>	Your accounting must be structured to accurately capture and classify qualifying R&D expenses.
<b>Smaller functional legal units (Note)</b>	<b>5% Effective Tax Rate</b> (20% rate on 25% of income)	Are you structuring your operations and splitting functions? If you have distinct smaller units (e.g., sales, support), are they structured as separate entities to qualify as "Smaller Enterprises" (Income/profit ≤ 3M RMB)?
<b>Reinvestment</b>	<b>Withholding Tax Deferral</b>	Using <i>Caishui [2018] 102</i> to reinvest profits directly into China rather than paying withholding tax on repatriation.

*Note: Smaller functional units may enjoy tax preferential policy afforded to Small Low-Profit Enterprise defined as those with the following attributes: Annual taxable income  $\leq$  3 million RMB, Employees  $\leq$  300, Total Assets  $\leq$  50 million RMB.*

## 7. Call to Action: The PONDARA Strategic Analysis

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In a rule-based economy, your specific fact pattern determines your success. Do you know where you stand?

We invite you to complete a complimentary "**China Strategic and Compliance Health Check.**" This brief assessment is designed to analyze your strategy against current regulatory realities and identify hidden risks.

**We will analyze your answers for:**

- **The Margin Trap:** Local competitors often undercut foreign prices by 30%. Have you modelled the full impact of Import Duties + VAT? (If not, your pricing model may be broken).
- **Compliance Drift:** Does your current business license scope match your revenue streams? (Mismatched are now a primary audit trigger).
- **Trapped Cash:** Are your profits stuck? When did you last successfully repatriate dividends? (Check for SAFE compliance gaps).
- **Restructuring Potential:** Are there legacy footprints that require remodelling? (Check for possibility of ROIC improvement).

### Next Steps

We will use our **PONDARA** system to process your answers. This is a complimentary strategic analysis designed to show you how structural efficiency can unlock value in your specific operation.

[\[Link to Questionnaire\]](#) | [\[Contact Us to Begin\]](#)