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Strategies for
Success in
China



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EXECUTIVE SUMMARY

China's extraordinary economic growth presents unprecedented opportunities in its domestic market. But more than this, it also offers multinational companies a way to enhance their global competitiveness—provided they are tough and fast-moving enough to see off local competition, and can gain the expertise necessary to figure out and the government's own economic agenda.

China is the world's most challenging business market. The opportunities it presents are enormous, demanding to be seized. But the obstacles to success should intimidate even the boldest executive. Its markets can be brutally competitive, fought over by numerous players—or closed off to all but state-owned giants. They can grow exponentially overnight, but take years to prepare for—and then disappear almost as fast, overtaken by the country's next big thing.

To succeed in China, companies need to be resilient and flexible. They must commit for the long term, but be able to react rapidly to change. They need to understand what motivates the country's hundreds of thousands of entrepreneurs—and what fills the minds of its millions of officials. And, most importantly, they must be able to cope with the intensity of the country's competitive environment.

All this calls for a deep understanding of China's context—its history and culture, the social forces driving its change, and the aspirations of its people, be they consumers or business owners, country dwellers or the new urban middle classes.

Businesses trying to make sense of this must pay particular attention to four issues:

- What opportunities they will find.
- What competition they will face.
- What attitude officials will take to them.
- Whether they can use their China operations to enhance their global competitiveness.

Let us examine these one by one.

OPPORTUNITIES

Perhaps the only common feature shared by China's business opportunities is their bewildering variety. Companies new to the country may expect to find an underdeveloped economy market, still dominated by low-end manufacturing. What they will find is a hugely diverse country at every stage of development—from factories and mines still seemingly in the 19th century to ultramodern 21st century semiconductor plants and high-speed railways.

The variation between and within sectors is enormous. Since embarking on liberalizing its economy 30 years ago, the government has opened the economy to an extent unprecedented in any other major economy in the world—but it has not done so uniformly across sectors. Some, such as consumer goods, have been almost totally unfettered for the last couple of decades. Such sectors that are targeted at the mass consumer segments are filled with hundreds of thousands of businesses, many scraping by on the tightest of

margins. Others, such as finance, remain tightly regulated, with small numbers of foreign players. Foreign banks, for example, are allowed to operate freely anywhere in China, but they cannot take control of a domestic bank—total foreign ownership of any Chinese financial institution is capped at 25 percent—and tough licensing requirements can make launching new products a headache. Unsurprisingly, while many international banks have looked at China, setting up representative offices, only a handful have attempted to establish a major presence.

Markets vary enormously by region, and within regions, change is transforming localities by the month. China's rate of urbanization is unprecedented. Twenty years ago, three-quarters of the population lived in the countryside. Today, that share has dropped to half, meaning that around 300 million people have made the transition to city living. Another 300 million are expected to follow them in the next two to three decades.

COMPETITION

In its open sectors, China is the most competitive environment in the world. This competition has proved the major driver of growth, as businesses, both foreign and Chinese, have scrambled to sell their goods or services to the country's burgeoning markets. But it is also what makes China such a fast-changing and tough environment in which to operate. It gives the country a business intensity unmatched worldwide.

Nowhere is this more true than in China's private sector. Here, literally millions of companies are driving themselves forward, striving to become the next Apple or General Electric, but aiming to do so in a fraction of the time. They know success is possible—already China has its own pantheon of business heroes—but they also know they must struggle for everything they need, be it finding finance or the right staff, protecting their goods from copycats, or building distribution

networks. But if they succeed, they will undoubtedly be tough, flexible and growing extremely fast.

Take Tencent. In 2009, it increased its revenues by 74 percent to US\$1.8 billion, making it China's biggest internet company. Set up in 1998, in the last decade, its revenues have grown by 100% a year on average—and its profits by nearly 120%. The company's strategy is misleadingly simple—whenever a new internet service arises, it develops a Chinese version, tailored to the needs of local users. Its first hit was in instant messaging, with its QQ service. Now its portfolio includes online games—from which it earns much of its money, selling virtual goods—social networking, ecommerce and a host of value-added mobile phone services.

Most multinational businesses enter China with their global products (or services) that is usually aimed at the top end of the market. Once

established, they then try to adapt their products for the mid range. Here, however, they meet Chinese companies coming up from the bottom tiers—businesses such as Li Ning, the sportswear company, which built themselves on the back of the low-tier mass markets, and which now want to improve their margins by selling to more affluent consumers.

A lot of foreign companies struggle in this environment. Most have built their markets in China by selling

global products to a relatively small customer base. But as they expand they run into businesses which have grown on the back of volume sales, usually with the thinnest of margins. Inevitably, foreign companies find their prices heavily undercut—making it a struggle to achieve volume. On top of this, they generally have far higher cost bases—and their knowledge of local markets is far narrower—concentrated in a handful of richer coastal cities or merely certain product market segments.

In a country of multiple market segments—by region as well as by income for B2C businesses and by customer needs for B2B businesses—all of which are undergoing rapid change in their requirements and spending abilities, it is not surprising that many foreign companies find it hard to keep up.

OFFICIALS

China, despite its embrace of the market, remains a country where officials call many of the shots. True, the government has long since moved away from full central planning and closed hundreds of thousands of state-owned companies. But it remains intent on keeping control over the economy's strategic heights—explaining why it keeps sectors such as oil & gas and telecom services off-limits to foreign involvement.

While China has continually liberalised its economy, there is no indication that it will ever give up its control over these strategic sectors. Often, when it allows entry to a “strategic” industry, overseas companies are required to form a joint venture and transfer technology, as is happening in the commercial aviation sector.

Despite many recent reports to the contrary, official attitudes towards foreign business are not going into reverse. Widely reported complaints by multinationals that China is becoming less welcoming towards foreign investment are misplaced.

A large part of the explanation for the dissatisfaction stems from multinationals having lost various tax breaks and other privileges they enjoyed during the 1990s and

2000s. So not only is the competition tougher, but the playing field no longer remains tilted in their favor as it had been before.

Likewise, suggestions that China's promotion of an “indigenous innovation” policy favoring local companies over foreign ones are overblown. China of course wants to develop its own technologies. But its overall objective is bigger than this. It wants to build a modern, sustainable economy—one that is integrated with the rest of the world, not apart from it. Putting up barriers can only hurt this goal, as its leaders know.

When presented with evidence that efforts at realising this are hindered by promoting local interests over foreign ones, officials have backtracked—as happened when they abandoned proposals to use a Chinese-developed wireless local area network standard or reworked what were clearly discriminatory government procurement rules.

Only by knowing the real interests at stake can companies figure out what the prospects are for their sector, what regulatory developments are likely—or likely to be postponed for ever—and so how far officials may help or hinder them.

ENHANCING GLOBAL COMPETITIVENESS

Finally, companies must figure out whether and how they can leverage their China operations for global advantage. For while the business opportunities within China are large in themselves, what can make them truly transformational is bringing them to bear outside China.

Nokia is a good example. China is one of its leading production bases. In Beijing's main economic zone, the Beijing Development Area, it runs its own industrial park, developed at a cost of US\$1.2 billion, and filled with its factories and those of its suppliers. China is also one of its biggest markets—generating US\$8.6 billion in revenues in 2009 as it sold 73 million mobile phones in the country last year, 35% of all phones. But Nokia also runs R&D operations at its Beijing campus, developing phones there both for China and the world, tapping into the engineering and software strengths emerging from the country's universities and colleges. (Beijing, home to several of China's top universities, produces more than 50,000 masters and doctorates. After

expanding its education system in the last two decades, China in total produces six million graduates each year.)

Other companies have similar strategies. U.S. industrial systems and materials company Honeywell opened a global engineering center in the western municipality of Chongqing to develop products for mid- and low-tier markets in China, which it can then take to other emerging markets. Intel has set up plants in the far west, at Chengdu, and the north-east, at Dalian, to tap into specific strengths offered by these regions—respectively a largely untapped emerging technology base and one of the country's main software services centers. More recently, in August 2010, General Motors (GM) and Shanghai Automotive Industrial Corporation (SAIC) announced they were establishing a partnership to develop a family of small-displacement auto engines. Both sides will jointly own the intellectual property generated from this joint venture.

PUTTING THINGS INTO PRACTICE

Possessed with an understanding of the opportunities, competition, officials and global potential China presents, companies can then go on to develop their own specific strategies. Most multinationals end with up a three-phase plan. First, they take their global products and services in China, exploring the market and selling to the top-end segments. In phase two, they continue selling their global products, but at lower costs than elsewhere, manufacturing and sourcing a greater share of their components locally. Then, in phase three, they move to producing locally adapted goods for the local market based on what the local customers need.

But taking advantage of China's opportunities is not something that most companies can do quickly. Success in China, whether it is producing and selling locally, or

developing goods for worldwide markets, takes time—typically, going through the three phases takes most multinationals between ten and fifteen years.

KFC, for example, spent a decade opening its first 100 restaurants. The knowledge it gained from this period of patient exploration then allowed it to add nearly 3,000 more in its second ten years. GM's leading position came after it spent years exploring in China, including launching a disastrous joint venture in Shenyang in the 1990s.

On the other hand, the advent of new, alternate business approaches can help companies accelerate their growth in China. For example, in the B2C sector, on-line marketing and sales is gaining momentum rapidly in China. Many companies are finding that the on-line channels are helping them to sell products to geographic markets where their products are not available, therefore accelerating their growth overall.

Many companies also attribute their success to having managers who

remained in the country, taking the time to understand how to do business there. Some of them have become legendary figures; these include Sam Su at KFC, Hudson Lee at Tetra Pak and Gary Chu at General Mills. This trio all spent years in the country—they were not rotated in and out—giving them the chance to acquire the depth of understanding and build the right teams for their companies to grow when the right time presented itself. The preservation of a company's "institutional knowledge" on doing business in China through a stable (and knowledgeable) local leadership is a key to success for many foreign companies in China.

With the right team and the right knowledge, companies then have to make sure they can cope with the rapid rate of change in China. Indeed, increasingly businesses are finding that they need different strategies for different regions, and different strategies for different market segments. They will then have to keep modifying and updating these strategies as they go along.

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CONCLUSION

Such is China's scale, and such is the intensity of its development that it is impossible for any multinational business to ignore what is happening there. There can be no sizable business on the earth that cannot find opportunities in the country unless they operate in sectors that are "restricted" by the Chinese government. Few of these businesses, however, will find themselves operating there without encountering competition—and for many, especially in open sectors, this competition will be more intense than that of any other major market worldwide.

Handling the business environment, and developing the skills and experience to negotiate the country's hands-on economic management—both in setting the overall direction and overseeing the running of its biggest companies and most

strategic industries—requires more than just management and business skills. It also makes a deep, broad understanding of Chinese society, history, geography and culture an imperative. Paradoxically, therefore, despite China's rate of change, and the volume of opportunities it presents, long-term success will likely also require a steady view on China and its relationship with the rest of the world.

But with the right people in place with continuity, with an understanding of the country's economic, political and demographic dynamics, and with the resilience to withstand the onslaught of tough competition, multinationals in many businesses will find themselves able to use their China operations to strengthen their global capabilities and effectiveness.

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