Opportunities for Action in Consumer Markets

In Harm's Way: Getting It Right in China

THE BOSTON CONSULTING GROUP

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Many Asian and Western companies, such as Coca-Cola, Danone, LG, Nokia, PepsiCo, Procter & Gamble, and Wrigley, are emerging as successful players in China. They aren't going there simply to pursue growth opportunities, however. They are there also to compete head-on with the Chinese. Whirlpool's most compelling reason for being in China, for example, is Haier, an appliance manufacturer and one of a growing number of Chinese companies that are becoming world-class global competitors. Because the Whirlpools of the world don't want to fight these companies in Indiana and Ohio (or in France or South Korea), they are joining the battle in China itself, hoping to take on Haier, Huawei Technologies, and other budding giants on their home turf.

With China's economy continuing to sizzle, the size of the prize can't be overstated:

- The Chinese economy doesn't only include a lot of small categories that are growing quickly. It also encompasses large categories that are growing *very* quickly: Chinese consumers' demand for cars, fast food, color televisions, beer, soft drinks, personal computers, and mobile phones is number one, two, or three in the world.

- China accounts for more than half of the world's growth in new infrastructure investment, which includes ports, power generation plants, railroads, highways, and elevators.

- Although its GDP is still considerably below $5,000 per capita (the amount commonly held to be the threshold for a middle-class market), China already

> boasts a huge middle class and a very large and growing affluent class. In the 20-some years since economic reform began in China, real per capita income has increased sevenfold. In fact, the middle-class and affluent segments together represent 8 percent of China's 390 million households—a number that is expected to climb to 14 percent by 2008.

Still, there are tremendous challenges to succeeding in China, and companies that take on all the known and unknown risks of doing battle there—not only with the Chinese but also with one another—are putting themselves deliberately in harm's way.

However, the biggest problems that multinationals encounter in China are often self-inflicted. That is particularly true for Western companies because they often fail to commit themselves fully and appropriately to the effort. To keep from getting sidelined when they arrive, China-bound companies must prepare to do business outside the big cities, in smaller and less familiar markets, and the home organization must be motivated to support the China strategy. What's more, these companies must invest aggressively in the quality and quantity of the people they send—an area in which Western companies are especially vulnerable.

Prepare to Do Business Outside the Big Cities

There are a growing number of significant markets in China, many at a distance from Beijing, Guangzhou, and Shanghai. By 2008, half of China's affluent households will be located outside the 40 largest cities. So far, most of the 500 million consumers living in or

near the country's cities and towns still shop at small markets and local department stores. (Although it is growing rapidly, hypermarket leader Carrefour still has fewer than 70 outlets in China.) But companies hoping to enter the outlying cities face unique challenges, such as highly fragmented and heterogeneous markets, demanding consumers with little brand loyalty, and intense competition from both multinational and local players.

Another big obstacle is that many local Chinese chains don't operate like chains in the West, and suppliers often have to deal with them on a store-by-store basis. Modern retailing methods will eventually gain ground in China, but right now local sales and distribution are critical. Foreign companies will have to work hard to establish reach and depth in complex local systems. And because the second-tier cities are likely to become the profit sanctuaries of their Chinese competitors, Asian and Western companies had better be prepared to win them now.

When it comes to distribution, active management of the wholesale channel—an approach that has been underleveraged by global companies—presents a great opportunity. Because it takes time to design and implement a good wholesale approach, most companies can create a sustainable advantage over their competitors by getting an early start, finding and locking in the most capable distributors to form an effective network. In the longer term, the additional profits generated through this large-volume, higher-margin channel can be invested to create brand pull—further reinforcing the advantages of both push and pull. To succeed with this promising local model, companies must carefully plan how they will design and manage it.

Organize the Home Front

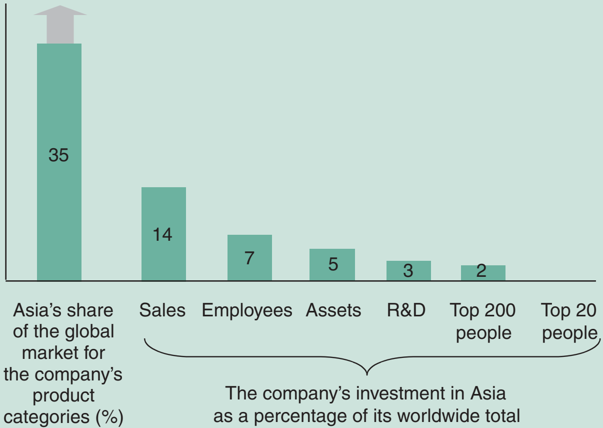
Companies often overlook the importance of preparing the home front to support their China effort. For example, sourcing from China usually increases logistics and other transaction costs, so managers back home are not likely to welcome it when their metrics motivate them to reduce those costs.

Many Western OEMs are building major purchasing capabilities in China. To realize the potential savings from sourcing low-cost components, they have to identify which companies to do business with by assessing their manufacturing costs, capacity, and product quality. But that's actually not their biggest challenge. The real problem for OEMs with large ambitions for sourcing from China is that their engineers back home don't give a hoot about the strategy. A low-cost component from China can't just replace a component sourced elsewhere. The Chinese component must be qualified. Even if the part looks exactly the same, it may require some reengineering. Do the engineers want to do this for part after part? Not if their incentives encourage them not to. To reap savings from operations in China, engineers and other workers back home must be motivated to support the China strategy.

Think People, People, People

Many multinational companies are underinvested in Asia as a whole and have even less investment in China itself. (See the exhibit "Many Multinational Companies Are Underinvested in Asia.") Companies that believe China is a growth opportunity—as well as a battleground—must support that conviction with their strongest resources. They should assign their

Many Multinational Companies Are Underinvested in Asia



SOURCE: BCG analysis.

best people to China and respond quickly to their needs. When a company sends its stars, the folks at headquarters are more likely to help.

But employees in China often need more than just a little help. To make sure expatriates get results, the company should have them report to those responsible for carrying out the China strategy. We are amazed at how often expats have to slog through several bureaucratic layers to be heard—reporting first to the Asia division, which might report to international, which might report to marketing. Corning, Kodak, Motorola, and Nokia, among other successful companies, have their China managers report either to the CEO or to an SVP who reports to the CEO. That way, decisions are made and actions are taken in weeks rather than months.

Send Expatriates Who Can Dig In

Companies that are serious about their China strategy will have to send entire families, and lots of them. Furthermore, those families will have to stay longer than just a couple of years—probably four or five. So persuading them to go will be much harder.

The South Koreans, and some Europeans, seem to know what it takes. Americans and Canadians, however, typically go for two-year tours of duty timed to coincide with the academic schedules of their children. They are overburdened with ceremonial chores—such as accompanying far too many visitors from headquarters who seek an introduction to this important market. On the personal side, they tend to retain a Western lifestyle, and they are often insulated from the local community and dependent on a bilingual staff. It is difficult for them to finish anything they start or start anything they have to finish.

By contrast, their South Korean counterparts may get only a week's notice to pack for China, with no guaranteed time of return. They typically report to a boss who has spent several years in the country and plans to stay. They live in the Chinese community and work long hours. They stay for four or five years. They finish what they start.

Pick any form of competitive sports (Formula 1 racing, baseball, golf) and consider the probable results of pitting against each other the South Korean and U.S. styles of talent building. So it shouldn't be surprising that a simple back-of-the-envelope analysis comparing time on task and the effects of experience on workers of equal ability will lead to the conclusion that a South Korean should be about twice as productive as two expats from the United States or Canada. (And the South Korean is likely to have more than

one overseas assignment in his or her career.) That is a huge competitive disadvantage for North Americans.

The Best Option

So what are the options for a global company facing down old and new competitors in China—and perhaps at home? It can do nothing and carry on as before. It can throw extra people at the competition when it gets tougher, bear the costs, and hope to find another source of competitive advantage to offset the increased expense. Or it can keep expats in China for more than four years. All else being equal, the last option should narrow the productivity gap by half.

But the best option of all is for a company to build its organization in China as fast as possible, offering employees golden handcuffs that confer status and importance, in addition to more money. And it should consolidate its activities there under a dedicated company representative with the clout to recruit and retain the best people.

Some companies seem to be getting it right. One successful global company has kept its China head in place for more than a decade. This Westerner has developed strong local expertise and deep connections, and has built a large, fully localized organization. At Pernod Ricard, which leads the spirits market in China, the country head is from France, but he is on his second stint in China and is a China expert.

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We advise young executives who want to be leaders in the global economy to go to China now. But they should understand that it won't be a cakewalk. Man-

agement may worry that these executives don't know their company well enough and have no in-country experience. To that we say, tell them the following: "Promise to learn and promise to stay. Don't ask for a return ticket—you'll earn one. If the growth opportunities for your company are linked to China, then the growth opportunities for you are linked to China." If they are reluctant to make the move, then maybe it's time they get pushed—right off the fast track. Success takes putting yourself in harm's way—for the sake of your company's success in China as well as back home.

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