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Emerging Markets II

China's high performers take the long view

By Gong Li, Bo Wang and Yali Peng

China's top companies were shaken but not toppled by the global financial crisis. Their success can be traced to long-term strategies that stabilize them in hard times while positioning them for future growth.

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The financial crisis was not kind to the world's biggest winemakers. According to a report from beverage industry watcher Canadean, eight out of the top 10 producers saw sales revenue contract by up to 10 percent in 2008. A single large company showed stellar results, however: China's 100-year-old Changyu Group. Having made the top 10 list for the first time in 2007, the company jumped to the No. 7 spot in 2008 with sales of \$508 million, a better than 26 percent year-on-year increase.

To be sure, not every Chinese company generated results like this during the downturn; in fact, even the country's high performers, on average, took a hit. But as a group, they were remarkably resilient in the face of global financial turmoil.

Earlier Accenture studies identified a class of Chinese high-performance businesses and, subsequently, a widening gap between high and low performers in the midst of the downturn. Our latest research confirms that this gap was not an aberration. Indeed, China's high performers have emerged even stronger from the global crisis. They achieved that strength by following a long-term vision that allows them to weather short-term shocks while positioning themselves for future success (see "About the research," page 5).

A checkered picture

Make no mistake: Although China continued to enjoy higher growth than any other economy on the planet, it was hardly immune to the global recession. Consider a few figures: Foreign direct investment, which had grown continuously in recent years, fell by 2.6 percent in 2009 from the previous year's total; imports were down by 11.2 percent and exports by 16 percent in 2009 compared with 2008; and between October 31, 2007, and December 31, 2009, the Shanghai stock market lost

45 percent of its value. GDP growth slowed as well—from 13 percent in 2007 to 8.7 percent in 2009.

Amid this checkered picture, the business results for Chinese companies also varied widely. We surveyed and analyzed the financial data of 206 companies meeting our screening criteria for Chinese businesses for the period from 2004 through the first quarter of 2009. The findings suggest that 30 of those companies, in 14 industries, consistently outperformed their peers in terms of the primary high-performance metrics.

The data reveal that high-performance businesses' 2008 revenue growth remained steady, at about the same rate it had averaged between 2004 and 2007 (a compound annual growth rate of about 33 percent). During the first quarter of 2009, however, their revenues decreased by 11.3 percent over the previous year's first quarter. The crisis took a greater toll on net income figures: High performers dropped from a CAGR of 42 percent for 2004–2007 to 17 percent in 2008, and then to a loss of nearly 13 percent in first-quarter 2009.

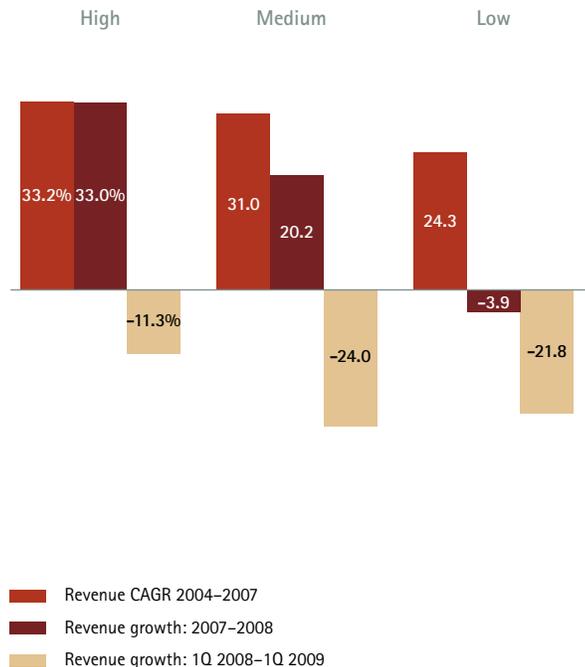
For average and low performers, however, the news is much bleaker. At average performers, revenue dropped by 24 percent in the first quarter of 2009 (from the previous year's first quarter), and at low performers, the decline was 21.8 percent. Profits, meanwhile, fell off a cliff, dropping by 38.5 percent in 2008 at average performers and by a stomach-churning 45.2 percent at low performers.

How did Chinese companies view the impact of the crisis? Many of the firms Accenture surveyed saw it as transitory and limited. In fact, according to 75 percent of our respondents, demand was recovering by the first half of 2009,

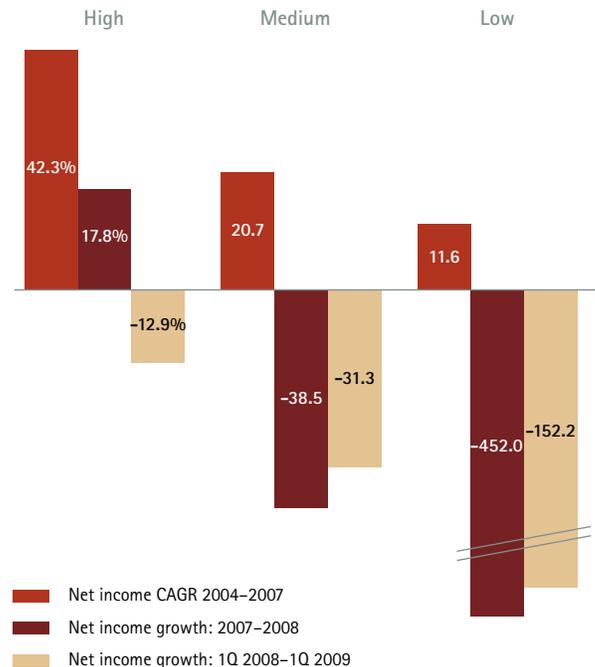
The performance differential

While all Chinese companies on average took a hit during the downturn, the high performers weathered the period much better than the medium or low performers.

Revenue growth



Net income growth



Source: Company annual reports; Accenture analysis

and the overall economic environment was improving. No talk of a “new normal” in China.

How did China’s high performers emerge with optimism from the world’s worst financial downturn since the 1930s? First, they took all the right short-term measures—maintaining strategic focus, cutting costs strategically, guarding cash and demonstrating flexibility.

Wuhan Iron and Steel (Group) Corp. offers one example. When prices for steel plummeted, especially for the high-end products that had been its specialty, Wuhan acted swiftly, extending its niche position from international and domestic high-end markets to middle-tier and low-end markets in Hubei Province. Wuhan also

moved to reduce its costs for importing ore, for shipping and for smelting coke.

Such salutary actions aside, what makes the story of Chinese high performers of greater interest is the way they maintained their vision for long-term growth.

Twenty-twenty vision

All high-performance businesses must be able to maintain a balance between overcoming short-term emergencies and meeting long-term goals. Most of the executives we interviewed at Chinese high performers confided that their major concern was not the economic downturn but their ability to gain a competitive edge during and after the recovery. In our research of high performers in China, we

An open-minded culture and flexible, resilient operating models are keys to versatility.

found that their vision for long-term growth beyond the crisis has four dimensions.

1. Pioneering the future

To forge ahead while others were stuck in the present, Chinese high performers aggressively sought new customers while retaining their existing base (see “Skyworth: Capturing the rural market,” page 7). They also intensified their focus on R&D, especially through collaboration.

Our research suggests that while lower performers care more about sharing risks and expenses in cooperative projects, China’s high performers keep their eyes on a different prize: the acquisition of better innovative resources. This is especially true when it comes to international collaborations.

A case in point: Li Ning Co. set up China’s first global sportswear design center in Portland, Oregon (near Nike’s headquarters) by hiring more than 20 experts experienced in the engineering and design of international brands. As a result, the company launched a series of new products in the fourth quarter of 2009.

As Chinese enterprises develop, they are trying to establish high-value brand names. One strategy: brand extensions. Yunnan Baiyao Group Co., a well-known maker of traditional Chinese medicines, extended its established brand (which centered on the treatment of trauma or sprains) to a host of new pharmaceutical products, ranging from bandages, capsules and creams to sprays and even toothpaste, shower gels and cosmetics. This approach makes sense because Chinese consumers tend to give the same loyalty to a firm’s new products as they do to its old ones.

2. Becoming more durable

For any business, the key to durability is its set of distinctive

capabilities. In our research, such distinctive capabilities are manifested in China and elsewhere in, among other traits, operational excellence, talent management and the strategic use of merger and acquisition capabilities.

Consider the steps Jiangsu Hengrui Pharmaceutical Co. took to optimize its sales operations during the financial crisis. One was to delegate responsibilities to the provincial level, where sales staff were closer to the customer. The company also improved its performance evaluation process for salespeople, connecting senior staff to younger employees as part of the process.

Hengrui also established a credit file for each customer, reinforcing relationships with those that paid their bills on time but suspending transactions with those that did not. And an important acquisition helped the company make inroads into the over-the-counter pharmaceuticals market.

A rigorous, focused approach to talent management will ensure that a company has the human resources it needs, regardless of economic conditions. When the recession hit, many companies in developed markets cut labor costs through layoffs and other measures. Yet nearly all high-performance businesses take a different approach: They continue to develop a large pool of talent to support their future growth (see “Zhejiang Medicine: A talent-friendly corporate culture,” page 8).

3. Building up a versatile company

The essence of versatility is a combination of agility and a strong business model. But even with the best business model in place, an enterprise must continuously adapt, using different tactics and

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About the research

Accenture has now published a High Performance Business in China study for three consecutive years (2007–2009, with year four now under way). This record gives us confidence in our findings on Chinese high performers. We have found, for example, that the proportion of high-performance businesses in the total sample has been stable over the three years. In addition, more than 80 percent of high performers were able to maintain their status in the year following each study.

Our 2009 study had the following components.

Financial analysis and high-performance business screening

Drawing on the financial analysis in Accenture's High Performance Business global research, we evaluated the performance of Chinese enterprises. This year, we identified 30 Chinese high performers after assessing 206 listed companies in 14 industries. In accordance with the Accenture methodology for determining high performers, we confined our research to enterprises that have been publicly listed for at least five years and have annual revenues totaling at least RMB 1 billion. Currently, the financial, transport, Internet and real estate sectors, as well as non-listed companies, are not included in our research.

Survey

We surveyed the 206 companies (and received 107 responses), asking their executives a series of questions on the following areas:

- The impact as well as the opportunities and challenges brought about by the financial crisis;
- The opportunities offered by the Chinese government's economic stimulus package;
- Their strategies in areas such as marketing, regional development, risk management, operations, human resources and capital structure;
- Their expectations regarding the recovery;
- Their preparations for the next growth cycle.

Interviews

We conducted in-depth interviews with selected senior executives of Chinese companies identified as high performers this year, and also with executives of some influential non-listed companies that demonstrated outstanding performance in coping with the financial crisis.

Case studies

To paint a full picture of Chinese enterprises' quest for excellence, we did not confine our case studies to those enterprises covered in our financial analysis and surveys. Given the short history of China's capital market, many outstanding enterprises have not yet been listed. Further, some industries that play pivotal roles in the Chinese market were not included in the financial analysis because our global study has not yet examined those industries. Nevertheless, all companies that were profiled in case studies have turned in outstanding performance in their industry.

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approaches as the business environment changes. An open-minded culture is one key to versatility. Another is the construction of flexible, resilient operating models.

A company's operating model reflects its culture, adaptability and philosophy. To construct a flexible model, executives must be willing to make changes in functions that closely relate to consumers, such as production, distribution, sales and customer service.

Take Hangzhou Steam Turbine Co., for example, which has adjusted its operating model in recent years. First, the company stopped relying so heavily on the Indian market. After selling boiler feed pump turbines to the United States for the first time in late 2007, it entered into a two-year agreement with Doosan Corp. of South Korea to jointly produce the equipment. Meanwhile, it also secured contracts to supply four dual-stream turbine pumps to Indonesian and Thai power plants.

Second, to achieve a more balanced product portfolio, Hangzhou reduced the proportion of power-generating products in its aggregate sales. As a result, sales of turbines used for vehicles surpassed for the first time sales of those used for power generation, reaching a 62 percent share of revenues. Finally, the company changed how it sold its own products, securing orders through cooperation with foreign manufacturers.

4. Growing prudently

Like versatility, prudence is a manifestation of a company's performance anatomy, which is made up of those core business elements related to culture, leadership and the workforce. The components of prudent growth include preemptive actions, strong risk management

systems and expanded financing channels—the latter is especially important in China, where companies have traditionally relied heavily on bank loans as their sole source of financing.

The global financial crisis made executives around the world keenly aware of the importance of corporate risk management, which can give companies a competitive edge and increase the odds of excellent performance even under the most turbulent conditions.

Luthai Textile Co. excels at managing risk. The company has long guarded against exchange-rate risks, for example, using hedging, long-term settlements, reasonable arrangements for settlement periods, exchange-rate lockup agreements and foreign currency loans to avoid exchange losses.

Henan Lingrui Pharmaceutical Co. shows how preemptive action can stave off disaster. Company executives had a strong sense of the impending crisis well before the global downturn actually occurred. By integrating its marketing channels in 2007, Lingrui significantly reduced the number of dealers it worked with. In addition, it shifted from credit to cash sales and, starting in 2009, has required customers to pay for their purchases in advance. Through these means, the company markedly improved its operational efficiency while reducing its operational risk.

Lessons from a crisis

So where do Chinese enterprises go from here?

Perhaps most important, they must be alert to the possibilities for transformation on several levels. First, companies should seize the opportunity to transform their conventional business model—centered on low-cost product manufacturing—to an

Skyworth: Capturing the rural market

One way to ride out difficult times and position your company for the future is to identify and aggressively pursue new customer groups. That was the strategy of Skyworth Group Co., the Shenzhen City-based television manufacturer.

Skyworth had been preparing to enter China's rural markets for a few years when the economic crisis hit in October 2008. Soon after, the company was given greater impetus when the Chinese government decided to expand its "home appliances going to the countryside" policy, an initiative to grant subsidies to farmers for purchasing household appliances that had been piloted in certain provinces.

Also in October 2008, Skyworth began replacing the CRT televisions it was producing with flat-panel LCD TVs, a trend that had already begun in first- and second-tier Chinese cities. In February 2009, when the "home appliances going to the countryside" program was put into practice throughout the country, the highest number of LCD products selected for the program came from Skyworth.

In April 2009, Skyworth carried this focus several steps further, officially releasing a strategic plan for serving China's rural

markets. To execute this strategy, Skyworth had to change its products as well as tailor its business processes to rural customers.

This approach created value for both Skyworth and its customers. In the "great leap forward" service program in China's northeast, for example, the company gathered customer feedback through return visits to users, customer surveys and the monitoring of services networks. It began providing a free on-site cleaning service and gave away stickers reminding people how to protect their electrical appliances. The company plans to initiate similar programs in the northwest, southwest and other regions.

By developing promotions catering to rural residents, Skyworth has built a strong brand. Such moves have gone a long way toward establishing a loyal customer base and securing steady sales. According to statistics released by the Ministry of Commerce's data center for "home appliances going to the countryside," from January through September 2009, Skyworth's color TV sets accounted for 22.4 percent of the program, making the company an undisputed industry leader.

innovation-driven business model. As they move up the value chain by focusing more on design, branding and distribution, they should strike more of a balance between those activities and their traditional manufacturing strength.

Another important outcome of the financial crisis is industry consolidation. China is a huge but scattered market with a low geographic concentration of industries. Over the years, market fragmentation, poor infrastructure and local protectionism have hindered industry consolidation. The financial crisis has prompted a reshuffling of players within many industries and showed that industry consolidation could help create a more rationalized and efficient economic structure.

And what about globalization in the wake of the crisis? Does China need to further open up its financial and capital markets? Should Chinese

companies draw on Western market rules and economic systems?

Here is an area where China still lags behind. Because its market economy is relatively new and immature, the process of globalization at Chinese enterprises has been slow. For example, China has comparatively weak economic institutions, a collective mindset insufficiently geared to a market economy, limited understanding of global business mechanisms and low manpower reserves. Caught up in the globalization rush, Chinese companies have not fully recognized these weaknesses. As a result, some made a number of serious mistakes and suffered major setbacks, including having to suspend their globalization efforts.

China's government has a role to play in remedying these problems. The country has relied too heavily on exports, high savings rates and the high consumption of low-cost

Zhejiang Medicine: A talent-friendly corporate culture

Many Chinese companies, especially those that place a premium on intellectual property, restrict their employees' ability to leave the business in various ways. Zhejiang Medicine Co. reverses that approach, and has turned itself into a magnet for talent as a result.

As far back as the 1990s, Zhejiang's main subsidiary, Xinchang Pharmaceutical Factory, has practiced a policy of "freedom of movement." Located in a mountainous area, Xinchang cannot offer the working and living conditions that attract employees to China's large cities. To recruit workers, it must rely on other strategies. Under its policy, scientific and technical personnel who want to leave the company can do so, while internally trained staff members are given wide scope to pursue their own career goals.

For example, the company provides a monthly stipend of RMB 500 to 1,500 (\$74 to \$221) for those admitted into undergraduate or graduate programs. The company also pays the tuition of employees accepted into programs overseas. These commitments cost the company some RMB 15 million (\$2.2 million) annually.

What makes the company's approach especially unusual is that it does not bind employees by any contract to return to Xinchang after they complete their studies. The company also

attracts and retains talent by offering benefits such as pay for performance, housing placement, living allowances and a 15 percent dividend payout for research groups on future profits.

The "freedom of movement" policy hasn't led to brain drain—on the contrary. Consider the example of Dr. Zhang Yingxiang. A graduate of Beijing Agricultural University, Dr. Zhang was hired by Xinchang Pharmaceuticals in 1996 as a technician. In July 2000, he left to work for the international pharmaceutical giant F. Hoffmann-La Roche. Two years later, he returned to Xinchang. "My return from a foreign enterprise back to Xinchang is entirely because of the latter's corporate culture," Zhang told an interviewer. "Its innovative way of promoting staff gives me latitude for self-improvement."

The policy helps explain why the percentage of senior-level scientific research personnel at Xinchang has increased annually. The company's R&D operation is led by experts holding PhDs and other advanced degrees; moreover, Zhejiang Medicine has become a national post-doctoral station as well as a state-level corporate technology center. In 2008, under the new national drug program, it secured government funding of more than RMB 30 million (\$4.4 million) for R&D for 2009 through 2011.

For further reading

"Gearing up for the two-speed global recovery," *Outlook*, October 2010

"Game over?" *Outlook*, June 2010

"A tale of two Chinas," *Outlook*, June 2009

energy. It should now seize the opportunity to speed up macroeconomic reform, as well as the reform of state-owned enterprises, to ensure sustained healthy economic growth.

As for Chinese executives, they should keep in mind that just because their firms have come through the Great Recession relatively unscathed, that does not mean they did everything right. Global best practices and management theories are still relevant for Chinese businesses. The country's corporate chieftains should continue to develop sound management theories of their own and contribute ideas and practices that have worked locally to the knowledge base of global best practices.

If Chinese business leaders avoid complacency, push for economic reforms and accumulate global management experience, they will continue to lead their companies toward a bright future. For China's high performers, the financial crisis was an opportunity to learn from adversity, and to emerge in a strong position as the global economy recovers.

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As the chairman of Accenture Greater China, **Gong Li** leads a team of more than 4,400 people. With more than 20 years of cross-industry business consulting experience, Mr. Li has collaborated with clients in government and a variety of industries, including electronics, high tech, energy, petrochemicals, financial services and consumer products. Based in Shanghai, Mr. Li also has extensive experience working with Chinese state-owned enterprises on various programs, including corporate restructuring, process transformation and commercialization.

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