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Can Chinese companies win in the global big leagues?

By Gong Li, Bo Wang and Yali Peng

The likes of Lenovo and Haier have shown that they can. But for other Chinese enterprises to enter the ranks of the world's premium brands, they must establish a significant global presence in operations, sales, distribution and R&D.

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When Lenovo announced its \$1.75 billion acquisition of IBM's personal computer division in December 2004, the size of the deal was only part of what caught the world's attention. Even more important was the symbolism. Here was a Chinese company swooping in to capture an iconic US brand—an event that signaled the arrival of Chinese truly global companies on the world stage.

Indeed, the rise of Lenovo was not an aberration. In the 2010 Fortune Global 500 list, 42 companies hailed from the Chinese mainland. Only the United States (139 enterprises) and Japan (71) could boast more entries.

Chinese companies have traveled a tremendous distance since Deng Xiaoping opened the country's economy in 1978. By the 1990s, despite their small beginnings, many companies had become export powerhouses. But to continue to increase their footprint globally, they have had to shift their focus from being mere exporters to improving their capabilities all along the value chain.

The next step? Chinese enterprises that want to join the ranks of global brands must establish a significant global presence in operations, sales, distribution and R&D.

The journey will not be easy.

To be sure, China Inc. has been on a roll. Outward FDI reached a high of \$56.5 billion in 2009, about 56 times the level in 2000 (see chart, page 3). And the value of transnational mergers and acquisitions has jumped from \$470 million in 2001 to \$30 billion in 2008 (before dropping back to \$17.5 billion in the downturn year of 2009).

The number of businesses established overseas by Chinese companies has also risen rapidly in recent years. By the end of 2008, 8,500 Chinese companies had

set up 12,000 businesses outside the country—in Asia (6,000), Europe (2,000), Africa (1,600), North America (1,400), Latin America (600) and Oceania (400).

Yet despite their growing presence overseas, Chinese companies as a whole retain a strong focus on exports. When Accenture asked companies actively involved outside the country how they were conducting business overseas, 25 percent of responses indicated that they were working through export agents or establishing export departments. Many (23 percent) also signaled that they were establishing representative offices overseas. About 18 percent had ventured into overseas production. But when asked about establishing operating centers or R&D facilities abroad, the number dropped to 7.3 percent and 5.6 percent, respectively (see chart, page 5).

Four stages

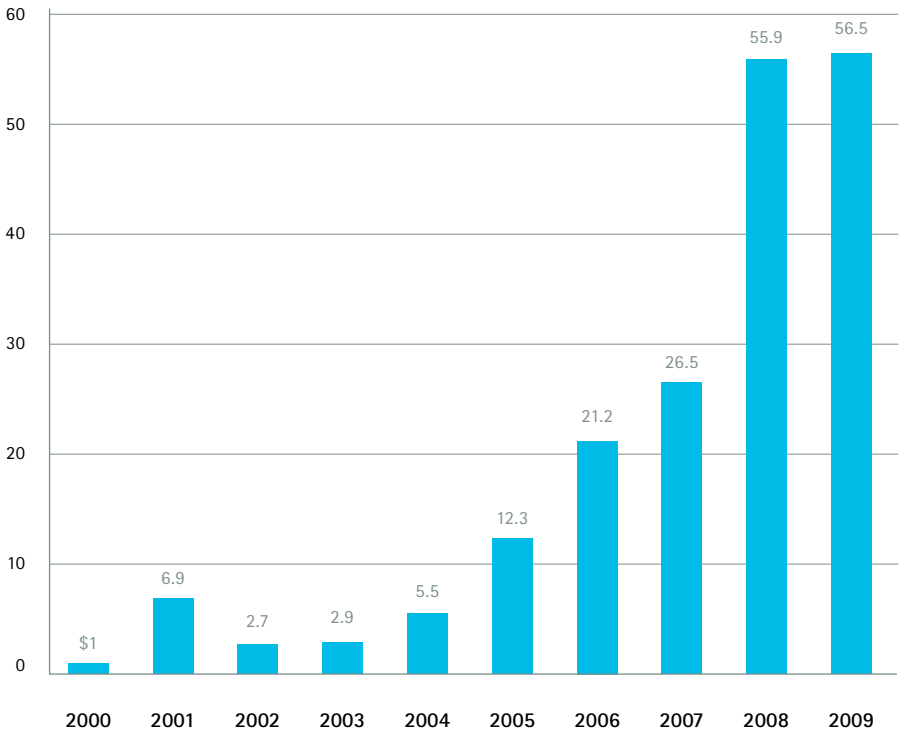
The continued reliance on exports—rather than the establishment of overseas business units—raises several important questions.

What distinguishes a truly globalized player? Does the fact that the company's products are exported mean that it is globalized? Should the share of its sales that come from overseas be a factor in assessing its global footprint? Is it globalized if it owns overseas assets or has established branches or subsidiaries in other countries? Or is it truly globalized only if it establishes operations and R&D centers overseas?

Whether a company can be considered a global player is of more than academic interest. It is important because companies that focus solely on exports can appear to be in stronger positions than they actually are. In fact, they are likely engaged in low-margin, low-value-added commerce that offers limited

Outward bound

China's foreign direct investment exploded from \$1 billion in 2000 to \$56.5 billion in 2009.



Source: Statistical Bulletin of China's Outbound Foreign Direct Investment 2009, Ministry of Commerce of the PRC

opportunity for future growth. They are limited to a narrow portion of the value chain.

For Chinese enterprises to continue on their high-growth trajectory, they are going to have to develop the capabilities other global players already have. For instance, in the past, a company's degree of globalization was measured by determining what share of its business came from overseas sales. While that measurement remains a valid part of the formula, we believe the company should also be assessed based on its operational and managerial capabilities on the global market.

Accenture has devised a framework showing four possible phases of globalization that takes into account both the traditional

measure of share of business and the degree of global operational capabilities.

When companies are selling beyond national boundaries but are limited in both their share of business and their global operations, they can be said to be in a proto-globalization stage. If overseas sales are strong but global capabilities are weak, they likely have an export orientation. More developed capabilities, even if share of overseas business is relatively low, indicate that the company is at the value-chain optimization stage. Only when companies earn both a relatively high share of total sales from overseas and have strong operational and managerial capabilities can they be said to have globalized operations (see chart, page 7).

About the research

To explore the globalization of Chinese enterprises, Accenture used in-depth interviews, questionnaires and related research. We interviewed 14 executives from influential Chinese enterprises from various industries. We also interviewed officials in government departments in charge of investment promotion. From May through August 2010, questionnaires were sent to 460 of China's top 500 enterprises; 89 enterprises from 11 industries responded. Most of the companies were large; more than half of them generated more than 10 billion RMB yuan (\$1.5 billion) in revenues in 2009, and 64 percent of them employed more than 5,000 people.

Proto-globalization

In the initial stage, some of an enterprise's raw materials, technologies, equipment and personnel originate in other countries. Its products are sold on the global market directly or indirectly, as finished or semi-finished goods. However, the company's global capabilities—R&D, for example, leadership and marketing—are weak, and its share of sales from beyond the domestic market is minimal.

For example, the New Hope Group, the largest animal feed producer in China, has set up subsidiaries in Bangladesh, Indonesia, the Philippines and Vietnam. The overseas operation is a simple duplication of the company's existing domestic business, and the scale is much smaller. New Hope's combined overseas sales are less than 1 percent of its total sales, so it is considered to be in the proto-globalization phase.

Chinese companies took their first steps into this stage in 1978, when the country launched its broad program of economic reform and openness. They began to participate in the international division of labor by exporting their products and establishing joint ventures with foreign companies. In November 1979, the Beijing Friendship Store established Kyowa Co. in Tokyo through a joint investment with Japan's Maruichi Shoji, marking the onset of overseas investments by Chinese enterprises.

Economic globalization and regional economic integration gathered momentum starting in the mid-1980s. According to UNCTAD statistics, Chinese FDI surpassed the \$100 million threshold for the first time in 1984 and averaged \$670 million annually for the next five years. Still, at the time, only a scattering of Chinese enterprises were seeking to go beyond their nation's borders.

Export orientation

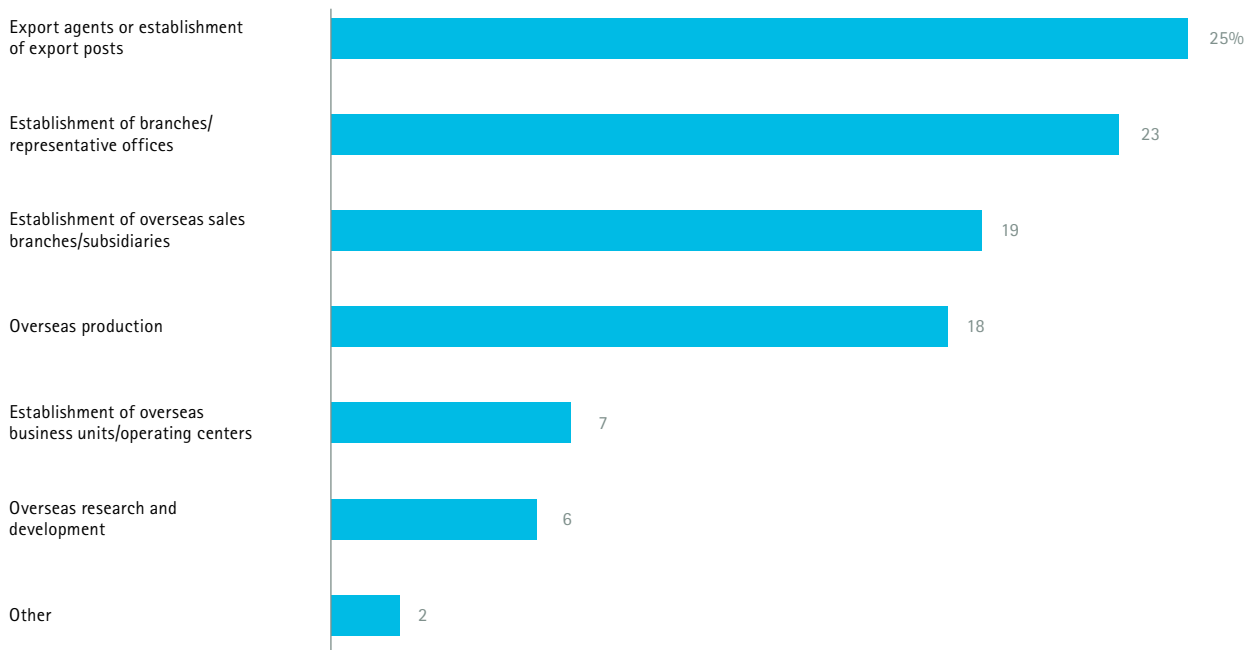
In this stage, companies manufacture products for overseas markets using cheap local labor. Few of them have their own brands or sales channels either domestically or abroad. They derive most or all of their income from exports, and their competitive advantage comes from providing low-cost and low-value-added products and services. Their global management and operational capabilities remain quite weak.

In the mid-1990s, China announced its "going out" strategy and introduced a series of policies and measures designed to encourage Chinese enterprises to expand into overseas markets along these export-orientation lines.

"Going out" didn't happen overnight. The idea was first raised in 1992, in Jiang Zemin's political report to the Fourteenth National Congress of the Chinese Communist Party. In 1997, Jiang formally used the term "going out" in various speeches, and it was adopted as a national strategy. Soon

Not global yet

When asked how they were conducting business overseas, Chinese enterprises indicated that they were primarily focused on exports; only 7 percent said they had established overseas business units or operating centers, and even fewer had invested in overseas R&D operations.



Source: Questionnaire surveys by Accenture and the China Enterprise Confederation, May-August 2010

a large number of new businesses sprang up. Today, as a result, many labor-intensive and export-oriented original equipment manufacturers and original design manufacturers populate China's Pearl River Delta and Yangtze River Delta areas and are examples of companies in the export orientation phase.

Value-chain optimization

An enterprise capitalizes on globalization in this stage to move up and expand its value chain. It views the global market as integral to this effort, although it does not yet depend on that market for a significant part of its business.

Activities at this stage include acquiring technologies, recruiting talent, expanding into new markets and building brands. Since 2001, when China was admitted to the World Trade Organization, Chinese

enterprises have further integrated into the world economy and deepened their understanding of the rules of the game in making overseas investments.

Many Chinese enterprises set their sights on the European and US markets to improve their competitiveness in areas such as research and development, product design, technology development, marketing and branding. Others have been eager to establish their presence in the Middle East, Africa and Latin America to tap these regions' abundant local resources.

Consider the Sany Group's rise to become the No. 1 maker and seller of concrete pumps. From the beginning, according to vice president He Zhenlin, the company's strategy was to focus on value chain optimization, not product exports (see sidebar, page 6).

How Sany targets high-growth markets

Construction machinery maker Sany Group's globalization plans are nothing if not geographically ambitious: The company has established production bases in the United States, Germany and India, and is planning one in Brazil.

The United States is the world's largest engineering machinery market and home to giant engineering machinery manufacturers. By setting up a base in the United States, Sany can secure an adequate parts supply and learn advanced management practices. Germany enjoys advantages in industrial design, precision instruments manufacturing, technology, business processes and R&D. By establishing a plant in Germany, Sany can assemble products there that were manufactured in China—thus making them cheaper to sell to European clients. Sany's presence in the high-growth markets of India and Brazil will also be critical to its ability to maintain low costs and close customer relationships in these booming economies.

From R&D through manufacturing, Sany uses a mix of domestic and global strategies. For example, Chinese engineers and their German colleagues work together closely, with the latter providing the conceptual framework and the former completing the functional designs. The company fosters this collaboration cost effectively by making use of IT-enabled tools. With the exception of precision devices, Sany's manufacturing takes place in China, where costs are a fraction of those in Germany. Finished products are then sent to Germany for assembly.

It's clear that Sany is developing the kind of capabilities necessary to compete on the world stage. At the same time, the percentage of its income derived from global operations, while impressive, is not huge: In 2009 (amid the financial crisis), Sany brought home nearly 1.4 billion yuan (\$215 million), or 9 percent of its total income, from overseas.

Globalized operations

When a company has developed world-class capabilities and a high percentage of its sales come from abroad, it can be considered a global player. In 2010, for example, Huawei Technologies Co.'s overseas sales reached 65 percent, and Lenovo's hit 63 percent. At this point in a company's development, national origin ceases to be a crucial factor. More important: The company transcends national borders in its strategic thinking, decision-making processes and corporate culture. Achieving this state is an arduous, protracted process.

Few Chinese enterprises have reached this stage. For now, more companies are like Sany, improving at each node of the value chain—from research and development to the acquisition of raw materials, from production and marketing to the delivery of finished products. In defining a globalization strategy, a business should first analyze its comparative strengths and weaknesses in terms of resources and capabilities, and then determine which links in the value chain should go global.

Meeting the challenge

As today's Chinese companies work their way through the phases of globalization, there are some key lessons to be learned from others that have gone before them.

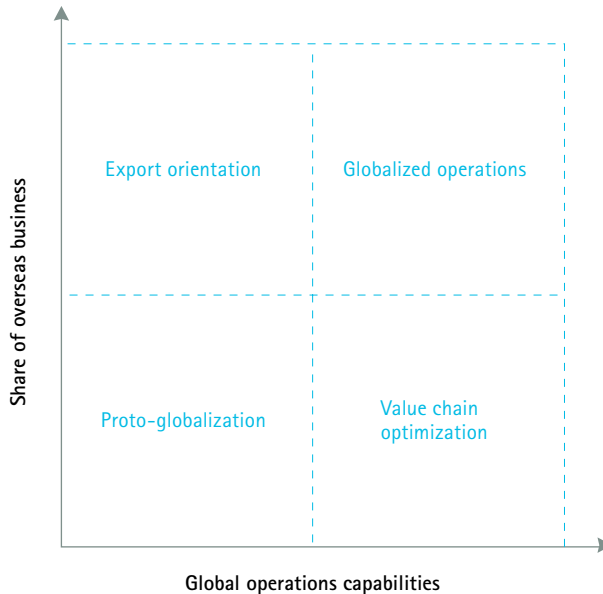
First, Chinese enterprises need to determine the right starting point. Not all can follow Haier's "difficult to easy" path—and launch in the United States first (see sidebar, page 8). Depending on their capabilities and the nature of their industry, some may find it easier to enter emerging markets first, or those that are geographically closer to home.

Second, Chinese enterprises must set up a leadership team with a global vision and overseas educational and work experience. When Lenovo acquired IBM's PC business, it created an executive committee that could help it meet its international aspirations. Eight members of this 14-person team had overseas backgrounds, including four former IBM executives, one former Dell executive and one former Microsoft executive.

No matter how busy they are, members of the committee meet

Measuring globalization

Although exports remain important to Chinese companies, there are other ways to measure the degree of globalization. Along with examining what share of its business is done overseas, the company should also be assessed based on its operational and managerial capabilities on the global market. Those companies that have a high share of business overseas and have developed global capabilities are in the most advanced stage of global operations.



Source: Accenture analysis

for two to three days every month to discuss key issues in strategy and operations. Further, the management teams below the executive committee allow their members to shift between different geographic locations and markets. Such practices have contributed significantly to Lenovo's emergence as a global company.

Third, Chinese enterprises must do more to understand local conditions—from policies, laws and regulations to sources of talent, natural resources and innovation. Many executives told us that a shortage of adequate information about local markets was holding them back. They lack clarity about what opportunities exist and how they can find them.

Fourth, Chinese enterprises can do more to develop a base of young

talent with the skills needed in a global environment. China State Construction Engineering Corporation, for instance, has built up a team of junior managers for its global business. Some of them are in their early thirties, but they are already leading overseas projects involving tens of thousands of workers and worth hundreds of millions of dollars.

In addition, enterprises should encourage the managers of their overseas operations to assimilate into the local society. When the Hangzhou-based Holley Group Co. first started its global operations, the company set strict rules regarding Chinese employees' behavior. They had to live in company dorms and were not allowed to leave them

(Continued on page 9)

Haier goes out, in and up

In 1984, the Qingdao Refrigerator Factory was a small, collectively owned enterprise with annual losses of 1.47 million yuan (prompting more than 50 employees to ask to be transferred to a more profitable company).

During the remainder of the decade, the company transformed itself into the leading refrigerator brand in China, winning a gold medal for product quality in 1988. During the 1990s, the renamed Haier Group concentrated on diversifying its product line, and by 1998, it had become China's leading home appliance brand.

But the future for a purely domestic company was not rosy. Rivals were upgrading their offerings, and consumers were growing increasingly sophisticated in their demands. Under these conditions, Haier knew it had to become a global competitor. As Zhang Ruimin, the company's chairman and CEO, expressed it, "If we had not had a grand vision and gone out, we would still be small. Like a fish in a small pond, we would never grow big. So we must go out."

In 1999, Haier defined a three-step strategy of "going out, going inside and going upward." That is, it would first gain a foothold in overseas markets with exports. Next, it would establish local operations throughout the world, and enter mainstream distribution channels. And finally, it would create a global brand known for the quality of its products.

To execute its plan, Haier took a "difficult-to-easy" approach, selecting foreign markets with meticulous care. It first set its sights on the hard-to-penetrate US market, where it established operations in 1999—a design center in Los Angeles, a manufacturing facility in South Carolina and a marketing center in New York City—characterized by mature technologies and varied consumer demand. By doing so, it established a solid reputation in the world's developed markets.

Its successful experience in the United States would serve as a model for expansion to other countries and regions.

Europe. In 2001, Haier took over a refrigerator manufacturing facility under Italy's Meneghetti Equipment (the first transnational M&A case involving a Chinese home appliance

manufacturer). Earlier, Haier had established R&D centers in Italy, the Netherlands, Germany and Denmark. It had also constructed a marketing center in Milan.

South Asia. In 2001, Haier set up an industrial park in Pakistan. By 2005, the company owned nearly 3,000 sales outlets and 14 exhibition halls in India. In 2007, its first manufacturing facility in India began operations.

Africa. In 2000, Haier and Great Britain's PZ Cussons established a joint venture in Nigeria for assembling and marketing the Haier Thermocool product line. In June 2007, Haier's largest exhibition hall in Nigeria opened in Victoria Island, the business center of the capital city of Lagos.

ASEAN. In July 2005, Haier established an exhibition hall in Malaysia. In May 2007, it acquired the Refrigerator Factory from Sanyo in Thailand.

Oceania. In New Zealand and Australia, Haier co-owns factories with local partners. In 2009, it participated in the recapitalization of Fisher & Paykel Appliances, a leading New Zealand home appliance manufacturer. At the plan's completion, Haier will hold a 20 percent stake in FPA. Haier is also forming alliances with local marketers in the region.

Haier's 2010 revenue was RMB135.7 billion (\$21 billion), more than 30 percent of which was generated overseas. It owns 16 industrial parks (4 overseas), 29 factories (24 overseas), 8 R&D centers (5 overseas), 61 trading companies (19 overseas) and 58,800 sales outlets (45,800 overseas). The company employs 60,000-plus people (more than 3,000 overseas). Its overseas business revenue has been growing at a spectacular annual rate of 30 percent to 50 percent.

For each of the past eight years, Haier has topped the list of the most valuable brands in China. In June 2010, it was ranked 28th on *BusinessWeek's* list of the 50 Most Innovative Companies. Data from the business intelligence firm Euromonitor International, cited by *Newsweek* in December 2010, put Haier in the top spot in worldwide white-goods retail volume, boasting a global share of 6.1 percent.

For further reading

"China's high performers take the long view," *Outlook* 2010, No. 3

"A tale of two Chinas," *Outlook* 2009, No. 2

For these and other articles, please visit accenture.com/Outlook.

(Continued from page 7)

at night. But as managers began to understand the importance of cultural mingling, they changed policy: Employees could rent their own apartments and socialize in restaurants after work. Today, a number of Holley's Chinese employees have served in overseas markets for more than 10 years, gathering deep insights into the markets they live in.

Fifth, Chinese companies can create a globalization ecosystem by establishing alliances with local partners and other Chinese companies. For example, Holley allied with its local Thai partner to create the Thai-Chinese Rayong Industrial Zone, which has attracted more than 20 Chinese investors and a combined investment of \$170 million. Few enterprises can successfully expand into overseas markets alone. Alliances of two, three or even more parties can help the

participants identify and capitalize on global opportunities.

Sixth, Chinese companies must become more innovative—in research and development, marketing, brand construction and other key business functions. They used to compete on cost and price, without core innovative technologies or independent brands, and seldom broke into the highly profitable service sectors. Now they need to shift their products' reputation from "Made in China" to "Made with China" or "Created in China."

In addition to increasing their own capabilities, Chinese enterprises also see government support as crucial for successful globalization. Many executives told us they expected the government to be more supportive. They noted, for example, the significant role that the Japanese and Korean governments (and industry associations) have played in helping their enterprises go global.

China emerged from the global financial crisis relatively unscathed, which has put its enterprises in an advantageous position. The time is ripe for Chinese companies to leave the beaten track and transform their business and operating models to fuel new growth. This transformation calls for strong capabilities in innovation, brand building, customer value, resource allocation and cultural integration. Chinese companies' expanding strength and the need for transformation are pushing these enterprises to go out and face the world.

In this new context, globalization is a natural choice for Chinese businesses.

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As the chairman of Accenture Greater China, **Gong Li** leads a team of more than 5,800 people. With 25 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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