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China rising

By Gong Li, Andrew Sleight and Paul F. Nunes

Chinese companies are increasingly capturing the business world's attention. While their profitability seldom matches that of high performers from the developed world, their agility, adaptability and global mindsets are making them formidable competitors.

Just a few years ago, readers of the Western business press would have been forgiven if they couldn't name a single Chinese company. For all the rapid development within China, global multinationals entering that market got nearly all the ink in major newspapers and magazines.

But the astonishing success of several Chinese companies has led executives everywhere to recognize a new reality: A growing number of Chinese businesses are poised to become major global players—and competitors to be reckoned with outside their home country.

Accenture recently completed a detailed quantitative and qualitative analysis of nearly 200 publicly listed Chinese companies. We identified more than 25 that we would designate as

Chinese high-performance businesses, because they have significantly outperformed their local rivals within a relevant industry peer set over the long term. These top-performing companies are in 13 different industries. Two-thirds of the industries have at least two high performers; almost one-third have at least three; and two have four (see sidebar, page 3).

While the most successful Chinese companies equal and sometimes even surpass their global counterparts on many measures of financial performance (for example, significantly higher revenue growth), they are well behind in profitability, generating only half of that achieved by global high-performance businesses. Although these companies have a solid foundation from which to launch themselves into the ranks of high-performing US,

European and Japanese multinationals, their performance still lags that of these global powerhouses.

Like high performers everywhere, the success of China's top companies rests on the three building blocks of high performance—market focus and position, distinctive capabilities and performance anatomy. What is particularly striking is the speed with which they have mastered the crucial skills, processes and mindsets that constitute these building blocks.

Thus they are rapidly building dense, effective networks to overcome the relatively undeveloped nature of Chinese markets. They also create—and discard, and create again—capabilities that their competitors can't match. And they are quickly emulating multinational best practices in the development of performance mindsets, which they temper at times with traditional Chinese views. All these traits combined have begun to make many of China's high performers formidable competitors in international markets as well.

Networked market focus

Chinese high-performance businesses approach market focus and position in much the same ways that their global counterparts do. For example, nearly 90 percent of China's top companies say they focus on markets where they believe they have unique strengths. These markets are very often other emerging economies, where Chinese high performers can mine their experience to successfully manage the sort of high volatility and turbulent change they have mastered at home. Likewise, they are as good as their global equivalents at simultaneously managing multiple horizons in their strategic planning—short term (less than a year), medium term (one to five years) and long term (more than five years).

Paradoxically, perhaps, the Chinese ability to take the long view helps them move quickly. They know that long-term success is dependent upon their ability to rapidly construct business networks. These networks are built using the companies' local knowledge as well as their connections with government organizations, industry associations, international companies, suppliers, companies in other industries and, in some cases, even competitors.

These networks help Chinese high performers break into and embed their businesses in local markets. The networks also help the companies navigate what is still, outside of a few large cities on the eastern seaboard, a fairly immature market with fragmented supplier and distribution networks and often inconsistent regulatory environments. Finally, such relationships help Chinese high performers accommodate the many differences among the country's diversified regional markets.

Chinese high performers sometimes collaborate to a degree alien to (and seldom—if ever—replicated by) most foreign companies. This occurs mostly in the state-owned sector. For example, energy giants China Petroleum & Chemical Corp. (known as Sinopec), PetroChina Co. and China National Offshore Oil Corp. regularly exchange information, share best practices and visit one another's sites. Partnerships with non-Chinese companies are also common. China Mobile, for example, has signed collaboration agreements with Vodafone, Ericsson, Google and others to boost its revenues from services. Household-appliance maker Guangdong Midea Electric Appliances Co. has become a master at building effective webs of business (see sidebar, page 4).

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About the research

Researching high-performance businesses in China presented us with several challenges related to the uniqueness of the market. Large emerging markets—particularly China, with its postwar history of a planned economy and many state-owned enterprises—require us to adjust our High Performance Business criteria to take into account that many relevant companies were publicly listed only recently. As a result, we eliminated the long-term screen and restricted our time frame to three and five years.

Choosing the companies for analysis was the first step. Our initial set included publicly listed Chinese companies with annual revenues greater than RMB1 billion, and with at least 50 percent of sales generated within China. We then eliminated companies that had been listed on a capital market for less than five years, because our methodology requires that a business outperform its peer group over the medium term to be considered a high-performance business.

Next, we narrowed the number of industries for analysis, taking into account the fact that many Chinese companies, including a large percentage of the country's 130,000 state-owned enterprises, are not listed. We also had to ensure that the companies we looked at in each industry represented the entire industry, not just a subset. We therefore selected only those industries in which the combined market capitalization of the companies that met our selection criteria made up at least half of the industry's total market cap.

This process yielded 183 Chinese companies in 13 industry peer groups, to which we applied Accenture's proprietary High

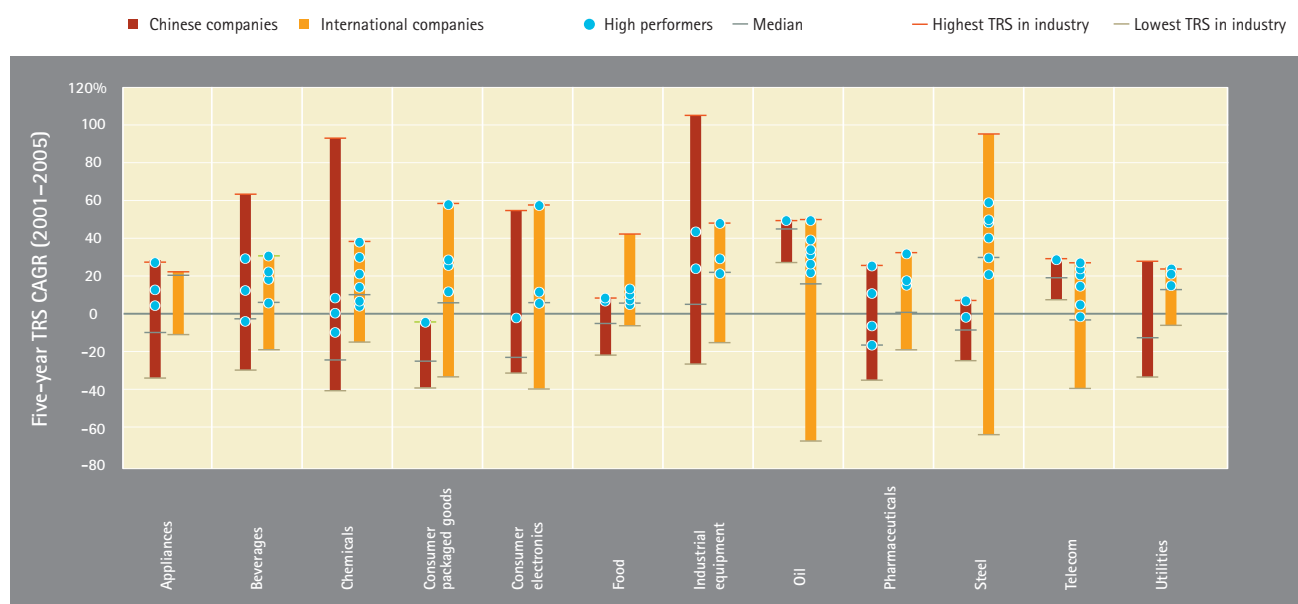
Performance Business methodology. We also compared the performance of these Chinese companies with that of their competitors in our global industry peer sets.

From this group, we identified more than 25 Chinese high performers. These companies, already industry leaders compared with their Chinese peers, averaged total return to shareholders of 7 percent between 2001 and 2005; during the same period, the average TRS for all Chinese companies was negative 13 percent. Despite these comparatively weak returns, they outperformed global high-performance businesses on several metrics. Their revenue growth, for example, was almost double that of their global counterparts. And their capital efficiency easily matched that of their relevant global peer set.

Their ability to return profit greater than their cost of capital, however, falls far short of the top global players, which had profitability rates of 4 percent between 2001 and 2005. The Chinese high performers could only match that of mid-range global companies, with an average profitability of 2 percent. The average Chinese company, meanwhile, scored negative 5 percent on profitability.

We supplemented our quantitative analysis with a 63-question, six-section survey, which was circulated to more than 80 senior Chinese executives, at both high performers and low performers. This data helped us understand the differences in performance, and how high performers are taking a superior approach to the three building blocks of high performance (see story).

In most industries,* international companies outperformed Chinese companies in their total return to shareholders in the five-year period from 2001 to 2005. However, in chemicals and industrial equipment, Chinese companies provided higher shareholder returns.



* Excludes companies, except appliances, without a five-year time line; appliances based on a three-year average. Source: Accenture research

Midea: The art of networking

Capturing the most profitable markets is a hallmark of Chinese high-performance businesses. Few have been better at this than Guangdong Midea Electric Appliances Co., a maker of appliances such as electric cookers, refrigerators, washing machines and air conditioners. The company, moreover, owes much of its success to the networked approach that distinguishes the market performance and positioning of China's top companies.

Consider how it secured its position as China's No. 2 manufacturer of air conditioners. In 1998, Midea established a joint venture with Japan's Toshiba Corp. This was a critical supply chain move, as it meant that Midea would have a secure flow of compressors for its products. The move also boosted Midea's profitability, because the gross margin for the compressor industry was nearly 10 percent higher than for the air conditioner business.

Then in 2005, Midea invested more than \$13 million to establish a distribution network of 10,000 retailers in China's underserved interior regions. Through these outlets, the company introduced a new type of air conditioner, one that is specially adapted to an intermittent, low-voltage power supply but that also meets national standards for energy efficiency.

Since then, Midea has expanded its network of collaborations. In June 2007, the company set up a technology partnership with the Chinese Academy of Sciences' Technical Institute of Physics and Chemistry. Through the partnership, Midea is able to certify that its products are free from bacteria; for its part, the academy draws on Midea's resources for its cryogenic research. Midea has also expanded abroad: A manufacturing plant in Vietnam, opened in early 2007, will be followed by the construction of facilities in Russia and possibly India.

By cleverly building and exploiting networks, Midea has helped meet the burgeoning taste of Chinese consumers for more sophisticated white goods.

(Continued from page 2)

Although Chinese high performers want to be the first to penetrate the best markets, they are not primarily interested in quick wins. And they work diligently to maintain their collaborative networks. In particular, local governments are seen as important partners in business success: More than 80 percent of the companies we surveyed considered themselves very good at creating win-win situations with local governments.

The task of building networks is important to businesses everywhere, but Chinese high performers have raised the practice to an art.

Distinctively rapid adaptation

Like their global counterparts, China's top performers fully recognize the need for distinctive capabilities that help them respond to what customers really want. More than two-thirds of the high performers say they target their investments to improve customer satisfaction and loyalty. They also constantly rethink core processes to keep the customer at the center of their business models.

High performers recognize a central fact that keeps them ahead of competitors: In China especially, distinctiveness is fleeting. Chinese consumers are becoming more demanding and sophisticated. Young

Lenovo: Establishing a distinctive lead—again and again

In Chinese terms, computer maker Lenovo is a venerable business, with roots going back to the mid-1980s. In 1987, Legend (as Lenovo was originally known) began selling an add-on card that allowed Chinese software applications to run on English-language operating systems. In the 20 years since then, Lenovo has practiced the serial distinctiveness that has helped it become one of the best-known Chinese brands in the world.

Lenovo established a leading position in China's PC business by building a superior marketing and sales function. As international heavyweights moved into China and the competition heated up, Lenovo captured the higher-end market by offering quality products at low prices, and within a decade, the company was the top PC vendor in the Asia Pacific region. By the time the company was renamed Lenovo in 2003, it was poised for global expansion.

Lenovo's 2005 acquisition of IBM's PC division made it the world's third-largest PC maker. Since then, the company has launched the 3000, its first worldwide product line and, more recently, a new range of laptop and desktop PCs, aimed at mid-level to high-end buyers. In 2007, Lenovo announced plans to open four new manufacturing plants—three of them overseas (in Mexico, India and Poland)—and one new fulfillment operations center in the United States.

This high performer will be challenged to sustain its successful record of serial distinctiveness as competition from multinationals increases, both in China and around the world. But Lenovo's recent announcement that it will outsource all international marketing campaigns to India, working closely with advertising agency Ogilvy & Mather Worldwide, strongly suggests that the company has already embarked on the next stage in its development.

consumers, in particular, are partial to foreign brands. In this environment, companies need to be “serially distinctive,” changing business models quickly to suit new markets, new opportunities and new constraints.

Three-quarters of the Chinese high performers we spoke to say that they make significant investments to ensure that their businesses can adapt when interrupted by external factors. Wuhan Iron and Steel (Group) Corp. actually writes serial distinctiveness into its rules on new-product development: “We have what others don't have; what others do have we excel at; we distinguish ourselves from what others are excelling in; and when others catch

up with our distinctiveness, we find something new.”

Even the five-year plans that many Chinese companies follow are more flexible in high-performance businesses. The pharmaceuticals company Yunnan Baiyao Group Co., for example, pursues what the company calls a “Steady the center and emphasize two wings” strategy that seeks continual sales growth from its core medical products while it simultaneously develops two new departments that specialize in skin and personal care. And some companies, like the computer maker Lenovo, are masters at reinventing themselves before competitors force them into defensive moves (see sidebar, above).

Changyu: Traditional virtues, international best practices

Yantai Changyu Pioneer Wine Co. was established more than a century ago. But although its motto—"Love the country, love the job, pursue high quality, and be the best"—reflects traditional Chinese virtues, Changyu also pursues a long-term strategy that combines tradition with international best practices. It actively hires foreign wine experts and MBAs, for example, while sending outstanding Chinese employees to Europe and America to study. It also has consistently demonstrated its willingness to adapt to changing customer preferences.

Our research suggests that this sort of flexibility is a key to the long-term global success of China's top companies. Already the biggest winemaker in Asia, Changyu was the first Chinese vintner to successfully penetrate Europe. It was the first to be sold in 3,000 supermarkets across Europe, for example, and its wine is served to first-class passengers of Lufthansa, the German airline. The company has also signed cooperation agreements with foreign producers, including a Canadian producer of sweet wines. The two businesses plan to build the world's largest sweet-wine production facility.

Domestically, Changyu is outperforming the competition in part through its three-tier sales network, a structure that is unique in China. Divided into four regions, the network includes 26 distributors and 500 sales reps supported by well over 3,000 retail franchises.

Recent results have been impressive. In 2005, Changyu's sales were up by 34 percent in Guangdong and 50 percent in Beijing. Particularly in the way it develops and uses talent, Changyu is creating mindsets that reinforce its winning tradition.

Mindsets that blend East and West

Chinese high performers exhibit many of the mindsets that make up the performance anatomy of global high-performance businesses. More than 60 percent, for example, are investing heavily in product development and R&D, often in partnership with foreign multinationals. These investments demonstrate a mindset that balances the need to serve today's markets while also creating tomorrow's. Similarly, Lenovo recently announced the launch of its first innovation center in India, in partnership with such global giants as Intel Corp., Microsoft Corp., IBM and Cisco Systems.

Another important consideration is a focus on human capital, and specifically on the development of

a talent-multiplier mindset. More than two-thirds of Chinese high performers, for example, believe that they gain unique business advantages from their management of human capital. The talent-multiplier strategy at Chinese meat producer Henan Shuanghui, for example, explicitly states: "Take in, train, make good use, award and keep." (For additional information on the talent-multiplier mindset, see "Talent: Leveraging your most important asset," *Outlook*, September 2007.)

A third key to a healthy performance anatomy is a mindset that considers IT to be a source of both operational excellence and competitive advantage. In this regard, a lack of legacy IT systems has enabled many Chinese high performers to leapfrog the global competition in terms of leveraging the very latest technology.

Chinese high performers are also beginning to adopt global best practices on the management of intangible assets, establishing systematic performance measurement for key intangibles such as brand equity and intellectual property. Furthermore, they are proactively managing their corporate reputations. In 2007, for example, a high performer in China's dairy sector was the first company in the country's food industry to publish a detailed corporate social responsibility report; the company is also actively tracking its relationship with the wider society alongside the tracking it already does with its shareholders, employees, consumers and suppliers. Changes like these will help Chinese companies develop a mindset that measures performance selectively, by identifying the most important attributes of company success.

What makes these top companies' performance anatomy quintessen-

tially Chinese, however, is the way the companies blend Western business cultures, styles and management methods with those that are traditionally Chinese.

Consider, for example, how they approach risk. Two-thirds of China's high performers say their culture supports experimentation and risk taking. Yet they also guard against what is sometimes seen as a Western inclination toward recklessness, and they temper what they consider Western aggressiveness with the traditional Chinese virtues of perseverance and persistence. Even when they expand overseas, they retain their Chinese heritage and traditions—adapting at the same time, as Yantai Changyu Pioneer Wine Co. has done, to international best practices, especially in areas where they have been historically weak (see sidebar, page 6).

Make no mistake: The path to high performance for Chinese companies will be far from smooth. And the challenges begin at home. China's capital markets and interest-rate mechanisms are underdeveloped. Intellectual property protection is in its infancy. Regulatory change occurs swiftly and unpredictably. Wages are rising rapidly, along with inflation. Foreign companies are gaining the sort of local knowledge that was once the exclusive preserve of the Chinese. And investors' expectations are soaring on the back of stock market growth. Meanwhile, in a multi-polar world in which no single country or region dominates, the competition for talent, capital, consumers, resources and innovation will be intense.

But don't count out the Chinese high performers. Remember that not so long ago, they weren't even on the Western world's radar. Our research suggests that Chinese companies can create long-term sustainable competitive advantage in global markets. The most successful Chinese companies have demonstrated an ability to penetrate the right markets, to serially create distinctive capabilities and to develop winning mindsets within their organizations. And this, of course, is the recipe for high performance—in China, and around the world.

For more information on Chinese business and Chinese markets, see "High Performance Business in China 2007: In Pursuit of Profitable Growth" (Accenture, August 2007); "Open for business" and "Getting IT right the first time: A bold new agenda for China's CIOs," Outlook, May 2006; "Moving up the value chain," Outlook, September 2006; and "The infrastructure imperative," Outlook, May 2007.

About the authors

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Consumers (Harvard Business School Press, 2004). In addition, Mr. Nunes is the senior contributing editor for *Outlook*.

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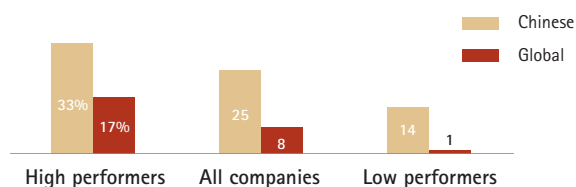
By the numbers

Contenders on the world stage

The high performers in China are growing more quickly than their global counterparts. In addition, they have return-on-invested capital and operating margins that are on par with those companies.

Between 2001 and 2005, Chinese companies had much higher revenue growth than their global competitors. This is understandable, because the Chinese companies typically started from a much smaller base.

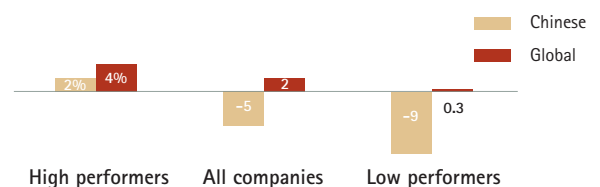
Four-year median revenue growth performance (CAGR)*



* Excludes companies, except appliances, without a five-year time line; appliances based on a three-year average. Source: Accenture research

But during the same time period, most of the Chinese companies were not profitable. Only the high performers were—and their spread was still lower than those of their global counterparts.

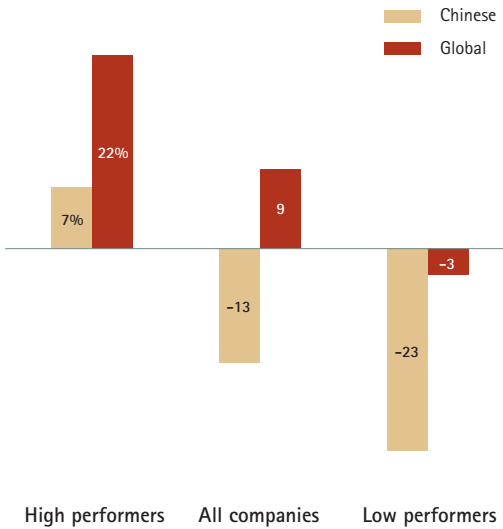
Five-year profitability performance median (average spread)



Source: Accenture research

Between 2001 and 2005, only the top performers in China created any shareholder value.

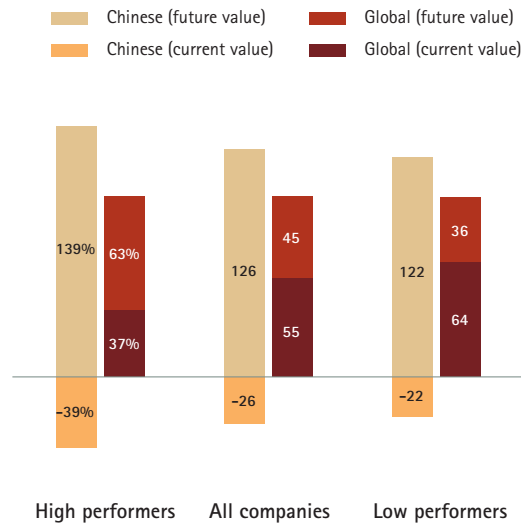
Five-year median TRS performance (CAGR)*



* Excludes companies, except appliances, without a five-year time line; appliances based on a three-year average. Source: Accenture research

Future expectations, not current performance, drive the share price of Chinese companies.

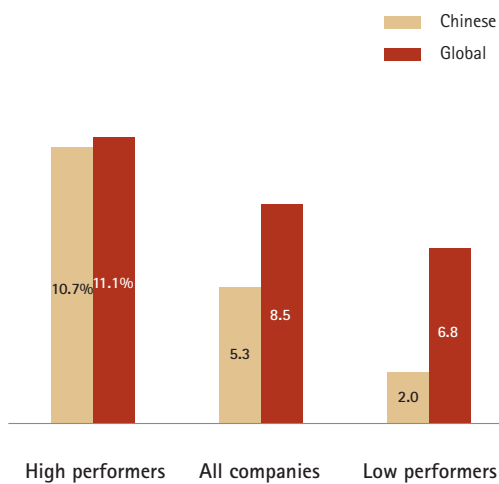
Five-year profitability performance median (average future value/current value)*



* Excludes companies, except appliances, without a five-year time line; appliances based on a three-year average. Source: Accenture research

High performers in China are catching up with their global peers when it comes to return on invested capital.

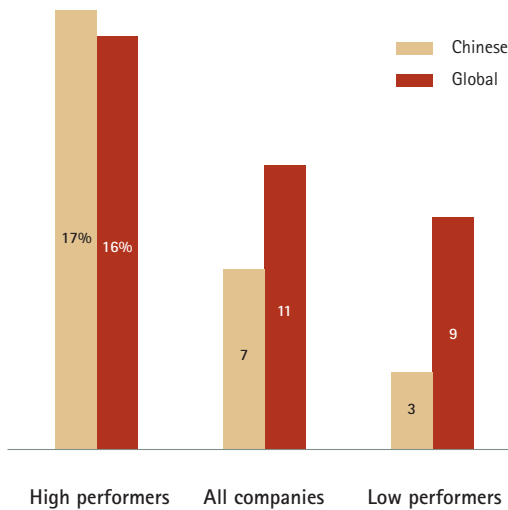
Return on invested capital median (five-year average)



Source: Accenture research

High performers in China have similar operating margins as global companies. For all others, there is a substantial gap.

Operating margins: EBITA /revenues median (five-year average)



Source: Accenture research