High Performance Business in China: Pioneering the Future amidst Financial Crisis
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The People’s Republic of China recently celebrated its 60th birthday. Over the past 60 years, China has met with upheavals. In particular, after three decades of reform and open-door policy, China’s economy has rid itself of the low efficiency and shortages characteristic of its planned economy. It has also integrated itself into the international economic community to become one of the world’s leading powers. This change amounts to a miracle in the contemporary history of the global economy. For those not involved in such a change, it is difficult to grasp the country’s extraordinary performance and understand its far-reaching implications for the world.

As a global management consultancy, Accenture is fortunate to both witness and participate in China’s great journey. Our business in China has been maturing and thriving together with China’s economy and the clients we serve. For more than 20 years, Accenture has developed its presence in Greater China. Today, we have an over-4,000-strong team with six branch offices in the region.

In serving our Chinese clients, we combine our global experience with local knowledge. Through this approach, we have helped multinational and local corporations achieve significant momentum in their growth. Meanwhile, Accenture itself has developed into a local enterprise with a global vision. Perhaps now is the time for us to apply the local wisdom we have gained in the Chinese market to our work with other members of the global business community.

The innovations, ideas and practices generated in China indeed belong to the world. In today’s multi-polar world, the old unilateral flow of capital, knowledge and expertise has given way to multilateral flows.

What happened in China during the global financial crisis supports our viewpoint. While many economies worldwide were devastated by the downturn, China sustained the world’s highest growth. The country is bailing out the world economy with its own economic power. At this unique moment in history, Accenture conducted its third annual study of high performance business in China. We looked at the impact of the financial crisis on China’s economy, how high performers in China behaved during the recession, how they coped with the situation and what lessons Chinese enterprises should learn from the crisis.

The coping strategies implemented by the Chinese government and enterprises, especially high performers, are inspiring. We hope that as the recovery gains momentum, Chinese companies will not only close the gap with the world’s leading businesses but also birth sophisticated management ideas and become a benchmark that other countries look up to. The success of the Chinese market should be reproduced in developed markets. Our research has disclosed many encouraging findings that reinforce our hope. For example, Chinese petroleum giant Sinopec has been ranked among the world’s top 10 enterprises in terms of revenues. Perhaps a Chinese version of GE, Coca-Cola, Wal-Mart, Toyota or Sony will emerge in the coming years.

Looking ahead, China’s economy is brimming with new growth opportunities. Scientific and technological research and innovation, rural financial reforms, elimination of urban-rural barriers, monetization of agricultural land, construction and improvement of the social welfare system—these and other developments will likely become new drivers of economic growth. As long as the Chinese government’s macroeconomic policies support rational economic development—coupled with environmental protection policies, social justice and good business management practices—China’s economy will continue to blossom.

While a multi-polar world is emerging, China has undoubtedly become one of the most prominent poles. Our hope is that Accenture’s ongoing High Performance Business in China study will further enhance this country’s competitiveness in today’s world.

William D. Green
Chairman & CEO, Accenture
This report presents Accenture’s High Performance Business in China research for the third consecutive year. Our first two studies found the Chinese economic environment calm, albeit with some ripples. We concluded that Chinese high performing businesses (HPBs) focused on not only quantitative but also profitable growth. And we took particular interest in how HPBs in China leapt forward (like “the carp jumping over the dragon gate” in the Chinese legend) to rank among the world’s best performers.

As the financial crisis struck, we turned our attention to questions such as how the downturn affected these enterprises, how corporate leaders responded and what challenges and opportunities the crisis posed for the Chinese economy. In addition, we studied these enterprises’ diverse attitudes, perspectives and thoughts on the crisis.

Our research findings include the following:

• Although the crisis indeed had an enormous negative impact on Chinese enterprises, high performance businesses still exist in China.
• While dealing a much lesser blow to Chinese enterprises than to their overseas counterparts, the crisis transformed Chinese business leaders’ notions about management.
• Chinese enterprises in general—and high performance businesses in particular—should not settle for safely climbing out of the financial turmoil; rather, they should define loftier ambitions.
• Macroeconomic as well as microeconomic (management) forces underlay the crisis. The fastest way out of the downturn is through better management.
• High performing businesses have a vision and know how to balance their short-term survival with their long-term development needs.
• While the crisis brought difficulties, it also presented huge opportunities for new learning and for transformation.
• That the crisis originated in Western countries does not justify negating contemporary Western management models and experiences. Chinese enterprises should extract lessons from the crisis, avoid complacency and engage in deep reflection as they move to build their own future.

The current financial crisis—the most disastrous since the Great Depression—has proven once again that the Chinese economy has a strong resistance to risks as well as great resilience. As long as Chinese enterprises continue to strive for excellence, their setbacks will be temporary and will not block their way ahead. After 30 years of opening up and participating in the world economy, China has grown into an important player on the international stage. It has gained valuable experience in enterprise management—experience that other countries can learn from. However, its new approaches must continue if it is to fully reach its potential.

The legendary phoenix collected parasol branches at the age of 500 to burn itself. It would then be reborn and enjoy eternal life thereafter. A well-known poem by the modern Chinese poet Guo Moruo reads:

When the phoenix sings,
We are reborn,
We are reborn.
Each and everything renewed.
Each and everything renewed.

We hope that, like the phoenix, Chinese enterprises will emerge from the ashes of the financial crisis and soar to new heights.

Gong Li
Chairman, Accenture Greater China
I. Introduction
The subprime credit meltdown in the U.S. delivered devastating effects and became what Warren Buffett described as a financial weapon of mass destruction. It eventually evolved into a full-blown financial crisis during the second half of 2008, marked by the collapse of Lehman Brothers. It was the worst financial nightmare since the Great Depression. The crisis rapidly spread to other developed markets as well as to emerging markets, rocking not only global financial institutions but the entire global economy.

What implications does the financial crisis have for Accenture’s high performance business research? In other words, what specific issues will these research efforts examine?

Accenture’s research on high performance businesses worldwide has roots stretching back to 2003. We are particularly interested in investigating questions such as the following: What are the qualifications for high performance businesses? What are the criteria? How is high performance measured? How is it sustained? Our research, covering 6,000 listed companies across 36 industries, has thus far identified 500 of them as high performance businesses. In 2005 Accenture’s high performance research was rated by Harvard Business Review as one of the top 10 initiatives during the last 25 years.

In 2007, when we conducted our first study of high performance business in China, we wanted to know whether some Chinese enterprises obviously outperformed their peers in terms of revenue growth, profitability and total shareholder returns. If so, were they truly positioned to compete on the world stage? To what extent was their high performance sustainable? Our findings assured us of their existence, but we saw a significant difference between them and the world-class high performers. Their sustainability depended on the establishment of critical management systems and business models. Regardless of how successful the Chinese high performers were, we suggested that they focus their future endeavors on the quality, rather than quantity, of revenue growth. (See Accenture report: High Performance Business in China 2007: In Pursuit of Profitable Growth.)

In 2008, 30 years after its initiation, China’s economic reform effort came to a critical juncture as benefits from reform diminished and the country’s competitiveness eroded. Also, disturbing signs in the global economic environment did not augur well for China. In such a volatile climate, it was particularly important that Chinese enterprises continue to achieve high performance. They had to undergo a transformation by “jumping over the dragon gate” and gaining a foothold among the global high performers. For this reason, Accenture’s 2008 study of high performance business highlighted the Chinese enterprises’ historical mission of significantly narrowing the gap between them and the world-class high performers. (See Accenture report: High Performance Business in China: Jumping over the Dragon Gate.)

The global financial crisis in 2009 added new dimensions and perspectives to high performance business research. As a result, our research has come to focus on the following four questions:

- What impact has the crisis had on Chinese enterprises?
- Given the magnitude of the crisis, do high performance Chinese businesses still exist?
- How are high performance businesses in China coping with the crisis?
- What lessons can Chinese enterprises learn from the crisis?
About Accenture's High Performance Business Research

Accenture's high performance business research is a worldwide project covering thousands of enterprises across a wide range of industries.

We have analyzed more than 6,000 companies in depth, more than 500 of which we have identified as HPBs. These organizations range from familiar "stars" such as General Electric, Toyota and Procter & Gamble to other equally outstanding enterprises overshadowed by industry giants, such as software company Adobe (the recognized industry giants being Microsoft and Oracle), pharmaceuticals maker Genentech (the big names being Pfizer and GlaxoSmithKline) and consumer products maker Reckitt Benckiser (the well-known names being Unilever and P&G).

Unlike other performance assessment efforts, which use basic financial measurements such as operating profit, Accenture's study uses a combination of five different metrics to evaluate an enterprise's performance. The result is a more comprehensive and accurate assessment.

We recognize a company as a high performance business only if it has significantly out-performed its industry peers on a series of composite indicators for a number of years. By further studying different enterprises from the same industry using a specific set of indicators, we can assess how various sectors differ in performance.

The Three Building Blocks of High Performance

We have found that the basic characteristics of what we call high performance remain the same across different industries. We envision these characteristics as three building blocks. A high performance business excels in these aspects and constantly adapts to market changes to achieve dynamic growth. The three building blocks are:

• Market focus and position – a clear understanding of competitors, future market conditions and development directions
• Distinctive capabilities – unique approaches to creating and using capabilities
• Performance anatomy – the underlying culture and way of thinking formed during the enterprise's development, which enable it to out-perform its rivals no matter what strategies it follows

Financial Analysis and Screening of HPBs

In assessing a business's performance, we consider five criteria: profitability, growth, positioning for the future, consistency and longevity. We classify a company’s results within its peer group (sector) by means of a standard distribution, on the basis of which we calculate the HPB scores on a 0 to 5 scale. The overall HPB score per company within its peer group is the unweighted average of the score for the five criteria. If a company scores an average of 3.8 or higher in a particular criterion, it is a high performance business in that aspect. Likewise, if a company scores an average of 3.8 or higher on all five criteria, it is a high performance business overall.
Calculating the five criteria

We calculated the five criteria using updated data available from Standard & Poor's at the time of the research.

1. Profitability

Profitability is calculated as the unweighted average spread over the past three or five years.

- Profitability: average spread over the past three years, or average spread over the past five years
- Spread: return on invested capital (ROIC), weighted average cost of capital (WACC)

2. Growth

Revenue growth is calculated as the unweighted compound annual growth rate (CAGR) over the past three and five years.

- Revenue growth = (CAGR for the past 3 years + CAGR for the past 5 years) / 2

3. Positioning for the future

Positioning for the future is calculated on the basis of future value over a period of five years and the change over two periods of time.

- Future value = Enterprise value – Value of current operations

Calculations

- Enterprise value = Market capitalization + Net debt
- Value of current operations = Standardized NOPLAT / WACC
- Standardized NOPLAT = Net operating profit less adjusted taxes
- Beta value of an enterprise is calculated from industry beta value
- WACC = Debt/EV*Ke*Kd*(1-Tr)+Equity/ EV*Ke
- Ke = Rf + Company Beta * Rm
- Company beta = Industry beta * [1 + (1 – Tax rate) * (Total debt/Market value)]

- Level of future value = Average future value for the past 5 years / Average invested capital for the past 5 years
- Change = (Average future value for the past 3 years – Average future value for the past 3 years) / Average invested capital of last year

Definitions

EV: the enterprise value of the company (Debt + Equity)
Kd: Cost of debt
Ke: Cost of equity
Tr: Marginal tax rate (determined by country of operation)

Beta: a systemic securities risk assessment tool for measuring the volatility of an investment security or an investment portfolio relative to the overall market

Rf: Risk free rate
Rm: Market risk bargaining

4. Consistency

Consistency is calculated as the number of years over a five-year period the company has scored in the top median of its own peer group in terms of the performance criteria of growth, profitability and positioning for the future.

5. Longevity

Longevity is calculated on the average of the compound annual growth rate (CAGR) of Total return to shareholders (TRS) during the past three, five, seven and 10 years. TRS is the sum of the share-price increases and dividends.
II. The financial crisis’ impact on the Chinese economy
1. The global crisis hit the Chinese economy hard

Virtually no country has been left unscathed by the global recession. An array of statistical data indicates the damage the financial crisis has inflicted on Chinese enterprises. The country’s rapid economic growth has slowed suddenly. Its GDP growth declined from 13% in 2007 to 9% in 2008, and dropped further to 8.7% in 2009. (See Figure 1.)

Foreign trade remained intact in 2008, but import/export figures shrank in 2009, down 13.9% (11.3% for imports and 16% for exports). (See Figure 2.) According to statistics, machinery and electronic exports alone dropped 21.1% in the first half of 2009, the first decrease in half-year results in 20 years. (Note that the annual growth rate for exports of these categories has averaged 30.9% since 1985.)

Figure 1  China’s GDP growth rate 2004 - 2009


Figure 2  China’s gross imports and exports, 2004 - 2009

Foreign Direct Investment (FDI), which had experienced sustainable growth over the years, saw its first decline in 2009, as the FDI actually used decreased by 2.6% over the same period the previous year. (See Figure 3.)

The stock market fluctuated wildly. The Shanghai Stock Exchange Indices, which stood at about 6,000 points in late October 2007, shed 72% of their value, totaling some 1,700 points in the same period the following year. At the end of 2007, the market capitalization of the Shanghai stock market remained RMB 27 trillion. One year later, it had plummeted to RMB 9.7 trillion, or RMB 17.3 trillion (64%) in losses. (See Figure 4.)
All business sectors felt the financial crunch to varying degrees as both revenues and profitability deteriorated. In the devastated iron and steel industry, demand shrank rapidly, which in turn drove global steel prices down by a big margin. Steel exports have seen number of orders plummet since the fourth quarter of 2008. According to customs data, in January 2009, exports stood at no more than 1.91 million tons, down 53.8% from the same period last year. In February 2009, exports lost a further 62%, decreasing to 1.56 million tons. The China Iron and Steel Association even forecasted a drop of 80% in exports for 2009. The industry has reported losses for four consecutive months since October 2008, with 71 major enterprises’ aggregate losses totaling RMB 48.8 billion.²

Numerous Chinese companies saw their financial results slide. When the crisis first broke out, orders shrank, and many export companies in Guangdong Province cut back on production or shut down. The domestic home appliances industry, which had enjoyed double-digit growth in recent years, also felt the pain. The three major air-conditioning manufacturers—Gree, Midea and Haier—saw their core businesses contract in the first quarter of 2009. Only Gree managed to maintain profit growth for its core businesses. In that quarter, Midea attained RMB 8.8 billion in revenue, a 29% decrease, while net profit dropped 43% to RMB 187 million. Haier experienced a 17% drop in revenue to RMB 6.8 billion, and its net profit was RMB 104 million, a 40% decrease.³

Chinese enterprises at the forefront of globalizing also felt the impact. Lenovo, for example, could not stop its performance and profitability from slumping. For the fiscal year ended March 31, 2009, it saw its largest deficit since its establishment. Financial data put its revenue for the fiscal year at US$14.9 billion, a decrease of 8.9%, with a deficit amounting to US$226 million. These figures knocked Lenovo out of Fortune magazine’s Top 500 in 2009.⁴ Another major globalized enterprise, Baogang Holdings, suffered an almost unimaginable 97.7% decrease in net profit for the first quarter of 2009.⁵

Accenture’s research findings on 206 listed companies reveal that Chinese enterprises’ overall financial results declined from 2008 to the first quarter of 2009 under the onslaught of the financial crisis. (See figures 5 and 6.)

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**Figure 5 Revenue growth (over previous year) 2004-2008, Q1 2009**

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>1Q09/1Q08</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>24.2%</td>
<td>33.8%</td>
<td>30.2%</td>
<td>27.6%</td>
<td>19.2%</td>
<td>-22.9%</td>
</tr>
</tbody>
</table>

Source: Listed companies’ annual reports, Accenture analysis, 2009

**Figure 6 Net profit growth (over previous year), 2004-2008, Q1 2009**

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>1Q09/1Q08</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>20.9%</td>
<td>23.0%</td>
<td>20.8%</td>
<td>21.3%</td>
<td>-43.0%</td>
<td>-32.3%</td>
</tr>
</tbody>
</table>

Source: Listed companies’ annual reports, Accenture analysis, 2009
Meanwhile, of the 206 enterprises that responded to our survey, 35% revealed that the financial crisis had no impact or a minor impact on them. The remaining 65% reported a medium or above impact, 11% of which indicated a very significant/significant impact. (See Figure 7.) The impact manifested itself as lowered consumer demand and intensified competition. (See Figure 8.)

2. The crisis has delivered an unprecedented psychological shock to Chinese enterprises

The market conditions up to the end of 2009 show that the crisis dealt a lesser blow to China than to other markets, and affected Chinese businesses in different ways. China will likely emerge from the recession more quickly than other economies. Nevertheless, the crisis has dealt a severe psychological shock to Chinese enterprises.

The subprime credit crash in the U.S. triggered the meltdown of the credit market and led to exorbitant losses in the financial system, estimated at US$3 trillion. The catastrophe not only ruined investment and consumer confidence but rippled through some already ailing economies and set off a financial tsunami.

As the crisis originated outside China, in some sense the country was a victim of the catastrophe. The impact manifested itself as a sudden fall in demand for Chinese goods. As a result, Chinese businesses could not sustain production, which triggered closures and unemployment (especially in the manufacturing industry). Dwindling commercial activity worldwide also hampered consumption by domestic consumers (China’s service sector). Cross-border investments reported losses as well (the financial sector).

Different markets around the world experienced the crisis in different ways. Although emerging markets such as China, India and Brazil could not avoid the pain, they felt less of it owing to their unique patterns of economic development. Specifically:

- They had new economic structures which is not so closely related to the developed economies thanks to increased South-South trade and investments.
- They were less affected by Western financial disturbances because they had opened their financial sectors prudently.
- They relied less on exports than many observers believed. For example, in Brazil and India, exports represent less than 15% of GDP. Although China’s exports accounted for 34% of its GDP for 2008, they mainly involved low value-added processing.
- Their enormous domestic demand absorbed the excess production capacity resulting from overseas markets’ weak demand.
Their exports were highly diversified, ranging from apparel and low-priced electronic consumer goods to machinery, ships, petrochemical products, iron and steel and services. Based on the estimate of IMF, the world GDP in 2010 expects to grow by 4.2%. While emerging and developing economies are expected to grow by 6.3%, the advanced economies are estimate to grow by 2.3%. Emerging Asian markets will reputedly experience a 5% GDP growth in 2009 while G7 countries may suffer a fall of 3.5%.

Although China’s GDP growth fell in 2009, at 8.7% that growth still led the world. Meanwhile, the Chinese government’s RMB 4 trillion economic stimulus package is paying off. Many of the companies surveyed by Accenture perceived the impact of the crisis as transitory and limited because they had done more than merely survive it. For 75% of our respondents, demand was recovering and the overall environment was improving. (See Figure 9.) China may recuperate from the crisis before developed countries do. However, Chinese enterprises, especially high performers, should not be content with merely getting out of the financial storm.

In fact, the impact of the global recession on China’s economy and enterprises largely remains ideological and conceptual. Before the crisis, mature Western markets had always served as role models for Chinese enterprises in terms of management philosophy and leading firms’ experiences and practices. As such, they inspired their Chinese counterparts to catch up. But then the ailing mentors collapsed, leaving Chinese enterprises perplexed and wary. Chinese executives wondered, Should we integrate into the global business framework? Will the financial and capital markets open up further? Is a free-market economy still competitive? Is the Western management philosophy still worth learning and emulating? Can we still draw on multinational corporations’ experiences and practices? Are financial innovations still viable?

![Graph showing the percentage of respondents who noticed any upswing in the wake of the financial crisis and in what aspects.](image-url)

Source: Accenture survey, 2009
This is the third year Accenture has conducted the High Performance Business in China study. In the two previous studies, we focused on applying in China the theoretical frameworks and methodologies of Accenture HPB research. After analyzing the differences in performance between Chinese enterprises and their foreign counterparts, we made recommendations for how they could achieve and maintain superior performance. In this year’s research, we shifted our focus to analyzing the impact of the global economic crisis on China and the countermeasures Chinese enterprises used to achieve excellence in different stages of the economic cycle. We hope our findings will serve as a reference for Chinese enterprises as they continue to mature and globalize during the recovery.

After three consecutive years of study, we are confident that Accenture’s HPB research is applicable in China. The HPBs we have studied have demonstrated consistency. Specifically:

- In each of the three years, the proportion of HPBs in the total sample remained stable.
- Despite minor changes owing to the inclusion of newly qualified companies and a small portion of privatised enterprises, over 80% of HPBs were able to maintain their high performance status in the following year of each study.

This year’s HPB research comprises the following components:

### Financial analysis and HPB screening

Drawing on the financial analysis in Accenture’s HPB global research, we evaluated the performance of Chinese enterprises. This year, we identified 30 Chinese HPBs after assessing 206 listed companies across 14 industries.

### Questionnaire

The 34 questions included in this year’s HPB study covered the following areas:

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

We received 107 valid, completed questionnaires representing 14 industries.

### Case studies

To paint a full picture of Chinese enterprises’ quest for excellence, the cases in this report are not confined to enterprises covered in our financial analysis and surveys. The reasons for this are as follows:

- Given the short history of China’s capital market, many outstanding enterprises have not yet been listed.
- Some industries that play a pivotal role in the China market were not included in the financial analysis because our global study has not yet examined those industries.
- Although some enterprises do not qualify as HPBs in terms of overall performance, their outstanding performance in a particular area serve as a good reference and will be mentioned in relevant chapters of this report.

### Interviews with corporate leaders

To further substantiate the research, we conducted in-depth interviews with selected senior executives of Chinese companies identified as HPBs this year and of some influential non-listed companies that demonstrated outstanding performance in coping with the financial crisis.
III. High performance businesses stand firm in the tidal wave
Unlike the HPB research Accenture conducted in the previous two years (which showed no obvious signs of crisis, in China or elsewhere), our current high performance study was conducted in the context of the worldwide downturn. Inevitably, we focused more on how Chinese enterprises achieved and sustained high performance in the face of hardship, learned lessons from the crisis, enhanced their capabilities, helped reshape the competitive landscape and gained a strong foothold among the world’s best businesses as the financial tsunami subsided.

Do HPBs still exist in China? The answer is a decided “yes.” We surveyed and analyzed the financial data of 206 responding companies for the period until the first quarter of 2009. The findings suggest that 30 of these enterprises across 14 industries outperformed their peers in terms of the primary metrics for high performance. These numbers reveal high performance businesses’ viability and resilience in the face of hardship.

Our analysis suggests that high performance businesses’ 2008 revenue growth remained at the same level as in previous years. Entering the first quarter of 2009, however, their revenues decreased by 11.3% over the previous year. Average and low performers bore the brunt of the crisis in 2008, with their revenue growth rates declining 24% and 21.8%, respectively. (See Figure 10.) The same happened to profit-growth metrics. While high performers experienced positive (albeit diminishing) growth in 2008, low performers already suffered negative growth in that same year. (See Figure 11.)

Undoubtedly, high performance businesses possess greater sustainability and vitality than low or medium performers. Since the inception in 2007 of Accenture’s high performance business research in China, we have identified 42 companies as high performers. Of these, 15 have earned the name for three consecutive years, 16 for 2 years and the remaining 11 for one year. Of those receiving the honor in 2007, 85% (22 enterprises) successfully carried the name over to the next year. For those short-listed in 2008, 75% (24 companies) came to hold the name in the following year. (Note: Owing to constraints imposed by our methodology, we confined our research to enterprises across 14 industries that have been publically listed for at least 5 years with 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. As the Chinese economy develops further, we envision our research expanding to encompass a broader range of enterprises.)

Sources: Listed companies’ annual reports, Accenture analysis, 2009
IV. How do high performance businesses cope with crisis?
1. Multinational corporations have extensive experience dealing with crisis

This is the first time since China’s integration into the global economy that its own economy has been jolted so heavily. However, the current worldwide downturn is part of a longer-term cycle. Western developed markets are more accustomed to the cycle of crisis and recovery and thus have accumulated a wealth of experience in coping with downturns. Through Accenture’s research on multinational companies, we have identified three major coping strategies that high performance businesses employ: i) survival, ii) repositioning, and iii) growth.

i) Survival

The survival strategy comprises short-term initiatives that aim to sustain a company’s continued operations until conditions improve. These initiatives include cost reductions, cutbacks on unnecessary expenses, liquidation of assets and renegotiation of debt terms and pension obligations. For example:

- Deleveraging and restructuring of debt: For companies facing actual or potential cash-flow shortages, deleveraging and restructuring of debt is a top priority. To improve cash flows, many companies reduce or suspend dividends. Despite potential shareholder opposition, such moves are better than waiting passively for share prices to drop during the debt crisis.

- Cutting costs while increasing cash: Improving cash flows from operations is a critical component of survival. Different industries and companies have different ways to improve cash flows. Nevertheless, some common tactics worth exploring include cutting certain overhead expenses (such as travel), controlling procurement costs, strengthening management of receivables and using sophisticated pricing strategies to maximize returns from existing customers.

- Renegotiating pension obligations: Pension crises follow on the heels of share-price declines, which for some companies may mean a 50%-60% surge in pension obligations. To cope with the risk, enterprises may need to take swift measures such as readjusting benefit programs for new employees, reducing the proportion of corporate contributions and raising the retirement age.

ii) Repositioning

The repositioning strategy applies mainly to companies that have a healthy balance sheet. They may have suffered a decline in revenue but not serious damage. They can seek opportunities to reposition themselves, adopting tactics such as innovation, selective acquisitions, workforce enhancement and sustainable development. For instance:

- Designing future business models: Cutting costs indiscriminately may pose considerable risk if it impairs capacities critical for a company’s future success and prevents it from responding flexibly to changes in market conditions. To minimize such risk, executives should arrive at consensus on answers to the following questions:
  - What are the sources of our future growth? Do we need to drive growth through mergers and acquisitions?
  - On what will our future organizational structure be based: products, geographic areas or business processes?
  - What core capabilities are essential for our success? Where are we falling short in our core capabilities? How can we make up for those shortfalls?
  - Which business activities can be shared across our different business units, and which do we need to implement separately?
  - Which activities must be done in-house? Which can we outsource to business partners?

- Sustaining innovation: Accenture’s HPB research suggests that high performance businesses insist on investing in innovative products and services even in times of economic recession to facilitate their adaptation to a changing environment. During an economic downturn, the purchasing habits of consumers and corporate customers will change. Innovative offerings provide greater value to them and enable enterprises to improve their market position.

- Seizing merger/acquisition opportunities: Crises present merger/acquisition opportunities for companies with sufficient cash reserves or financing abilities. However, to seize M&A opportunities in times of crisis, executives must have a clear idea of what kinds of assets their enterprise should purchase and what synergies can be achieved through M&A moves. Only then can their organization be prepared to maximize the benefits offered by these activities.

- Building up a talented team: An economic downturn presents an opportunity for companies to readjust and enhance their human resources to gear up for future operations. Recruitment may be a somewhat sensitive issue and may need to be handled judiciously; however, this may be a good time to invest in new skills.

- Deploying sustainable development tactics: Sustainable development means doing business with an eye toward environmental and social responsibility while reducing costs and controlling risks. In Europe, a new business operating environment is taking shape as the EU and individual countries implement regulations in response to climate change. For example, the British government’s forthcoming plan for reducing carbon emission in the next five years will affect as many as 5,000 companies. Such companies will have to weigh the consequences of the regulation when formulating their business strategy.

iii) Growth

The growth strategy is based on the following assumption: The industry consolidation characterizing the past few years still has momentum. Large-scale mergers and acquisitions remain an attractive source of future growth, with their economies of scale, geographic expansion and guarantee of maximum benefits from acquired resources. During an economic recession, competition for certain attractive assets may ease, owing to the sluggishness of the private equity market and cash-flow difficulties faced by many businesses. Enterprises with good financing capacity should pursue M&A opportunities to secure a leading market position for the future.

Take DuPont. Executives had a premonition in October 2008 that a crisis was looming which would lead to market disturbances. In gathering market information, CEO Ellen Kullman became aware of two changes. First, Wilmington, Delaware, where DuPont is headquartered, saw a 30% jump in hotel vacancy rates...
over 10 days. Because many large corporations are headquartered in Wilmington, a sudden increase in vacancy rates means a sharp decline in their businesses. Second, DuPont’s automotive paint orders dropped by a large margin. (Note that 30% of the vehicles in the U.S. use DuPont paint, and car makers usually keep only two days of stock.) Alarmed, management convened an urgent meeting and arrived at two decisions: (1) Control expenditures and strive to preserve cash reserves and open up credit resources for rainy days, and (2) call on middle management to begin preparing for the worst. The company took additional swift action as well, such as canceling international conferences and suspending external consulting projects and third-party service contracts. Within 10 days, all 60,000 DuPont employees had talked with their supervisors face-to-face about the situation and had put forward cost-saving recommendations. Meanwhile, the CEO, CFO and COO discussed concrete measures with the company’s 14 most senior executives and unanimously agreed on two points: preparedness for long-term difficulties and immediate implementation of all measures adopted. Thanks to its ability to recognize and respond quickly to red flags, DuPont remained sound during the crisis.8

2. Management holds the key to weathering a crisis

The financial crisis is attributable mainly to imbalances present in the global economy; specifically, the high levels of consumption in developed countries versus the high savings rates in developing countries, and excessive liquidity and cheap capital in the U.S. market. Unchecked consumption and high leverage triggered the credit crisis, which crippled the global economy. The equilibrium of the global economic structure must be restored to correct the situation for the long term.

While the aforementioned imbalances are definitely a cause for concern, we should not neglect the microeconomic factors also at play.11 Mr. Zhou Xiaochuan, Governor of the People’s Bank of China, told us that such factors, centered on Wall Street, played a crucial role in provoking the crisis. These factors included lax credit policies, excessive leverage, superfluous development of derivatives, chaotic design and sale of securitized assets, questionable ethics of credit rating agencies and loose governance of companies. These problems have brought to light the dangers of insufficient monitoring of financial-system players.

Microeconomic factors to a large extent emerge from management decisions and practices. Indeed, management professor Henry Mintzberg holds that the current crisis is one of management rather than of economic or financial malfeasance. We can identify two ways in which managers erred: (1) They neglected the long-term impact of their decisions and their organization’s well-being while pursuing short-term goals motivated by a desire for attractive bonuses. (2) They alienated themselves from daily operations and hence failed to see important developments unfolding at the lower levels of the corporate hierarchy.12
It is widely known that American auto giant General Motors, running beyond its means, has entered Chapter 11 bankruptcy protection and has relied on the federal government’s financial assistance for survival. The company is now negotiating with various stakeholders to work out debt-restructuring deals and is seeking buyers for assets under its selling plan. In contrast, the second industry leader, Ford Motor Company, neither requested a penny from the government nor teetered on the verge of bankruptcy. In June 2009, GM sustained a 33% fall in motor-vehicle sales (over the same period of the previous year), while Ford saw only an 11% decrease. GM’s management is now subject to orders from its new major shareholder—the federal government—while no such trouble has come to Ford’s management and shareholders. How is it that these two companies, both located in the automotive industry haven of Detroit, have fared so differently?

Ford Motor Company
Ford had the full support of stable, united family shareholders.

The Ford family holds 40% of voting rights through ownership of the company’s special shares. Family members have been holding quarterly meetings to discuss operational issues over the last 20 years, since Henry Ford II passed away in 1987. With attendance now up to 35, the meetings have all communication channels open. Once they reach a resolution, they expect firm support from everyone. In 2007, some family members moved to hire a Wall Street investment company to plan long-term strategies for the business, including exploring the possibility of merging with other companies and selling shares. The motion was vetoed and was never brought up again. Family members provide not only financial but also emotional support. Besides Chairman Bill Ford, there are four other members who are full-time paid staff. The unwavering support from family shareholders provides a stabilizing influence that GM lacks.

What else have family shareholders done apart from conducting quarterly meetings? In 2001, in light of the company’s unsatisfactory performance, family shareholders decided to dismiss then-CEO Jacques Nasser and replace him with Bill Ford, who had been Chairman for two years.

In 2006, Ford faced another bout of operational difficulty worse than that of GM. At Bill Ford’s suggestion, family shareholders adopted two risky measures.

First, in an unconventional move, Ford appointed a CEO from outside the automotive industry. This was the first time in its history that the company had done this. Alan R. Mulally from Boeing was hired to succeed Bill Ford. Second, the company put all its assets on mortgages to secure US$23 billion in loans. This move enabled Ford to avoid a cash crisis and remain independent, while GM and Chrysler were forced to file for bankruptcy protection owing to depletion of their cash.

When Mulally took office, he had a different business vision from Nasser’s. He streamlined the highly extensive and complicated business lines developed by his predecessor and raised massive loans to support structural reform. To persuade banks to lend to Ford, the company rescinded dividends, making family shareholders forfeit incomes amounting to millions of dollars each year. Since then, with simplified operations worldwide, Ford has begun making inroads into the production of small, energy-saving cars.

In August 2009, Ford announced plans to replace or improve 90% of the car models sold in North America and elsewhere by 2012. By 2014, the company will complete the first cycle and be halfway through the second cycle of the introduction of new car models—at a much faster pace than in its previous introduction of new models. (Usually, it takes automakers four to five years to introduce new models.)

The rapid introduction of a series of new car models enhanced Ford’s sales volume. In July 2009, the company realized sales growth for the first time in two years. Since the Fusion model was launched in the spring, its sales grew 27% in August 2009 over the previous period. In contrast, sales of mid-sized sedans saw an overall decrease of 24% amid fierce competition.
The value of the 70.1 million special shares granting family shareholders voting rights fell to an all-time low of US$140 million in January 2009, compared with its value of US$2.2 billion 10 years ago. Ford still suffered a US$1.4 billion loss in the first quarter of 2009. Under industry-wide sales declines, sources of income were not guaranteed, while cash reserves also shrank. However, Ford family members denied losing confidence and hope, and they said they had not felt forced to sell their shares.9

General Motors

General Motors’ predicament has catalyzed discussion in academia and media in China and abroad, much of it focusing on the struggle between the company and its trade union. We choose to look at the company from a managerial point of view, drawing from an insightful analytical framework developed by Dr. Ichak Adizes (CEO of the Adizes Institute).

According to this framework, GM’s bankruptcy has stemmed from the loss of the company’s entrepreneurial spirit. When this happens, companies tend to look inward, placing more emphasis on internal affairs than on the external market. Over time, sales decline. In extreme circumstances, such as the credit crunch, companies can go bankrupt.

But what caused GM to lose its entrepreneurial spirit? We identified the following factors:

1. GM has been an unrivalled market leader for the last 20 to 30 years. Feeling satisfied with its market share and its position as a market leader, GM grew complacent.

2. GM’s insistence on centralized management confined its leaders to an “ivory tower,” where they remained immersed in bureaucracy rather than in entrepreneurial vitality. They began relying heavily on numerical data to manage the company, neglecting other types of equally important information such as customer feedback and new market trend in product development.

3. Except for Robert Stempel, GM’s previous five CEOs all came from a financial accounting background. Managers from such a background tend to fix their eyes on the dashboard rather than the road ahead. To foster a culture that encourages entrepreneurship, a company needs a leader with an innovative spirit and a vision that impels people to continue extending the enterprise’s boundaries. GM has lacked such a leader.

4. At GM, leaders have “an aged mind.” What they desire is what they expect to get. So they question the need for reform.

These four factors cost GM its entrepreneurial spirit.
In every enterprise, it is the daily activities, management actions and management decisions that combine to collectively shape larger economic trends. Management is the foundation here. Only when companies commit to improving their management to boost performance will the overall economy return to healthy growth and develop the resilience to stave off future crises.

Some enterprises fared far better than others amid the financial crisis because they had put in place three managerial building blocks for high performance identified by Accenture: a clear market focus and position, concentration on developing their own distinctive capabilities and solid performance anatomy (that is, a mindset and corporate culture conducive to achieving high performance). Bearing these in mind, we undertook the current HPB research with the goal of shedding light on how high performing enterprises view the current crisis and long-term development opportunities and how they balance short-term survival with the need for long-term development. Moreover, we looked for evidence of how these enterprises continually improve their management practices to leave crises behind.

3. Chinese HPBs take proactive measures to counter short-term effects of downturns

Let us look now at how Chinese HPBs deal with the impacts of a crisis. Our research found that these high performing businesses manage to excel in the face of adversity because of their strong risk awareness and prompt responses to crises. Once the signs of a risk emerge, they take immediate measures to ensure short-term survival while striving to minimize the imminent impact of the situation. Their best approaches to combating crises lie in strict management, particularly of risk. In our research, we identified four characteristics of such management: i) Focus, ii) Flexibility and speed, iii) Rapid and sustained cost reduction, and iv) Cash and financial flexibility.

i) Focus

During an interview with a senior executive in the financial sector, our interviewee commented on how an enterprise should cope with a financial crisis. In his view, what really counts is not what the enterprise does during a crisis, but rather what it does in normal times. If it does its "homework" properly in normal times, it will be able to weather the financial storm. As the crisis loomed, our respondent's company stayed focused and just fine-tuned its operations without changing its established strategic direction. For example, the iron and steel industry was one of the hardest hit during the crisis. Our interviewee's company reduced loans to enterprises in this industry. When the central government issued a RMB 4 trillion economic stimulus package to drive local governments' financing needs, the company increased the business volume of government financing accordingly. An enterprise with a clear set of strategies in place can stay composed when a storm strikes. In addition, it focuses its effort not on "filling holes" but on proactively detecting risks. Its strategies are shaped by top-down consensus reached after repeated discussions and deliberations. It embraces challenges with foresight and vision.13

Another executive in the beverage industry remarked that struggling for survival had always been central to the life of her company. Dealing with mini-crises in normal times helped the management team tackle bigger crises with confidence.

So the current financial crisis did not take Chinese HPBs by surprise; instead, it placed higher requirements on them. They faced the test of withstanding a larger impact and identifying aspects of their business that needed strengthening.14

Some took pre-emptive measures against the crisis a few months before it came. Tsingtao Brewery is an apt example. The company first strengthened cash-flow management as early as three years ago, an effort that came in handy during the downturn. It also refined its marketing initiatives to beef up its profits. For instance, by using marketing opportunities presented by the Olympics, it strengthened sales, achieving double-digit profit growth. In addition, it augmented inventory management with selling of non-liquid assets, and dispensed with non-operating assets. In September 2007, the management team took advantage of the bullish stock market by converting 0.5% of its stake into convertible debt and raised RMB 1.5 billion at a low interest rate of 0.8%. This move enabled Tsingtao Brewery to survive the financial winter safely at low cost.15

The lesson? Makeshift tactics deployed in a panic are not feasible. Instead, companies must strive for ongoing excellence and continual use of good management practices. Such practices taken by HPBs to contain the impact of the crisis include anticipating and responding to risks, responding swiftly to those risks, committing to staying on course and focusing sharply on core competencies.

Focus on core businesses inevitably raises the controversial question of how much an organization should specialize versus how much it should diversify. There is no clear-cut answer to this question. An organization’s decision depends on a number of factors, including the industry in which the enterprise operates, its stage of development and its scale of operations. Accenture’s research reveals that HPBs are either specialized or relatively diversified. However, regardless of where they stand on the specialization-diversification spectrum, they sharply differentiate between their core and non-core businesses. Gree Electric Appliance, for example, specializes in the production and marketing of air-conditioners. But air-conditioning can be differentiated into market segments such as consumer versus commercial, hanging versus tank, high-power versus low-power, inverter versus non-inverter, and so forth. Gree’s senior management, strategic planners and operational leaders know the answers to questions such as which mature products bring in the most cash flow for the company, which products will likely become mainstream products over the next few years and which products can become long-term reserves. In a nutshell, they are keenly aware of the difference between Gree’s core and non-core businesses.
During times of economic growth, enterprises have enough resources to manage both core and non-core businesses. But when a crisis strikes and demand dwindles, a company may need to focus on its core businesses and divest non-core ones through selling, downsizing or ceasing production. This enables it to concentrate resources on its core businesses. For instance, under the pressure of the crisis, Wuhan Iron and Steel Company (WISCO) suspended all projects not directly related to iron and steel production. At the same time, it shut off two blast furnaces, cutting production by more than 20%. It focused on producing only marketable products. Likewise, China Life Insurance withdrew from the market of high-risk investment products such as universal insurance and investment-linked products and focused on relatively stable dividend-based and traditional products. Trimming its investment products helped it reduce losses by lowering risks. The company incurred a loss of RMB 12.8 billion in 2008. However, after refocusing on dividend-type and traditional products, it chalked up a net profit of RMB 5.387 billion in the first quarter of 2009 (up 55% over the same period in the previous year), a 3.7% rate of return on net assets (up 61.6% from the previous period) and RMB 1.07 trillion in total assets (an increase of 7.84%).

Core businesses have their core customers, who have core needs. Focusing on core businesses amounts to meeting those customers’ needs. (See Figure 12.) During a crisis, core customers may have special needs in terms of financial assistance, product functions and quality or special requirements on delivery time and methods. Companies should listen even more carefully to these needs and, if necessary, channel resources toward meeting those needs.

“Specialization of course carries risks and pressure. If anything goes wrong in the air conditioning industry, it will definitely lead to Gree’s collapse. But if we burn our bridge behind us, we may be able to ‘purchase resurrection.’ Therefore, returning to their focus, their own advantages, and their core business is the best way for Chinese enterprises to [avoid this] plight.”

– Dong Mingzhu, CEO of Zhuhai Gree Electric Appliance.

ii) Flexibility and speed

By flexibility and speed, we mean executives’ ability to anticipate a crisis and take precautions before any major impact strikes. Precautions may include speedy actions that are unconventional but that minimize the impact. To demonstrate flexibility and speed, a leader must be visionary, bold and highly proficient in management.

“China Merchants Bank’s unique core competence is reflected in our motto ‘We change because of you.’ Our management framework, service levels and culture change as customers’ needs change.”

– Zhang Guanghua, Vice President of China Merchants Bank.

Flexibility and speed take the form of changes in strategies, operations, structures and personnel. Executives must consider matters such as current investments, product lines, geographic locations, alliances and strategic priorities. Operational changes should center on management styles, departmental functions, personnel hierarchy and training.

Figure 12 Currently, the most important strategy in your company is:

<table>
<thead>
<tr>
<th>Focuses of different performers</th>
<th>All</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reinforce the loyalty of most valuable customers</td>
<td>48%</td>
<td>57%</td>
<td>46%</td>
<td>47%</td>
</tr>
<tr>
<td>Expand customer base</td>
<td>42%</td>
<td>33%</td>
<td>46%</td>
<td>41%</td>
</tr>
<tr>
<td>Disinvestment on customer to get liquid</td>
<td>3%</td>
<td>5%</td>
<td>3%</td>
<td>12%</td>
</tr>
<tr>
<td>Others</td>
<td>6%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Accenture survey 2009
Market orientation, a sense of urgency and risk awareness are deeply rooted in the culture of China Merchants Bank. As early as 2004, the bank made a series of strategic readjustments including concentrating on developing its retail business, intermediary business and SME loans; raising the proportion of retail banking to 50%; modifying debt structure and income structure by increasing non-interest income from intermediary business; increasing the ratio of small customers and strengthening services to SMEs; and optimizing the balance sheet and raising the proportion of quality long-term loans. China Merchants Bank’s business strategies took shape after a critical two-year period of deliberation. This deliberation played a pivotal role in the company’s rapid development in the next five years and helped it lay a solid foundation for weathering the crisis.

In the worst part of the recession, except for decreased demand for credit, demand for other consumer businesses maintained momentum. China Merchants Bank’s strategic realignment in 2004 enabled it to stand the test of the crisis.

“Earlier, better, faster” is the bank’s philosophy. Its retail business has been doing well because the bank is good at discerning the opportunities within new developments. Once it identifies such opportunities, it takes action promptly. As early as 10 years ago, the bank began to pay attention to trends in the industry’s retail business and launched an innovative bank-card system. It became the first bank to provide remote-access services and transformed the domestic personal retail business. In the first half of 2008, it issued more than 40 million credit cards, with an average card balance 2.5 times the national average. With only 39 outlets in Shanghai, the bank attracts more deposits than some much larger banks headquartered in Shanghai. Accurate positioning and excellent product lines have made retail a premier business of the bank. Six years ago, when China Merchants Bank developed China’s first standard credit cards, it established its own brand, even declining Citibank’s offer for a joint card project. By providing such innovative services, the bank has succeeded in softening Chinese consumers’ resistance to buying on credit. Today, China Merchants Bank credit cards command 30% of the Chinese credit-card market. Over 30% of its credit-card customers use revolving credit.

The bank’s revenue from intermediary business has maintained an upward curve, despite intensified competition in the credit market arising from macroeconomic decline, accelerated inroads by foreign banks and declining interest spreads. In recent years, the bank has undertaken notes underwriting, fund custody and other intermediary businesses—fostering greater profitability and a strong immunity to crises. In early 2009, its Shenzhen Branch successfully underwrote 2.5 billion notes for China Merchants Group.

In December 2008, China Merchants Bank had also established China’s first small to medium enterprise (SME) credit center in Suzhou. The center specializes in providing financing to SMEs across the whole country. The bank uses a detailed screening process to identify qualified SMEs. At present, loans to SMEs account for 44% of the balance of the bank’s total loans, with loans granted reaching RMB 1.6 billion (with interest rates up to 20% above standard rates). The bank has not only created a new wellspring for its own profit growth, but it has also helped solve the financing difficulties facing many SMEs.
To react rapidly and flexibly, a leader needs to have foresight even when a crisis may lie in the distant future. He or she should also ensure that the organization has risk management and control systems in place, so any signs of risks will trigger an early warning mechanism. The leader must also be certain that managers throughout the company have ways to sense changes in the market and in the enterprise’s daily operations. Only then will they feel a sense of responsibility for anticipating and responding to crises. Finally, a leader should understand that flexibility reflects the company’s entrepreneurial spirit—it’s willingness to venture into new realms and make the changes called for by new challenges.

After the financial crisis broke out, China’s iron and steel industry was the first to stumble, as prices for steel products, especially high end, plummeted owing to shrinking demand. Because high-end products have always been WISCO’s niche market, the company felt the crunch acutely. Its management team made some proactive changes to extend the company’s niche position from international and domestic high-end markets to the medium to low-end markets in Hubei Province. Executives also decided to sacrifice some profit margin for market positioning.21 Enterprises that show an inflexible or sluggish response suffer losses. For instance, a domestic computer manufacturer ignored the euro exchange rate risks under the financial turmoil and thus made inappropriate bidding strategies. Moreover, it dragged its feet in changing the exterior design of its notebook computers, and it failed to manage its monitor division effectively. It finally made emergency readjustments in November 2008. But this response came too late. The company was saddled with excess inventory of panels and other components, which took some time to digest.

iii) Rapid and sustained cost reduction

A direct consequence of any economic downturn is lowered income levels. Companies that fail to reduce expenses to offset the decreases in income may suffer cash flow problems or even end up in bankruptcy. As income levels tend not to rise in the short time during the crisis, enterprises should cut expenses to reduce costs.

Cost reduction is an obvious solution because it promises immediate results. But the challenge is to reduce costs without undermining a company’s future development. Businesses must aim for sustainable cost reduction—decreases in expenses that align with corporate strategic goals. The following practices can help:

• **Reduce non-essential expenditures.** Minimize expenses not related to core businesses, innovation or long-term strategic reserves—whether such expenses take forms such as investments, advertising, office supplies, travel or meetings.

• **Reduce staff costs.** Cut or freeze salaries, reduce work hours and consider paid leaves or layoffs. For example, in August 2009, Lenovo announced its plan to shed 2,500 staff from its operations worldwide, representing 11% of its total workforce, while trimming senior management’s salaries and benefits by 30%-50%. In addition, the company merged its Asia-Pacific and Greater China divisions to reduce administrative costs.22 Reduce staff costs prudently, especially when it comes to layoffs. Inappropriate handling of a layoff will backfire. According to Accenture’s research, the 20 U.S. enterprises that had massive layoffs between 1996 and 2001 recorded shareholder returns inferior to the average figure of Standard & Poor’s 500.23

• **Reduce procurement costs.** Controlling procurement costs is an important source of efficiency, especially for companies using commodities as raw materials. Optimal use of raw materials, improved technology and management processes, centralized purchasing, long-term supply contracts, investment in upstream shares, optimal logistics, outsourcing, proximity to raw-materials sources—these and other practices can help a company dramatically decrease its procurement costs. WISCO is a good case in point. (See case study.)

• **Improve business processes.** Network operating costs account for 5% of many companies’ revenues. For IT-intensive enterprises (such as financial services companies), the percentage is even higher. Through short-term process-improvement tactics (such as integrating suppliers and reducing billing errors) and long-term process improvements (including automation and outsourcing), companies can substantially reduce their network operating costs. Consider Yantai Wanhua Polyurethanes. By adopting new project management systems, the company reduced project expenditures.24 In 2009, China National Offshore Oil Company (CNOOC) reduced costs in three areas: oilfield services and facilities, employee incentive programs and application of technological innovations. For example, it actively promoted regional development among qualified oil and gas fields to enable sharing of production facilities, which reduces drilling costs. At the same time, it further improved and refined its management practices, which lowered internal management costs.25

The point we want to emphasize is that companies should strive for “sustainable” (non-detrimental) cost reduction, which enhances long-term competitiveness while ensuring short-term survival. Sustainable cost reductions support a business’s long-term strategic goals. In considering ways to decrease costs, executives should avoid sacrificing R&D, innovation and future competitive power. Indiscriminate cost-cutting weakens the functions critical to the enterprise’s future or strips it of the flexibility needed to cope with or adapt to market changes. For core businesses on which the enterprise’s fate and core customers’ needs depend, companies should not only avoid slashing costs in those businesses; they may even want to allocate more resources to them.
The costs of iron ore, coke and other bulk raw materials have spiraled up since 2008, raising operations costs for China’s iron and steel industry. Wuhan Iron and Steel Co. responded by cutting its internal costs, from mining to transportation to refining, to ease the impact of falling steel prices.

Reducing ore costs:
Since imports account for 85% of WISCO’s ore demand, its procurement costs are much higher than that of its peers such as Baoshan Iron and Steel. Shortages of mineral resources put severe constraints on WISCO. As a countermeasure, the company invested in Enshi Mine, which has verified reserves of iron ore totaling 1.29 billion tons, including 650 million tons of industrial reserves, or 50.9% of the total.

Taking advantage of the declining overseas mining industry, WISCO also made three acquisitions of overseas mines to further safeguard its ore supply and reduce mineral costs. Specifically, it acquired a 50% stake in an Australian iron mine from Centre Metals for AUD 180 million in December 2008. It acquired shares in the Canadian mining firm Consolidated Thompson for US $240 million in April 2009, thus becoming the latter’s largest shareholder. And it participated in the company’s operations in the Bloom Lake mine in Australia, becoming the second largest shareholder of Australian WPG. It also took part in joint development of a mine in the central part of southern Australia. In the first half of 2009 alone, WISCO reduced costs by RMB 670 million through quality purchases at prices close to market lows.

WISCO then invested RMB 2.1 billion in Pingdingshan Coal Group and participated in the Group’s construction of a newly developed coal mine to jointly build a coal reserve center with a capacity of tens of million tons. The joint-venture will ensure a steady supply of coke with a unit price RMB 200 lower than market price, resulting in approximately RMB 600 million in cost savings.

Reducing logistics costs:
Qingshan, where WISCO is based, is far from China’s coast. As a result, WISCO has endured high transportation costs for many years. But by setting up a base in the Fangchenggang Port of Guangxi Zhuang Autonomous Region, the company will lower its iron-ore transportation costs by an estimated US $20 per ton of crude steel, which translates into annual savings of over RMB 1 billion.

To further reduce transportation costs, WISCO and China Ocean Shipping (Group) Company (COSCO) reached an agreement to jointly explore and expand strategic cooperation in ore transportation, steel exports, domestic logistics, port construction and uses of steel.

Improving the smelting process:
Smelting accounts for 50%-55% of the costs for WISCO’s entire steel production process. By reducing its furnace coke usage by process improvement from January to May 2009, the company decreased its average monthly blast furnace coke, resulting in RMB 63.7 million in cost efficiency for the period. Meanwhile, WISCO developed a proprietary technology that enabled it to use coal tar residue in its coke production.

This not only reduced costs by RMB 500-700 per ton of coke but also enabled WISCO to recycle waste and extract energy from it. In the first quarter of 2009, the company recycled more than 2,200 tons of tar residue (800 tons for March alone).

Through across-the-board cost controls, WISCO registered steel sales of 5.49 million tons in the first six months of 2009. These sales generated revenues of RMB 22.4 billion, with a production/sales ratio of 1.0 and a strategic direct supply rate of over 80%. Customer satisfaction stood above 92%. WISCO bested domestic listed companies in the same industry in terms of half-yearly profits.
Our survey results suggest that during the crisis, most Chinese companies gave top priority to lowering sales and administrative expenses, financing costs and other capital expenditures, while not making significant cuts in salaries, R&D and talent development expenditures. This shows that Chinese enterprises are becoming mature; in particular, that they are keeping strategy in mind while making cost reductions. (See Figures 13 and 14.)

iv) Cash and financial flexibility

In a recession, "cash is king," as the saying goes. Robust cash flows provide the safest protection for any company. Take Lenovo. According to Mr. Huang Weiming, CFO, the company strived to increase its cash flows during the current economic downturn more than in other times. He pointed out that cash flow is just as crucial for a company’s survival as blood is to a person’s survival. More important, healthy cash flows enable an enterprise to gain needed capabilities and other assets (for reasonable prices) through mergers and acquisitions. Lenovo accumulated net cash reserves of US$1.5 billion for the second quarter of 2008.

Cash comes from four major sources, the first of which is an enterprise’s reserves. If a company is financially conservative (it retains a certain level of cash and liquid assets), chances are that it will be better positioned to survive the crisis. For instance, Hong Kong–based Hutchison Whampoa has consistently sought to maintain its profit through conservative cash management practices. Thanks to its "high cash, low debt" financial policy, the assets-liabilities ratios of its subsidiaries are as low as 12%. The company holds US $22.1 billion of funds, of which 69% is cash and the remainder consists of government bonds—the safest instrument for investment.

Savvy management of accounts receivables can serve as a second source of cash. Our analysis reveals that, compared with the first quarter of 2008, Chinese enterprises’ days of sales outstanding in the first quarter of 2009 were extended by an average of 4–5 days, or an increase of 12%–15%. (See Figure 15.) Clearly, these businesses relaxed their customer credit policies during the financial crisis. The move was justified as it helped companies maintain customer relationships and market share, despite weak customer demand and ability to pay. However, while it makes sense to extend the receivables period, companies should also carefully monitor customers’ ability to pay. Such monitoring can help a company stave off an increase in bad debts, which jeopardizes its own financial security and profitability. Moreover, companies should turn assets not related to core businesses or long-term development into cash or even sell them at low prices when necessary. For example, when the recession struck, Hutchison Whampoa sold part of its properties in Shanghai at low prices to maintain cash flows as well as improve its market share over the next few years.

A third source of cash is prudent management of investment expenditures. In a downturn, companies should abandon investment projects that have huge capital requirements and a long return cycle without immediate benefits. Mr. Wei Jiafu, President of China Ocean Shipping Group, believes that reducing or eliminating such investments during economic crises is smart because a lack of returns in the short run only aggravates the situation. He disclosed that COSCO Group is
currently holding more than RMB 70 billion in cash, which will enable it to stay afloat for several years to come.30

A fourth source of cash is increasing efficiency in use of capital. Our analysis shows that HPBs’ days of inventory outstanding had only a slight extension during the recession (an average of 3 days, or 2.5%, in Q1 2009, compared with Q1 2008). The figure for other enterprises was 25%. (See Figure 15.) HPBs’ advantages in inventory management stem from their longstanding experience in improving operations and from their timely and appropriate countermeasures during crises. They have long focused on process optimization, supplier relationship management and other practices to strengthen inventory management, and this has give them important advantages over other companies. Amid the financial crisis, they also took decisive steps to reduce inventory to levels compatible with customer demand. This move greatly decreased their operational risks.

In order to analyze the overall operational efficiency of Chinese enterprises under the financial crisis, we have further compared companies’ cash-conversion cycles with differing performance levels. (We define cash-conversion cycle as days of inventory outstanding plus days of sales outstanding minus days payable outstanding.) Our analysis shows that during the downturn, cash-conversion cycles were lengthened overall. The average figure for the first quarter of 2009 was 4.6 days longer than that for the first quarter of 2008. The cycles lengthen more as a company’s level of performance (in terms of profits) declines.

During the recession, HPBs managed to shorten their cash-conversion cycles through effective management of their working capital, reducing the cycle by more than 10 days on average compared with Q1 2008. With unchanged profit targets and improved operating efficiency, they could offer better prices to customers. This is an important strategy during economic downturns especially. If profit margins remain unchanged, higher operating efficiency will lead to more substantial operating profit. This enhances company performance in the capital market, which in turn facilitates future financing.

While companies should pay attention to cash flows, they should not ignore financial flexibility when economic trouble strikes. Enterprises with financial flexibility fulfill their financial obligations through a variety of means. Such flexibility has four sources:

- Ties with parent and sister companies, as well as the usual mechanism of mutual aid.
- Financial support from strategic investors. A case in point is the potential advantage in electric vehicles R&D gained by battery and car manufacturer BYD. In August 2009, BYD received HK $1.8 billion in strategic investment from Warren Buffett’s company.31
- Strategic partnerships with commercial and investment banks.
- Realizable assets. Some assets remotely related to core businesses, such as commercial properties, hotels, retail premises and entertainment facilities, may create stable cash flows in normal times. But companies should sell them quickly in times of need.

Figure 15 Cash conversion cycle and comparison of each component, Q1 2009/Q1 2008

![Cash conversion cycle and comparison of each component](image-url)
V. High performing businesses’ vision for long-term growth beyond the crisis
Confucius said, “Those who do not plan for the future will find trouble on their doorstep.” This is especially true for a high performance business. HPBs should not be content with merely withstanding the current crisis; rather, they should have a long-term vision. They should be able to maintain a balance between overcoming short-term emergencies and meeting long-term goals as well as seizing future opportunities. In our interviews with executives of HPBs, most of them confided that their major concern was not the current economic downturn but how they will gain a competitive edge during and after the recovery. (See Figure 16.) HPBs’ visions for long-term growth beyond the crisis have four dimensions: pioneering the future, becoming more durable, building up a versatile company, and growing prudently.

1. Pioneering the future

When a crisis strikes, some companies become so panicked and overwhelmed that they neglect to examine the fundamentals of corporate development. In contrast, HPBs remain aware of their positioning in the current economic situation. While taking contingency measures to alleviate the crisis, they do not flinch in face of adversity. Instead, they retain their market focus and positioning to realize long-term corporate strategic visions. They insist on taking actions that are conducive to achieving their long-term goals. These actions include: i) customer acquisition and retention; ii) intensified focus on R&D to embrace open and collaborative innovation; iii) brand name maintenance and brand value maximization; and iv) investment in the future.

**Figure 16** In your company’s strategic planning, how do you allocate your effort between coping with the crisis and post-crisis development?

<table>
<thead>
<tr>
<th>Main efforts on coping with the crisis, while looking ahead to future development</th>
<th>Equal emphasis on the two</th>
<th>Main efforts on post-crisis development</th>
<th>Totally engaged in coping with the crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>All n=106</td>
<td>High n=21</td>
<td>Medium n=85</td>
<td>Low n=20</td>
</tr>
<tr>
<td>38%</td>
<td>32%</td>
<td>42%</td>
<td>41%</td>
</tr>
<tr>
<td>70%</td>
<td>26%</td>
<td>25%</td>
<td>18%</td>
</tr>
<tr>
<td>5%</td>
<td>34%</td>
<td>41%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Accenture survey 2009
Figure 17 Please prioritize the impact of financial adversity on domestic and overseas customers. (n=87~100) (‘1’ being the most important.)

<table>
<thead>
<tr>
<th>Lowed consumer demand</th>
<th>Domestic consumers</th>
<th>Overseas consumers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes in customers’ needs in the new economic environment</td>
<td>65%</td>
<td>8%</td>
</tr>
<tr>
<td>Changes in purchasing activities</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Customers turn to low-end products to reduce costs</td>
<td>6%</td>
<td>65%</td>
</tr>
<tr>
<td>Lowered payment capacity of customers</td>
<td>6%</td>
<td>39%</td>
</tr>
<tr>
<td>Rising probability of client default</td>
<td>17%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: Accenture survey 2009

i) Customer acquisition and retention

An enterprise cannot survive without customers and excellent performance. Our research suggests that a recession’s greatest impact on domestic and overseas customers’ behavior is to lower their demand for products and services. Consumers’ needs and purchasing behavior also change. (See Figure 17.) HPBs give top priority to strengthening customer loyalty. To win and retain customers, they use the following strategies:

- Pairing better customer analytics with sound analytical tools.

With information systems and consumer databases in place for years, many enterprises possess comprehensive analytical tools. These tools facilitate their understanding of customer needs and characteristics and hence contribute to corporate profits. Our survey shows that more than half of Chinese HPBs will make strategic investments in customer analytical systems. Moreover, the higher a company’s performance, the more importance it will attach to this endeavor. (See Figure 18.) During a global recession, understanding customers becomes more crucial than ever. For instance, drawing on customer analytics, Lenovo classified consumers into four categories: young white-collar workers; low-income urban youngsters and university students; game lovers; and rural dwellers. The company developed different products to cater to these different market segments.

For young white-collar workers, it launched the reliable ideacentreA600 single computer. For college students, it developed a thin, fashionable ideapad. Gamers were offered front-line high-performance desktop computers. And for rural residents, Lenovo defined a series of initiatives relating to products, channels, training and services to expand the rural market.32

Figure 18 In the current economic environment, how does your company view customer analytical systems? (n=101)

Source: Accenture survey, 2009
• Striving to meet customer needs.
The purpose of understanding customers is to satisfy their needs, be they current or future. While customers can articulate some needs, others are latent desires. For example, the private shipbuilding enterprise in Jiangsu, Yangtze River Shipping, firmly believes that “the owner is always right.” It tries its best to meet ship owners’ requirements for improvement, even at the expense of the company’s own benefits. In the words of Miao Weiqun, Deputy General Manager, the goal is to create a win-win situation for both parties. Yangtze River Shipping even publicly announced its plan to renegotiate with ship owners whose custom-made vessels are due for delivery in 2010, to help them overcome financial difficulties. Our research suggests that HPBs make building a customer-centered corporate culture a top priority, as Yangtze River Shipping does. (See Figure 19.)

“If you want to build up a brand, you should create users and demand. If you cannot create demand, it is impossible to build up a brand. So throughout our company, particularly design staff and marketing personnel, we are more concerned about users’ next desire, next change, next trend, etc.”

- Zhang Ruimin, Chairman and CEO, Haier Group.

• Committing to customer-focused innovation.
This means modifying existing products or services as well as introducing innovative offerings to meet consumers’ needs. (See “Case study: Skyworth’s strategies to win and retain customers.”). Customer-centered innovations mean considering customers first; that is, striving for “designing for customers, with customers and by customers.” For instance, to better provide customers with innovative products, Huawei established a joint innovation center with telecom operators Vodafone, Telefonica and Telecom Italia. Engineers from Huawei and the operators sit together to discuss network evolution and to talk about how they can develop network solutions tailored to customers’ needs.

• Aligning core processes around customers.
To achieve this alignment, companies should revamp business processes such as distribution, marketing, sales and services to suit different customers. Take Lanhui Electrical Equipment in Xi’an. Before the economic meltdown, it had established a return-visit service for users to ensure normal production of its equipment. During the crisis, it lengthened the warranty service by half a year. It also shortened service response time and set specific metrics and targets for response-time performance—for example, service staff would not leave the site until users were satisfied with the service. In addition, the company offered comprehensive facilities maintenance services free of charge to those enterprises affected by the financial crisis.

Figure 19 Please select the two most important customer-oriented initiatives.

Source: Accenture survey 2009
Case study

Skyworth's strategies to win and retain customers

In April 2009, the Hong Kong consumer-electrics holding company Skyworth Group released a strategic plan for serving the rural market as a key to surviving the global recession. Skyworth’s shift of focus to the rural market can be traced back as early as the onset of the crisis. In October 2008, in response to the downturn, the Chinese government decided to extend its “home appliances going to the countryside” policy. This was an initiative to grant subsidies to farmers for purchasing household appliances, and it was expanded from the pilot provinces to a total of 14. That same month, Skyworth launched an “LCD promotion program for rural areas.” It identified the rural market, for which it had been preparing for a few years, as a strategic growth market. Leveraging its business structure transformation and shift to flat-panel TVs, it replaced CRT TVs with LCD TVs in China’s rural areas, a trend that had begun in first- and second-tier cities. In February 2009, when the “home appliances going to the countryside” program kicked off throughout the country, the highest number of LCD products selected for the program in the whole industry came from Skyworth. The company’s rural strategy comprised five elements: service, LCD, technology, culture and public welfare.

To execute its rural strategy, Skyworth had to change its products as well as tailor its business processes to rural customers. Beyond simply developing new offerings for rural markets, 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 giving away a sticker reminding people how to protect their electrical appliances. In addition, the company provided strong support to facilities and services in county and town networks. It plans to initiate similar programs in the Northwest, Southwest and other regions.

By developing promotions that rural residents favor, Skyworth excels at brand maintenance. 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, in January–June 2009 Skyworth’s household electrical appliances delivered to the countryside accounted for 20% of the market, making the company an undisputed industry leader in this regard.
Our research indicates that in the current environment, a better understanding of and orientation toward customers are critical objectives for R&D efforts. (See Figure 20.) HPBs pay more attention to these objectives than other enterprises do. (See Figure 21.)

### ii) Intensified focus on R&D to embrace open and collaborative innovation

In the current multi-polar world, innovation centers (previously concentrated in developed economies) are springing up in different parts of the world, especially emerging markets. These new markets, through primarily government-led long-term support, are narrowing the innovation gap between themselves and developed markets. Innovations are usually strengthened by industry clustering. For instance, setting up a park to house new ventures, R&D centers and suppliers can create synergy.\(^{36}\) In some areas (such as aerospace, hybrid rice and low-temperature superconductors), China has scored world-class achievements. With China’s increasing economic strength, more and more enterprises have begun making innovation a top priority. Some leading enterprises even compete head-on with leading international businesses. (See the case study on Gree.)

Yet despite its volume of economic activities and manufacturing strength, China’s innovation prowess is still nascent. A gap remains between it and developed countries in many areas (such as computer software, chips, aviation, flat-panel televisions and mobile communications). The country’s R&D investments lag behind those of leading foreign enterprises. Many large Chinese companies are in the traditional manufacturing, metal and resource industries, which are huge in size but are relatively weak in innovativeness. Innovative high-tech companies are still in the minority within China. Only a few enterprises master core technologies and lead industry development. By contrast, a considerable number of enterprises rely on purchasing core components or technologies through royalties to sustain their existence.

In many cases, the impact of the financial crisis extended to business customers, causing a general decline in demand. However, demand for products important to customers’ core businesses remained relatively steady. The worse the crisis, the larger the demand for high-value innovative products. Enterprises should capitalize on this demand by creating such offerings. During an economic downturn, companies may do well to sharpen their focus on product innovation. When the crisis subsides, they can capture a larger market with their new, high-value offerings. In other words, enterprises should gradually step up the proportion of new products as they move from crisis to economic recovery.

One ingredient essential for innovation is an open and collaborative mindset. Whereas lower performing enterprises care more about the sharing of risks and expenses in cooperative projects, our research suggests that HPBs aim at obtaining better innovative resources. (See Figure 22.) This is especially true when it comes to international collaborations, which give innovators access to the world’s best resources and skills. A case in point is the innovation center established as a collaborative effort among Huawei,...
Vodafone, Telefonica and Telecom Italia. In January 2008, Li Ning set up the country’s first global design center in sportswear in Portland, Oregon (Nike’s headquarters), by teaming up with about 20 experienced experts in engineering and design of international brands. The company launched a series of new products in the fourth quarter of 2009. Another example is the joint effort between Sichuan electrical appliances manufacturer Changhong and Beijing CRT maker Rainbow Group. The two companies acquired a majority stake in South Korea’s PDP TV manufacturer ORION from U.S. investment fund Matlinpatterson Global Opportunities Partners LP to obtain plasma-screen technology. The three parties also invested US$2 billion to set up a plasma-screen facility in Mianyang, Sichuan. This will enable Changhong to master plasma-TV technology, without having to rely on foreign suppliers to provide the core components. Yet another example of collaboration in innovation is a joint R&D project by Gree Electric Appliance and Japanese air-conditioner manufacturer Daikin on fourth-generation inverter compressors. (See Gree case study.)

iii) Brand name maintenance and brand value maximization

A company’s brand name is at the heart of its identity and all its activities. In each stage of its brand name’s lifecycle (establishment, growth and maturity), a business should strive to enhance its performance to benefit consumers. As Chinese enterprises develop, they are trying to go beyond the low-cost, low-price market and establish high-value brand names. During an economic crisis, the best companies pay more attention to establishing and maintaining brand names because they understand that valuable brand names help them overcome short-term difficulties. Their brand efforts will pay off because the market will appreciate their commitment to consumers. Thus, they will reap double benefits when the economy picks up.

To maximize their brand value, enterprises should seek to align their brand with customers’ needs rather than simply carrying out marketing and promotional activities. After all, customers are users and beneficiaries (or victims if the brand is devalued). Positive word of mouth delivers immeasurable advantages for companies. Hence, delivering a positive brand experience to customers is the most fundamental way to maintain brand power. In addition, a company can encourage customers to participate in the brand-building process. China Mobile’s “M-Zone” offers an example. Ever since its launch, “M-Zone” has targeted young, fashionable consumers and college students, who promote the brand.

Brand extension is another powerful weapon. Mature brands favored by the market have enormous potential. Companies can leverage those brands to drive strategic business growth by extending mature brand names from existing products into new products. For instance, Yunnan Baiyao—a well-known company in traditional Chinese medicine—extended its established brand (which centered on treatment of trauma or sprain) to a host of new pharmaceutical products. These new offerings ranged from capsules, creams and sprays to toothpaste, shower gels and cosmetics such as facial masks. (See case study.) Perhaps one day Yunnan Baiyao will even develop shampoo or mouth wash.
The global financial crisis has posed unprecedented challenges for China’s air-conditioning industry. However, industry leader Gree Electric Appliances sustained growth despite market conditions. In Gree’s 2008 annual report, released on April 21, 2009, the company reported gross revenues of RMB 42.2 billion, up 10.93% from the previous year. Net profits reached RMB 2.103 billion, an increase of 65.6% over the previous year.

Gree’s successes in revenue and profit growth, including maintaining top domestic air-conditioning production and sales for 14 consecutive years and ranking first in the world for four consecutive years, hinges tightly on its commitment to technological innovation. As Chairman Zhu Jianghong explained, “One without backbone can never stand upright. A business without core technology is destitute of backbone.”

“Gree doesn’t put a cap on our investments in R&D. We will make investments whenever we feel the need,” commented President Dong Mingzhu. Gree devotes extensive manpower and resources to technical innovations that amount to RMB 1-1.3 billion per year. Its R&D investments in 2008 accounted for about 4% of total sales, with the percentage of new air-conditioners introduced as high as 20%. Gree has set up three basic research institutions in the areas of refrigeration, electrical and mechanical appliances. These institutions closely follow and develop medium- to long-term and cutting-edge air-conditioning technologies. In addition, Gree invested in the construction of a 30,000-square-meter science and technology tower and more than 300 laboratories to test its newly developed products under various extreme conditions. Thanks to its technological prowess, Gree was able to deliver appropriate products immediately in response to new state policies on energy savings, environmental protection, household appliances for rural areas, product upgrades and energy subsidies.

Today, Gree holds more than 2,000 patents. Of these, more than 300 items are patented inventions, and over 7,000 items are new product designs, making Gree a market leader by any measure. In early 2009, after 12 years of concentrated R&D, Gree successfully developed a third-generation DC inverter technology—G-Matrik—with 100% independent intellectual property rights. This new technology has filled the void in domestic DC inverter technologies and has set a new standard for China’s inverter technologies.

Gree’s R&D in conversion technology caught the attention of Daikin, widely regarded as the “father of frequency conversion.” Both parties entered into a global strategic agreement on February 18, 2009, to set up a new joint venture to develop the “fourth-generation inverter compressor.” Daikin contributed more than RMB 400 million to the RMB 910 million project. However, Gree held a controlling stake of 51% of the joint venture. This cooperation represented a large-scale strategic expansion against a backdrop of general contraction worldwide, paving the way for future exports and overseas expansion.

Amid the global recession, Gree continues to define and execute successful expansion strategies characterized by intensified R&D focus, “obsession” with technological innovation and relentless investments in high-tech products with independent intellectual property rights.
Yunnan Baiyao is a century-old brand, but it has always stressed innovation. By means of innovation and brand extension, the company has reshaped consumption patterns and seamlessly integrated its offerings with modern life, thus invigorating the traditional Chinese medicine industry.

In the past, Yunnan Baiyao’s profits stemmed primarily from drug sales. However, pharmaceutical R&D and brand building unfold over long time horizons and thus are vulnerable to policy changes. To mitigate its vulnerability, Yunnan Baiyao diverted from its original strategy. It used its parent brand name to develop an extended product mix, Yunnan Baiyao adhesive bandages, Yunnan Baiyao sprays, Yunnan Baiyao hemorrhoid ointments, Qiancaotang olive lozenges and other offerings built on the traditional Bai Yao products. In addition, it developed high value-added personal-care products, such as Yunnan Baiyao toothpaste and even medicinal cosmetics and skin-care products that are popular in Japan.

The Baiyao Chuangketie is a successful case of extension from the parent brand. Before 2006, the U.S. brand Band-Aid had enjoyed a 50% share of the domestic bandage market in China. As a latecomer, Yunnan Baiyao Chuangketie succeeded in differentiating itself with its unique anti-inflammatory and anti-bleeding features. A mere mention of Yunnan Baiyao Chuangketie reminds one of its commercial slogan, “It heals faster with medicine.” Baiyao Chuangketie quickly gained a prominent place in Chinese consumers’ minds. From its initial advantaged position in traditional Chinese medicine, the company occupied the strategic high ground by virtue of the “drug-containing” concept. Its market-share ratio with the foreign brand rose rapidly from 1:10 to 1:2.5. Meanwhile, Baiyao Chuangketie has become one of Baiyao Group’s seven top-selling products, generating more than RMB 100 million in revenues.

In addition, Yunnan Baiyao learned through a survey that 90% of Chinese adults have different levels of oral diseases. Gingival swelling, oral ulcers, bleeding and other such problems are rapidly spreading, intensifying demand for oral-care products. To satisfy the need, Yunnan Baiyao developed a line of toothpastes drawing on the traditional Baiyao ingredients and medications for controlling bleeding and bruising. The new toothpaste brands became instant successes. In 2005, when Baiyao toothpaste was introduced into the market, it chalked up sales of RMB 80 million. Sales jumped to RMB 270 million in 2007; in 2008, to RMB 500 million.

Yunnan Baiyao continued with brand extension, setting its sights on medicinal cosmetics ranging from facial masks to personal-care products such as a shower gel designed specifically for dry weather in northern areas and first-aid kits for workers. These new products are set to become Yunnan Baiyao’s new profit-growth engine. The company reached an agreement with Japanese cosmetics manufacturer Maleave to purchase (at relatively low prices) Maleave’s high-end and medium-to-high-end medical beauty products. Through R&D in the formulas, features and production technology of the Japanese brand, Yunnan Baiyao continues to expand its brand value and build a major presence in the medical cosmetics market.
The best way for an enterprise to maintain a brand is to satisfy customers with its own products and services. While adding value for customers, innovative products and services also add value to the brand.

iv) Investment in the future

As they battle the crisis, high performing businesses invest in the future because they believe that seeds sown during an economic downturn will bear better fruits. While low performers panicked in the recession and took drastic measures to reduce capital expenses, our research shows that high performing businesses remained calm and kept their capital expenses at stable levels. (See Figure 23.)

"When everyone else was skeptical about moving forward, we made an onslaught. In the wake of the economic crisis, we did not reduce but increase investments, so that upon economic recovery, we will be fully loaded and release all of our production capacity."

– Wang Xianglin, President, Erdos Group.44

Investing in the future during an economic downturn is desirable because those looking forward will see more opportunities ahead than those succumbing to difficulties. When business shrinks, enterprises will realize what capabilities are the most important and devote themselves to future development and growth. Since opportunities abound in normal times, it is hard to tell which of them are the most valuable or strategically important. Interestingly, it may be easier to make sound judgments during a crisis. In addition, investment costs are decrease in a sluggish market. For example, Xiuzheng Pharmaceutical Group set up a pharmaceutical development center in Beijing in March 2009. The center was the company’s most international and R&D-intensive project and involved the largest investments for any project in Xiuzheng’s history.
In 2009, CNOOC decided to make alternative energy a core business for future investments and to map out new energy strategies, including developing clean energy and low-carbon technologies. The company also positioned itself as a comprehensive energy enterprise, no longer only in the business of oil drilling.

Having formulated this long-term strategic vision, CNOOC announced on July 31, 2009, a plan to channel RMB 5 billion into the power-battery business. It constructed 20 power-battery production lines in cooperation with Lishen of Tianjin. It also set up in Tianjin Binhai a new energy company to further expand production and R&D capacities. Its goal? To build China’s largest industrial base of new energy and accelerate expansion of new energy.

In addition, CNOOC signed a Clean Development Mechanism (CDM) project agreement with Australia’s largest investment bank, Macquarie Bank. With an annual emissions-reduction target of approximately 390,000 tons, this transaction will enable CNOOC to receive about 400 million euros in compensation. These funds will be invested in the CDM environmental transformation project implemented by CNOOC’s refinery in Huizhou, Guangdong. CNOOC plans to import the most internationally advanced waste-heat recovery equipment. The company will use this equipment to calcinate the by-product of petroleum coke in the Huizhou Refinery, from which the resulting recycled heat can be used to generate steam and electricity used by other CNOOC facilities. This project promises to reduce operating costs while improving utilization rate of resources in implementing the CDM project agreement.

As CNOOC is committed to offshore exploration, it also aims to develop coastal wind energy. In 2007, the company set up a wind-power station in Bohai Bay, the first experimental field in its coastal wind power development efforts. In undertaking this project, it has accumulated valuable experience in offshore wind power development and has deepened upstream-downstream cooperation on the industry value chain. In 2008, CNOOC continued to develop and invest in offshore wind power by building the world’s largest offshore wind power project in Weihai City, with a total installed capacity of 1.1 million kilowatts. The project will further boost CNOOC’s transformation from the traditional offshore oil and gas explorer into an integrated energy company competing on the international stage.45
2. Becoming more durable

Regardless of its strategies and vision to build its future beyond the crisis, an enterprise’s own physical state dictates whether it can achieve long-term development. A strong business does not panic in the face of a storm. Instead, it weathers it with tenacity and perseverance. If “pioneering the future” represents HPBs’ market focus and positioning, then “becoming more durable” reflects their distinctive capabilities. In our research, such distinctive capabilities are manifested in i) operational excellence; ii) talent management; and iii) proper use of merger and acquisition capabilities.

i) Operational excellence

Many companies have learned a hard lesson from the financial crisis: Instead of expending all their energy on financial arrangements and operations, enterprises should get back to business fundamentals. That means developing and producing the right products, launching them into the market properly and satisfying consumers’ needs. In the process, firms must strengthen their core competencies involving people and organizational structures, operational and management processes, management tools and systems. Companies achieve this operational excellence by optimizing the four elements of their operating model: process, people, technology and organizational structure. In a nutshell, the goal is to get “maximum mileage” from a company’s operating model— for the least cost. Jiangsu Hengrui Pharmaceuticals is one company that accomplished this. (See case study.)

Our research suggests that high performing businesses are willing to improve internal processes and systems to enhance staff efficiency, which ultimately translates into operational excellence. We expect to see this approach continue in the next few years. (See Figure 24.) As operational models evolve, many companies are also flattening and streamlining their organizational structure. (See Figure 25.)

Figure 24 What measures are you planning/taking to optimize operations? (You may choose more than one option.)

![Figure 24](image)

Source: Accenture survey, 2009

Figure 25 Please prioritize the future development trend of your company’s operation mode (n=104)

![Figure 25](image)

Source: Accenture survey, 2009
Case study

Hengrui Pharmaceuticals optimizes sales operations

Despite the recession and the severe challenges confronting the pharmaceuticals industry in 2008, Hengrui Pharmaceuticals of Jiangsu Province reported growth in sales revenue of RMB 4.26 billion and after-tax profit of RMB 1.74 billion—an increase of more than 30% on all indicators over the previous year.

Benefiting from its independent distribution networks throughout the country, Hengrui was able to maintain sales momentum and ensure steady sales growth. Hengrui has established three subsidiaries specifically for sales and distribution: Jiangsu Hengrui Medicine Sales Co Ltd, Lianyungang Xinchen Pharmaceuticals Co Ltd and Lianyungang Huachen Pharmaceuticals Co Ltd, with sales outlets and nearly 200 offices throughout all provinces in China. Moreover, it has a 3,000-strong professional and dedicated sales force, representing an optimized sales structure. With a more than 40% annual growth rate, Hengrui continues to make new strides.

When the crisis hit, Hengrui did not fall into disarray. Rather, it divided its target markets into more specific segments according to product features, and further improved its sales networks. It also intensified sales and marketing development, changing the nationwide nine-region structure into one organized by provinces. It thus actively implemented a strategy of “radiating” from a major region to surrounding communities and towns, with the objective of fully penetrating the untapped market.

In addition, the company sharpened its focus on developing the major hospital market, and gradually increased investments in regions with weak sales networks. This move represented additional optimization of Hengrui’s sales structure.

Meanwhile, Hengrui intensified promotions of non-oncology medicines to further optimize its product portfolio in an effort to establish new sources of growth in emerging therapeutic fields. Accordingly, it modified its existing sales processes to more efficiently promote the new products. In short, it optimized its sales process.

Hengrui also strengthened its sales force management and built a strong sales team by gradually delegating responsibilities to the provincial level. By doing so, the company introduced a flat management structure. At the same time, it strengthened evaluations of sales personnel’s performance, with a focus on introducing senior-level personnel and training young capable sales staff. These efforts revealed an attention to optimization of sales staff. As for customers, Hengrui established a credit file for each customer, stipulating an appropriate payment cycle and crisis management measures. While it reinforced relationships with customers of good credit, it insisted on suspending business transactions with those of bad credit. This policy—which optimized Hengrui’s collections process—ensured that the percentage of accounts receivables decreased steadily while sales revenue grew.

In 2008, Hengrui determined to make an inroad into the over-the-counter (OTC) retail market. As it had previously sold OTC drugs directly to hospitals, it lacked experience in this market. To optimize the OTC drug sales network, it acquired Brilliance Company. Brilliance leveraged Hengrui’s OTC sales team of more than 200 professionals and 30 sales outlets throughout the country. To further utilize Brilliance’s sales network, Hengrui will gradually change Brilliance’s existing businesses so that they sell only Hengrui’s OTC products and will extend the network to cover all of China, further optimizing the company’s sales structure.
ii) Talent management

Corporate leaders worldwide proclaim that “people are our greatest assets.” However, the financial crisis slowed enterprises’ hunt for talent. In a reversal of the pre-crisis practice of seeking talent at all costs, many companies in developed markets have initiated sizable layoffs and other labor cost-cutting measures. However, nearly all high performing businesses take a different approach: They continue to develop a large pool of talent to support their future growth.

To be sure, in the current economic environment, it is neither practical nor wise to maintain a huge workforce. Layoffs, fringe benefits cutbacks and payroll freezes may be necessary to improve a company’s short-term performance. But these moves should be carried out strategically.

For example, to avoid brain drain as a result of labor-cost reductions, enterprises may conduct strategic role assessments to identify those positions critical for the company’s mission and those that are not, as well as current performance in each role.

(See Figure 26.) These assessments enable the company to determine which employees should be laid off or given pay cuts. Those in the upper left corner of the staff assessment diagram are the core force for the enterprise’s development. For these employees, the company should not only avoid the cost-saving measures discussed above, but also provide more incentives to retain them, such as salary increases and training opportunities.

Communication with employees is also of paramount importance. Regardless of how well talent management measures are designed, if managers communicate ineffectively with staff, their motivation tends to weaken. In times of job insecurity, what corporate leaders should offer most is transparency in their decision-making processes, which means communicating messages in a timely fashion to employees regarding the difficulties facing the organization and measures taken to tackle them. Executives should also demonstrate that they understand want to address employees’ concerns. If leaders can cultivate an atmosphere of camaraderie and care, employees will more easily identify with and commit to the enterprise’s long-term development.

Rapid trimming of labor costs is no easy task. Trim away “muscle” (strategically valuable staff) by mistake, and you injure your company’s “bones” (its long-term competitiveness). The economic crisis has deepened managers’ understanding that one does not build up a talent pool in a day. Moreover, a solid talent base and top-notch personnel are essential for achieving excellent performance. After implementing contingency measures to boost short-term performance, corporate leaders should re-examine their company’s talent strategy and ensure that it aligns behind the corporate strategy.

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**Figure 26 Strategic role assessment diagram**

<table>
<thead>
<tr>
<th>Value to the Organization</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exceptional</td>
</tr>
<tr>
<td>Mission-critical</td>
<td>✔</td>
</tr>
<tr>
<td>Core</td>
<td></td>
</tr>
<tr>
<td>Necessary</td>
<td></td>
</tr>
<tr>
<td>Non-essential</td>
<td></td>
</tr>
</tbody>
</table>

- Provide additional rewards and experiences and provide development opportunities to benefit individual and organization
- Identify as at risk: Provide additional training and performance management attention to improve motivation and performance, and/or to move into necessary or core roles
- Provide training and experiences to prepare for mission-critical roles
- Divest/seek alternative sourcing

Source: Accenture survey, 2009
Case study

Zhejiang Medicine's "freedom of movement" talent strategy

The competition between enterprises is in essence a war for talent. Contrary to most restrictions aimed at retaining valued employees, Zhejiang Medicine’s main subsidiary Xinchang Pharmaceuticals practiced a policy of "freedom of movement"—allowing college graduates and technical personnel to leave at any time without constraints.

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. Since the 1990s, Xinchang Pharmaceuticals has put in place its "freedom of movement" talent policy. Under this policy, scientific and technical personnel who want to leave the company can do so, while internally trained staff are given wide scope in pursuing their own career goals. Xinchang encourages employees to pursue learning and training opportunities by paying full tuition fees for selected staff taking on-the-job training or attending full-time study programs. The company provides a monthly stipend of RMB 500-1,500 for those admitted into undergraduate or graduate programs.

For employees pursuing studies overseas, the company also pays their tuition fees. The policy requires an annual financial commitment of RMB 15 million from the company. In addition, employees are not bound by any contract to return to Xinchang after completing their studies. Further reinforcing the "freedom of movement" strategy, the company offers benefits such as variable pay, housing placement, living allowances, rewards to R&D personnel and a 15% dividend payout on future profits for research groups to develop products.

The "freedom of movement" policy hasn’t lead to brain drain; on the contrary, it has helped Xinchang attract talent. For example, a graduate from Beijing Agricultural University, Dr. Zhang Yingxiang, was hired by Xinchang Pharmaceuticals in 1996 as a technician. In July 2000, he left to work for the international pharmaceutical giant Roche. Two years later, he returned to Xinchang. "My return from a foreign enterprise back to Xinchang is entirely because the latter’s good corporate culture touches me deeply. Besides, its innovative way of promoting staff gives me latitude for self-improvement. Not only am I confident in the company, but I have heart-felt respect for its broad-minded talent policy," Zhang told us.

Under the "freedom of movement" strategy, the percentage of senior-level scientific research personnel at Xinchang has increased annually, and it has a research team led by experts holding Ph.D. and other advanced degrees. With this team, the company has laid a solid R&D foundation. Zhejiang Medicine has become a national post-doctoral station as well as a state-level corporate technology center. In 2008, under the national new drug program, it secured government funding of over RMB 30 million for R&D 2009-2011.47
For companies suffering deteriorating sales mode and management capacity.

M&A target—its products, customers, market situation or other unexpected temporarily because of the overall companies that are bogged down enhance Geely’s competitiveness.

An individual builds up a strong physique through exercise and proper nutrition. Similarly, through mergers and acquisitions, an organization can quickly add needed capabilities that would be hard to obtain through gradual development.

During an economic downturn, enterprises with a solid financial foundation have an excellent opportunity to use M&A to establish market leadership and fuel their future development. However, in such a period, executives might overestimate the number of M&A opportunities available and underestimate their prices, which may prompt them to make hasty “bargain hunting” decisions. If the motive underlying merger/acquisition decisions is simply to snap up bargains rather than to complement or augment capabilities, these decisions may not pay off in the end.

We believe that executives should take four factors into consideration regarding their M&A efforts. First, the primary objectives of these efforts should be to support corporate strategic goals by acquiring missing capabilities. In making M&A decisions, including identifying potential targets, executives need to ask whether the move would meet corporate strategic needs, which may include gaining access to new technologies and intellectual property, entering a promising new market, ensuring a supply of resources, exploring a distribution channel, obtaining access to rare expertise or improving the value chain. For example, when Geely Automobil acquired the world’s second-largest automatic transmission company, DSI of Australia, in March 2003, the goal was to leverage DSI’s automatic transmission technology to enhance Geely’s competitiveness.

Second, executives should identify as targets otherwise outstanding companies that are bogged down temporarily because of the overall market situation or other unexpected factors. How to find such companies? Investigate the fundamentals of an M&A target—its products, customers, sales mode and management capacity. For companies suffering deteriorating performance, ask whether the value drivers (such as customer growth) are as seriously affected as the company’s market valuation suggests.

Third, executives must assess the potential synergies (such as cost reduction and revenue enhancement) that a merger or acquisition could create. They should make a comparison between general industry benchmarks and opportunities derived from M&As (such as merging redundant production facilities to save costs), to accurately quantify the potential for synergies.

Fourth, executives need to manage post-merger integration specifically to realize the synergies they have identified. Integrating the two companies’ capabilities after a merger or acquisition is the key to achieving synergies. The M&A transaction itself is only one part of the process. A successful transaction doesn’t imply a successful M&A outcome. (See the COFCO case study.)

“We won’t pursue any M&A without intellectual property transfer.”

– Xu Heyi, Chairman, Beijing Automotive Industry Holding Co Ltd

3. Building a versatile company

When the Internet economy was booming at the beginning of this century, the notion of a “nimble” company stimulated spirited discussion among academics and business leaders alike. At that time, many people saw Internet companies “click” business model as nimble, and the traditional “brick” model as clumsy and slow. An agile and flexible company can change its business model quickly to seize the advantages offered by new technologies, while a cumbersome and slow company cannot. Later, it became clear that some flexible and agile companies lacked a solid business model: They were unable to identify who their customers were and what they could offer them. With their attention focused on venture capitalists and IPOs, these companies rushed into action and then collapsed.

Agility, along with a pioneering spirit and youthful mind, helps companies notice and adapt swiftly to changes in the market. But businesses also need a solid business model as their backbone or core. If the business model is in line with market conditions, the enterprise will display different facets of itself depending on the changing business environment, rather than sticking to one way of doing business without making room for change. Being agile and flexible is the expression of the performance-anatomy HPB building block we discussed earlier. This building block has three dimensions: i) readjustments of established capabilities to adapt to a changing business environment; ii) flexible, resilient operating models; and iii) an open mind.

i) Readjustments of established capabilities to adapt to a changing business environment

While an enterprise may remain steadfast and focused in turbulent times, it must also revamp its existing capabilities to adapt to the changing business environment. In response to lowered consumer demand, an enterprise can take decisive measures to shift its market focus—for instance, from foreign to domestic markets, from urban to rural areas and from developed to emerging markets. In terms of its customer profile, a company may shift from high end to low end, or vice versa. Also, it may change its business model by adopting or enlarging online business. These readjustments require not only courage but also the ability to modify a company’s existing capacities—from strategy formulation, market research, product improvements and channel construction to terminal management and brand-building.

Since the onset of the financial crisis, many Chinese enterprises have manifested such capabilities. Consumer electronics producer Midea offers an apt example. Using what it referred to as a “balancing tactic,” it shifted its focus from the depressed U.S. market to other markets such as Eastern Europe and Southeast Asia, as well as from international to domestic markets, including China’s vast rural areas.
In March 2009, China National Cereals, Oils & Foodstuffs Corp. (COFCO) made a pledge of food safety “from farm to table” to consumers. Chairman Ning Gaoning said it was the company’s responsibility to contribute to achieving food safety. Thus committed, COFCO determined to become a business that integrates upstream and downstream activities and forges links along the whole industry value chain. It strives to make itself a safe and healthy food enterprise through systematic management of the industry value chain and effective control of key links. To achieve this strategic vision, COFCO initiated a series of large-scale mergers and acquisitions.

Livestock feed:
• Acquiring stake in Mengniu: In July 2009, COFCO and Magnolia made a combined capital of HK$ 6.1 billion for acquiring the common shares of Mengniu, representing 20.8% of the enlarged share capital of Mengniu Group. The move facilitated COFCO’s effort to make a high-profile entry into the dairy industry and hence extend its participation in the industry value chain.

• Pig-breeding agreement with the Tianjin government: In March 2009, COFCO and the Tianjin government signed an agreement involving a total investment of RMB 8 billion in pig breeding. COFCO is expected to spend RMB 17.7 billion establishing a pig-breeding industry chain.

Food for human customers:
• Acquisition of Wugudaochang: In February 2009, COFCO acquired instant-noodle maker Wugudaochang for RMB 109 million. Wugudaochang’s mindset about health is consistent with COFCO’s brand idea of “Reborn in the source of nature.” The acquisition offered COFCO a foothold in the instant-noodle industry and enabled it to explore other processed-food products.

• Rice-growing agreement with grain producers: In May 2009, COFCO signed a rice-growing contract with major grain producers in the northeastern region and Jiangxi Province. The company thus extended the industry value chain directly to the source – grain.

• Construction of a rice-growing base: In mid-May 2009, COFCO announced its plan to invest almost RMB 300 million in Sichuan to build a rice-growing base. The scheme would open up a north-south rice-processing and supply channel from northeast to Sichuan and Guangdong, bringing into full play the group’s advantages in every sector throughout the grain industry.

Sugar/juice:
• Acquisition of Rong’s Co. Ltd.: In July 2009, COFCO bought Rong’s Co. Ltd. of Shanghai, a leader in starch sugar production. Starch sugar is used mainly in beverages, fruit juices, cakes, milk products and other foodstuffs. With this acquisition, the company would be able to enter new businesses such as fruit juices and milk products.

• Launch of Yue Huo juice brand: In August 2009, after more than two years’ preparation, COFCO launched fruit and vegetable juices branded Yue Huo and marked “Products of COFCO.” The products hit the shelves in many large supermarkets in Beijing.

Vegetable oil:
• A comprehensive oil and foodstuffs base in Tianjin: In April 2009, a groundbreaking ceremony was held for COFCO’s forthcoming comprehensive oil and foodstuff base in Tianjin. With an investment of RMB 4 billion, the base will become COFCO’s grain, oil and food processing park serving the company’s full industry value chain.

• New generation of corn oil: In July 2009, COFCO held a press conference announcing the official launch of Fulimen corn oil phytosterols. The product is part of COFCO’s efforts to build an industry value chain of food grains and oils.
Under the countrywide integration of urban and rural areas, China’s rural market presents huge potential.\textsuperscript{50}

Another example is Nine Dragons Paper (Holdings) Ltd. As the recession tightened its grip, Nine Dragons postponed all of its overseas development efforts, shifting its focus to domestic sales, which currently account for 80\% of its revenues. In 2009, export sales are expected to fall to 10\%.\textsuperscript{51}

Qingdao Jin Wang Applied Chemicals offers yet another example. The candle manufacturer exported almost all its products before the outbreak of the crisis. Since October 2008, under the philosophy of “walking on two legs,” it has intensified development of the domestic market, without abandoning the overseas market. In 2009, it strove to raise its domestic sales to above 10\% and set a goal of establishing 1,000 franchised chain stores throughout the country over the next five years.\textsuperscript{52}

\section*{ii) Flexible, resilient operating models}

Under certain circumstances, an enterprise may have to change to its operating model to adapt to shifts in the business environment. A company’s operating model reflects its culture, adaptability to the environment and the depth of its thinking. Only those businesses with a flexible, tolerant mentality will manifest rationality under difficult situations. They can make flexible changes in functions that closely relate to consumers, such as production, distribution, sales and customer service. Changes involving people, process, technology and organizational structure may entail restructuring, expanding, downsizing and so on. A company determines each of these actions by taking the “market’s pulse.” (See the Luzhou case study.)

Consider Hangzhou Turbine International. As the financial crisis retarded its growth, the company launched three changes. First, it stopped relying so heavily on the Indian market. After selling boiler feed pump turbines to the U.S. for the first time in late 2007, it entered into a two-year agreement with Doosan Group of South Korea to jointly produce boiler feed pumps. Meanwhile, it also secured contracts to supply four dual-stream turbine pumps to Indonesian and Thai power plants.

Second, it chose to reduce the proportion of power-generating products in its aggregate sales. As a result, for the first time, the sales figures of hauling products exceeded those of power-generating products to reach a 62\% share of revenues.

Third, Hangzhou changed how it sold its own products. Through cooperation with foreign manufacturers and the company EPC, it secured orders for different products, including steam-driven turbines from an Indian nitrate manufacturer and five industrial steam-driven turbines for use in Indian ESSAR’s refinery project with annual production capacity of 34 million tons. The total number of overseas contracts (including dealer contracts) Hangzhou sealed in 2008 topped $130 million, a historical record.\textsuperscript{53}
Case study
Luzhou’s flexible marketing model

China’s high-end liquor market had been growing steadily, and then an unexpected crisis sent it into a severe winter. Plunging government and commercial demand caused huge damage to Luzhou, whose profits came primarily from high-end products. In the peak season of the fourth quarter of 2008, earnings per share was only 0.13 yuan, far lower than the 0.25 yuan in the usually off-season third quarter. Luzhou responded by readjusting its marketing strategy to focus on both the high-end and medium markets, rather than just the former.

In the high-end market, the company set out to boost sales of "Guojiao 1573" and maintain its luxury brand status. It established a wholly-owned subsidiary, "Luzhou VIP Services," in February 2009, using "Guojiao 1573" as the featured product to specialize in high-end market development. Different from the old model of selling through dealers, the new company deals directly with high-end customers, including the military, universities and large corporations. It also offers customized, exclusive brewing and packaging services for individual customers. For example, so far, it has provided specialized liquors for Southwest Jiaotong University, Luzhou Medical College and the Bureau of Retired Cadres of the central government. Sales of Luzhou’s high-end products have improved significantly, along with customer loyalty and brand position.

In the medium-end market, Luzhou adopted two measures to broaden sales channels through alliances with dealers. First, during April-June 2009, it established pilot regional sales companies in Hunan, Sichuan and Beijing. With Luzhou’s regional sales staff as a link, these companies aimed at attracting major local dealers to become share owners. While dealers who took up shares would be offered purchase discounts, they were also motivated to expand Luzhou’s sales by receiving dividends. This interest-bundling arrangement enhances Luzhou’s control over end-product prices and makes channel synergy work. Thus, it has helped Luzhou overcome the problem of sluggish sales due to dealers’ lowered purchases at the initial stage of the crisis.

Second, because the medium and low-end markets currently rely heavily on small and medium dealers, Luzhou formed a platform for province-level dealers and major distribution agents to set up a micro-loan company. This new enterprise specializes in offering loans to small and medium dealers who have cash-flow problems. Luzhou gives in advance liquor products of equivalent value to participating large distributors as collateral to eliminate their credit risk. The company has RMB 200-300 million worth of capital. Luzhou’s intent is to solve small and medium dealers’ financial difficulties while promoting product sales and strengthening its control of dealers, thus winning loyal, powerful channels.

Luzhou’s sales for the first half of 2009 grew 4.43% compared with last year, meeting the annual target of 51.16%; moreover, it achieved net profit growth of 14.90%, a rate attained by listed companies, and 0.61 yuan in basic earnings per share.
Our analysis shows that facing the challenges posed by the financial crisis, HPBs sustained high and stable operating margins through flexible arrangements of their operating models, while other enterprises saw greater declines in their profit margins. (See Figure 27.)

### iii) An open mind

An open-minded organizational culture enhances a company’s ability to adapt to hard times. Open-mindedness facilitates collaboration with all stakeholders who have a vested interest in creating mutually beneficial outcomes. An open mind requires use of interpersonal networks. The network theory in management science is the study of how enterprises make use of different networks (not necessarily business networks) to achieve corporate goals, such as approaching customers, handling public crises and cooperating on innovation.

Corporate leaders can set the tone for open-mindedness in their organizations, by demonstrating candor and vision and by forging links with other entities to expand the company’s networks. The most open-minded leaders show concern for business partners, consumers, the communities where their company does business and government entities. They take their company’s social responsibilities seriously and strive to create long-term advantages for all stakeholders, without sacrificing the future for immediate benefits.

High performing businesses place even more emphasis on cooperation between upstream and downstream parties to create win-win situations. This fact was confirmed during our interview with a corporate leader who described the relationships between parties along his company’s value chain. The interviewee, the general manager of a mechanical manufacturer, explained how the manufacturer shared information on consumers’ changing needs in real time with its parts suppliers. In this way, it realized cost savings through modifications of machine and parts designs, and shared the savings as well as the cost burden of its machines with its suppliers.55 (See the China Mobile and Yurun case studies.)

"In the Internet industry, no matter what ideas, models or products you own, there will always be others to learn, copy or imitate you. How should we deal with this? The only way is to go faster than others do. But how to go faster? With a more open mind, unite and mobilize our partners and all resources available to form a truly integrated force."

– Chen Tianqiao, Managing Director and CEO, Shanda Group.58
Case study

China Mobile fosters cooperation with an open mind

In January 2009, China Mobile, the world’s largest mobile phone operator, was granted the China standard TD-SCDMA (hereinafter referred to as TD) license with independent intellectual property rights standards. Although TD communications standards are not the same as China Telecom’s CDMA2000 and China Unicom’s WCDMA in terms of maturity and size of customer base, China Mobile has announced its plan to develop TD in an “unconventional manner.” Facing a tough industry environment and keen competition, China Mobile has vigorously linked networks, terminals and business partners to mobilize commitment to building TD.

To further intensify collaboration among all its stakeholders, China Mobile called on all parties on the industry value chain to work together diligently. With China Mobile’s strong support, Chinese and foreign equipment manufacturers have begun strategic cooperation. For example, Alcatel-Lucent and Datang formed a TD alliance, and domestic and foreign telecommunications equipment giants, including Huawei, ZTE, Putian, Ericsson and Alcatel-Lucent, have become China Mobile’s TD network equipment suppliers.

China Mobile has also raised its subsidies to TD handsets. A total of 34 Chinese and foreign handset makers, such as ZTE, Huawei, Samsung and Motorola, have become China Mobile TD terminal partners. 3G wireless broadband terminals (Internet access card, TD netbooks and so on) also receive support from China Mobile. The company shoulders the hardware costs for installation of TD Internet access cards. Under China Mobile’s vigorous promotion, many PC makers (including ASUS, HP, Dell and Lenovo) will have this built-in TD data card in their notebook computers and netbooks. China Mobile’s subsidies in 2009 for all TD terminals are expected to exceed RMB 10 billion, a move designed to attract more resources to focus on the TD terminal industry. In addition, following its cooperation in 2007 with Google’s mobile search engine, China Mobile has once again joined the Google Android alliance, through R&D and design of mobile embedded software based on the OMS platform, an independent development of the Android system. China Mobile will also launch a TD version of OPhone phones.

In TD business applications, China Mobile’s “G3” business will openly solicit partners. It will spare no effort to promote Service Providers/Content Providers’ participation in TD business innovations and will not charge for data transmission in the first year of a partnership.

In August 2009, China Mobile officially launched its mobile applications store, Mobile Market (MM). This is the first time a Chinese telecom operator has launched its own open and value-added business platform. China Mobile will work with application providers, terminal manufacturers and end-users while retaining responsibility for MM’s system construction to provide development support and business services for application providers and individual developers. Seventy percent of sales revenue from MM will go to sales providers and developers, and China Mobile will receive the remaining 30%. Mobile Market is set to become a huge shopping mall providing consumers with a variety of exciting applications and digital products. It will also become a dream workshop for developers.

In the context of the global financial crisis, China Mobile’s substantial investments in TD network, construction and operation will boost domestic demand and create job opportunities while enabling consumers to enjoy higher quality 3G services.
In the grip of the financial crisis, China’s food processing industry saw a decline in consumer demand. Yet Yurun Food Company recorded total revenues of RMB 37 billion in 2008, an increase of 20% over 2007. At the same time, Yurun’s slaughter capacity reached 18 million head, continuing to rank first in the country.

As an industry leader, Yurun believes that ethics and social responsibility are central concerns in the food industry. It developed the most detailed, rigorous and practical food safety management system in the industry, covering the three major areas of slaughtering, quality control and product technology. Yurun has won five major quality control certifications—the first in the domestic meat industry for its stringent quality controls and commitment to providing consumers with wholesome, nutritious and safe meat products.

Whenever Yurun invests in a food processing base, it aims to improve local agricultural businesses, forming the “Yurun-base-rural households” business model. With the expansion of the business model, tens of thousands of households have become better off by engaging in cooperative breeding of their livestock with Yurun’s. Meanwhile, Yurun promotes comprehensive technical training in rural areas, providing professional guidance and support free of charge to partnering households to improve overall breeding standards.

A large number of enterprises were hit hard by the global recession. Migrant workers were also affected. In 2009, approximately 25 million migrant workers were unemployed or underemployed. In response, Yurun developed its “Hundred, Thousand and Ten Thousand Project,” which involves building 100 agricultural industrialization bases in the next three to five years. These bases will cover 1,000 towns nationwide and have the capacity to absorb 10,000 migrant workers. Yurun also hopes that these bases will boost development of related industries in local areas to create more jobs.
4. Growing prudently

In overcoming the crisis and setting the stage for long-term development, a company should have a vision, manage prudently and grow steadily. Prudence is embedded in a company’s culture and style of its leaders, and is a manifestation of performance anatomy. When we realize that the financial crisis originated from excessive risk-taking by financial institutions, we will appreciate how valuable prudence is. The components of growing prudently include: i) preemptive actions; ii) strong risk-management systems; and iii) expanded financing channels.

i) Preemptive actions

The ancient Chinese Art of War teaches that subduing an enemy without using weapons is a tactic of the highest order. Of course, that doesn’t imply we can just sit back and wait for our enemy to surrender. Rather, it means sparing no effort outside the battlefield and thus being well prepared. If we gain the upper hand in the political, organizational, public, geographical, logistical and other aspects of a war, our foe will have no chance to win or even escape. The outcome is obvious even without an exchange of fire. In other words, efforts should be made not in but outside the battlefield.

The same is true for crisis response. Organizations must anticipate future situations and take precautions accordingly to weather storms as they approach. But how can one predict crises? As it is impractical to rely on fortune telling, the only way for an enterprise to hedge against the future is to expect hardship and hone their awareness of the bumpy road ahead.

Luthai Textile Co. Ltd is an apt example. This firm has always carefully guarded against exchange-rate risks through a variety of means, including foreign-exchange hedging, long-term settlements, reasonable arrangements for settlement periods, exchange-rate lockup agreements and foreign currency loans to avoid exchange losses. (See the Luthai case study.)

Lingrui Pharmaceuticals is another example. Lingrui had long maintained a strong awareness of crisis before it occurred. By integrating its marketing channels in 2007, the company significantly reduced the number of dealers it worked with. It also shifted from credit to cash sales and, from this year onward, sales by advance payment. As a result, its operational efficiency markedly improved while its operational risk decreased. By 2008, the company had maintained relatively high cash reserves, with its book value never dropping below RMB 100 million.59

"A year ago, I foresaw the possibility of an economic downturn. Now that many enterprises are faced with the 'winter,' it has a lot to do with decision makers. They do not understand the trends or have the right judgments. They are over-optimistic and follow suit in pursuing expansions indiscriminately. Without a solid foundation, they put up a swollen appearance. Isn’t that dangerous?"

- Li Chunbo, Managing Director, Zhejiang Pharmaceuticals60
ii) Strong risk-management systems

The global financial crisis made executives around the world sharply aware of the importance of corporate risk management. Accenture’s global research reveals that only 8% of managers believed their enterprises were extremely well prepared for the crisis. Risk management can give companies a competitive edge and increase the odds of excellent performance even under the most turbulent conditions.

Chinese enterprises have begun to engage in risk management only in recent years. Our survey shows that they set up risk-management systems chiefly to better understand risks, grasp business opportunities and ensure continuity of operations. Compliance with regulation is rated as a relatively low motive for establishing such systems. (See Figure 28.) While corporate managers are aware of the importance of risk management, they hope to build up a risk-management system that applies to their own situation and truly improves their business performance. In 2009, Accenture conducted a global survey of more than 250 senior executives from various industries, including CEOs, chief risk officers and other risk-management executives. We combined the findings from this survey with Accenture’s previous experiences in helping enterprises enhance their risk-management capabilities. And we discovered that whether a company’s risk-management system can help it attain excellent performance depends on whether executives and managers can take the following actions:

- **Establish a comprehensive risk-management system:** An enterprise’s risk management has to be systematic, holistic and congruent with its own operational system. Risk management should become an integral part of routine meetings and any assessment process. It should also run through corporate management frameworks, decision-making processes, training, corporate culture and incentive mechanisms.

- **Improve the quality of risk data and reporting frequency:** The fundamental goal of a risk-management system is to quantify risks to ensure that management receives the right risk information at the right time in order to make the right decisions. Enterprises with strong risk-management capabilities will, through a standardized system, report more frequently to stakeholders on possible risks and conduct timely monitoring of risks.

- **Base corporate performance management on risk-management considerations:** A company’s risk-management system should support entrepreneurship in the enterprise. If the risk-management and performance-management systems do not coordinate with each other well, corporate managers will probably be rewarded for enhancing corporate performance, but the corresponding risk factors generated will not receive enough attention. This will pose a hidden risk for the company’s future development. Therefore, an assessment system taking risk factors fully into account is important. Combining it with the traditional assets-liabilities management and profitability assessment benchmark allows a more objective evaluation of the firm’s performance.

- **Enhance the role of risk management in value creation:** The objective of risk management is not only to ensure that enterprises comply with rules and regulations, but also to create value for stakeholders. Nowadays, risk management is a proactive, sustained endeavor serving the purpose of value creation rather than just conservation of value or as a remedial measure. An effective and comprehensive risk-management system links risk and profit targets as a means to improve strategic decision-making and returns on capital. HPBs usually coordinate and consolidate risk-measurement functions within the corporate framework with the finance division, performance assessment and management.

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**Figure 28 Please prioritize the motives for setting up a risk management system. (n=104)**

<table>
<thead>
<tr>
<th>Motive</th>
<th>1=Most important</th>
<th>2=Least important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Better understand risks, grasp business opportunities</td>
<td>42%</td>
<td>28%</td>
</tr>
<tr>
<td>Ensure continuity of operations</td>
<td>38%</td>
<td>43%</td>
</tr>
<tr>
<td>Meet official standards</td>
<td>22%</td>
<td>29%</td>
</tr>
</tbody>
</table>

Source: Accenture survey, 2009
The lowered demand in the global market caused by the financial crisis has inflicted enormous damage on China’s export-oriented companies. For the textile industry, the situation is even grimmer. Not only did export orders decrease, but the huge foreign-exchange fluctuations resulted in more losses for foreign-trade enterprises. In particular, the fixed-exchange-rate system introduced more than a decade ago lowered most foreign-trade enterprises’ guard against exchange-rate risks. However, Luthai Textile, with a more than 80% dependence on foreign trade, beat the downward trend during the adverse economic environment and succeeded in circumventing exchange-rate risks. In 2008, it brought home operating incomes of RMB 3.922 billion, exports of RMB 459 million and operating profits of RMB 559 million, representing increases of 2.92%, 18.81% and 10.36%, respectively, over the same period in the previous year. It became a role model for foreign-trade enterprises struggling to avoid exchange-rate risks.

Exchange-rate risks are a major source of financial uncertainty. This is especially true for export-oriented companies like Luthai. Such companies’ export profits might be subject to considerable erosion with continued appreciation of the yuan. According to Luthai’s assistant general manager Qin Guiling, the company planned early for exchange-rate risks by collecting timely information and strengthening financial management and staff training. Through foreign-exchange hedging, long-term settlements, reasonable billing periods and exchange-rate lock-up agreements, it avoided possible adverse effects arising from exchange-rate fluctuations while also making gains. And by raising the import-export ratio of raw materials (such as cotton) and increasing foreign-currency borrowings, it partially offset the impact of RMB appreciation. At the same time, Luthai increased its foreign-currency liabilities to offset exchange-rate fluctuations.

From 2003 onward, Luthai began to “manipulate” the exchange rates of the RMB for the U.S. dollar. With years of business relationships, Luthai secured low-interest loans of US$45 million from foreign-funded banks, and converted the amount into yuan in accordance with the 8.27 ratio under the then state regulations. The loans are still in use. To repay the loans, Luthai need only follow the current spot exchange rate of 6.85.63
Half of the enterprises we surveyed have increased or will increase their investments in risk management, and high performers devote a higher proportion of their aggregate investments to these efforts. (See Figure 29.)

iii) Expanded financing channels

Another important way a company can fuel growth is to expand its financing channels. Traditionally, the financing channels available to Chinese enterprises have been rather limited, with a heavy reliance on bank loans. Stock and bond markets, especially direct financing from bond markets, represent a paltry share of the channel picture. Given that configuration, any market disturbance will prompt banks to tighten the money supply, which will create capital shortages and thus prevent sustainable development for many enterprises. To ensure undisrupted cash flows, companies must identify new means of obtaining financing and new types of capital sources available under China’s existing financial monitoring framework. (See Figure 30.)
Enterprises with access to overseas financial markets may try to combine domestic and cross-border financing. As the yuan continues to appreciate, foreign financing may offset exchange-rate risks while enterprises may also make exchange-rate gains, as has Luthai. For companies listed overseas, this is in every measure a viable approach.

In terms of financing sources, enterprises may obtain financial support from non-traditional sources, such as government economic stimulus packages, temporary suspension or reduction of dividends, strategic investors, a parent company, mutual-assistance arrangements with business affiliates or sales of non-core assets. Our research suggests that HPBs are more interested in stable sources of development funding, whereas other enterprises are more concerned about the cost of capital. (See Figure 32.)

Apart from the above means to expand financing channels, companies can also take advantage of innovative financing, in forms such as syndicated loans and joint bonds. According to Sichuan Daily, five cash-strapped bean-paste manufacturers in Pixian, represented by Sichuan Gaofuji Food Company, approached the local branch of the China Construction Bank to propose co-financing and joint guarantee through the creation of a union. The parties arranged for mutual monitoring through joint guarantee, which in turn spread the risks of the bank loans. The proposal gained the bank’s attention. After sending staff to Pixian to study the development of the bean-paste industry, the bank decided that this approach could diffuse the risks arising from insufficient collateral. It granted the five companies a new form of syndicated loan with joint guarantee.65

Figure 31 Under the impact of the financial crisis, how will your company obtain the required capital to support growth in the next upward cycle? (n=101)

Source: Accenture survey, 2009

Figure 32 Please prioritize your company’s future capital strategies. (n=100)

Source: Accenture survey, 2009

Enterprises with access to overseas financial markets may try to combine domestic and cross-border financing. As the yuan continues to appreciate, foreign financing may offset exchange-rate risks while enterprises may also make exchange-rate gains, as has Luthai. For companies listed overseas, this is in every measure a viable approach.

In terms of financing sources, enterprises may obtain financial support from non-traditional sources, such as government economic stimulus packages, temporary suspension or reduction of dividends, strategic investors, a parent company, mutual-assistance arrangements with business affiliates or sales of non-core assets. Our research suggests that HPBs are more interested in stable sources of development funding, whereas other enterprises are more concerned about the cost of capital. (See Figure 32.)

Apart from the above means to expand financing channels, companies can also take advantage of innovative financing, in forms such as syndicated loans and joint bonds. According to Sichuan Daily, five cash-strapped bean-paste manufacturers in Pixian, represented by Sichuan Gaofuji Food Company, approached the local branch of the China Construction Bank to propose co-financing and joint guarantee through the creation of a union. The parties arranged for mutual monitoring through joint guarantee, which in turn spread the risks of the bank loans. The proposal gained the bank’s attention. After sending staff to Pixian to study the development of the bean-paste industry, the bank decided that this approach could diffuse the risks arising from insufficient collateral. It granted the five companies a new form of syndicated loan with joint guarantee.65
VI. Hidden opportunities in the crisis
Chapter 58 of Laozi reads: “Blessing leans on disaster; disaster is hidden in blessing.” The global financial downturn has slowed the blistering pace of China’s economy. However, as soon as Chinese enterprises are back on their feet and looking to the road ahead, they may find that crises present opportunities. Difficult times induce changes that, in turn, open new doors. Companies aspiring to become high performers are even more likely to see opportunities for further development. As our survey shows, Chinese enterprises believe that two of the greatest opportunities afforded by the financial crisis are: i) accelerated industry consolidation and improved market situation, and ii) employees/business partners’ enhanced understanding of reform.

Of the many opportunities inherent in the crisis, several are worthy of our attention. First, the recession has provided Chinese corporate managers a rare opportunity for learning and reflection. Why did some companies collapse while others were able to stand firm? What insight does the downturn offer for organizations aspiring to become HPBs? Should Chinese businesses negate Western management philosophy and practice because of the crisis?

Second, the financial crunch has also reshaped the global competitive landscape, giving businesses in emerging markets a fairer starting point. In the business world, whenever one force diminishes, another will rise. The collapse of the old order leaves room for growth of a new one.

Third, the crisis prompted Chinese enterprises to reconsider the necessity of transformation to renew their business and operating models. Finally, it has brought new opportunities for global strategy. Some companies might adopt a “deglobalization” strategy by slowing down their pace of globalization and shifting their focus toward the domestic market. But more businesses will seize the opportunities created by the crisis to actively explore new ways of expanding their global footprint.

To sum up, the worldwide economic slowdown has presented four types of opportunity for Chinese businesses: i) learning, ii) competition, iii) transformation and (iv) globalization.

1. Opportunity for learning

Crisis offer rare opportunities for learning. The irregularities and imbalances in the economy overall, the chaos in companies’ management teams, entrepreneurs’ unethical practices, the negligence of duty on the part of market intermediaries and regulatory bodies’ inaction all offer important lessons for Chinese enterprises and the Chinese government. Why did some so-called long-established industry giants collapse, while others in the same industry did well? Companies can gain insights by asking this question as well as others.

The recession led many business leaders to question many practices and ideas that are widely taken for granted regarding matters such as executive compensation, financial innovations,
leverage evaluation, risk control and globalization. Chinese enterprises should look beyond the immediate impact of the crisis to investigate the ways in which such practices and ideas led to the downturn.

While we see the crisis as an opportunity for learning, we also see it as an opportunity to participate. Chinese enterprises can play a more active role in defining the rules of the game for business. These rules will govern everything from government reform programs, international dealings and monetary policy to commodity price negotiation mechanisms, technical standards and management best practices.

2. Opportunity for competition

The worldwide economic disaster has provided enterprises with a new starting point for competition. China's economy fully integrated into the international economy only in 2001 when it acceded to the WTO. Chinese companies had long been at a disadvantage in competing with their international counterparts, owing to lagging management concepts and systems, lack of core technologies, low value-added processing and assembly and other inherent problems. However, since the late 1990s, Chinese business, especially large state-owned enterprises, have undergone a substantial transformation through joint-stock reform, thanks to the introduction of strategic investors and foreign management practices, workforce reductions and improved efficiency and technological innovations. Although Chinese companies haven't completely eliminated their inherent disadvantages, the gap between them and their foreign counterparts has narrowed, and their competitiveness has shown significant improvement.

To some extent, the financial crisis has helped level the playing field. In today's multi-polar world, economic power has spread out from the traditional locus of Western developed markets to include new markets, and multinational corporations have become more localized. These developments have lowered entry requirements, a situation that offers Chinese enterprises opportunities to join the competition on the international stage. Indeed, 65% of our study's respondents said they believe they will enjoy improved competitiveness after the financial crisis.

For instance, Huawei, the Chinese networking and telecommunications supplier, once suspended its operations in the North American market, which, as a mature market, was difficult to penetrate. However, the financial crisis reversed this situation. When telecom operators faced cash-flow difficulties, long-established equipment suppliers, decimated by the crisis, were unable to adjust their prices accordingly. In contrast, Huawei's low-cost advantage became attractive. To capitalize on this opportunity, Huawei hired local Americans to enrich its management and increased its staff from 200 to 500.66

In another example, the CEO of a major rail equipment manufacturer revealed during an interview with us that despite the decreasing number of orders placed by the hard-hit U.S. and European markets, demand from developing countries remained stable. This manufacturer's total orders for the first six months of 2009 increased by 60% over the same period the previous year. Many third-world countries are still using railways and locomotive equipment from the colonial era because they lack the funding to invest in newer assets. (A locomotive could cost as much as US$3-4 million.) In the past, such countries' railway operations were supported by financing from European and U.S. banks. Although these banks are now fraught with problems, their Chinese counterparts are generally in good shape. And that presents a good opportunity for Chinese enterprises to join hands with Chinese banks to establish a presence in these markets. Although the majority of China's exports in the past consisted of mass-market commodities, they now include more machinery and equipment.67 The case study on Changyu offers additional insights into how the financial downturn presented new opportunities for Chinese businesses to compete.

3. Opportunity for transformation

Crises are painful, but they are also the best times for transformation. This is particularly true of the current worldwide recession. For Chinese businesses, especially state-owned enterprises, transformation has long been problematic. Government leaders, business media and management journals have long bandied about words like transformation, restructuring, integration and optimization. But transformation has proved to be a difficult and protracted process. We believe that transformation in Chinese businesses will manifest itself in three ways: i) an innovation-driven business model; ii) industry consolidation; iii) a move upward on the value chain.

i) An innovation-driven business model

For more than 30 years now, Chinese enterprises have developed under favorable conditions in the market-oriented economy. In the initial stage of reform, needy consumers snapped up whatever products were available, generating admirable profits for companies. Then, consumer goods shortages eased, and a huge market formed, which has nurtured many of today's well-known Chinese enterprises. In addition, as the shackles of the old system had laid upon rural Chinese were broken, these country dwellers freely pursued their own interests. The exodus of migrant workers from rural villages into factories provided an apparently inexhaustible supply of cheap labor for the manufacturing industry. Now, these so called “dividend” factors are waning and losing their power to boost economic progress.

Chinese enterprises are at a turning point. They must decide where to go next and what choices to make. In the aftermath of the crisis, they will face a new business environment, as previous business models become obsolete. They will not be able to do business as usual in the economic recovery. Many astute executives already understand how the rules of the game have changed, and they will be the ones to forge ahead. The crisis offers Chinese enterprises an opportunity to transform their conventional model centered on
During the global recession, wine companies who relied heavily on the European and U.S. markets saw their sales fall. According to the Canadean Beverage Report 2008, in 2008 the world’s top 10 wine makers averaged negative growth of 4.6%. (Eight of them experienced negative growth, the worst being -10%.) The only winery among the global top 10 that stood out was China’s hundred-year-old Changyu Group of Yantai. In 2007, for the first time it became one of the world’s top 10 wineries in terms of sales. And in 2008, it rose to the seventh slot on the list, with sales topping US$890 million.

Changyu’s success stems from its unique marketing strategy. In the fourth quarter of 2008, the company mapped out a five-year plan for advancing its “market segmentation and product-specific marketing” strategy. It subdivided its marketing functions, allocating corporate marketers and distributors to every regional market. Meanwhile, Changyu’s various marketing and management subsidiaries established in every provincial capital a wine dealer system based on classes of wine (low, medium and high) and wine categories (brandy, healthy liquor and imported wine). The company then developed distributor incentives keyed to product sales and distributors’ profitability. The Beijing Chateau Changyu AFIP, with financing from China, the U.S., France, Italy and Portugal, blends brewing, wine knowledge, training, travel and leisure services, and caters to the social elite. Located overseas, the New Zealand Kely Chateau Changyu, the only top winery with golf-course facilities, has identified high-end white-collar workers and fashionable people as its target consumer group.

In 2009, Changyu continued to increase its marketing efforts in Changyu Cabernet, Chateau Changyu AFIP and Changyu Golden Ice Wine Valley. The “Century Cellars” series, featuring Changyu’s high-end products, has entered the market and has benefited from celebrity endorsements.

For each kind of wine, Changyu adopts a specific marketing approach, with an eye toward cultivating wine consumers’ tastes. Its goal is to develop consumer segments for each kind of wine. Changyu’s four wineries present different wine “cultures” to Chinese consumers. Its joint venture with the French Castel Group, Chateau Changyu Castel (China’s first professional winery), targets high-end government officials and business executives. With 5,000 mu (cir. 824 acres) of ice-wine vineyards, Golden Ice Wine Valley (located near Huanlong Lake in Benxi, Liaoning), a joint venture with the Canadian ice wine company Aurora, has successfully targeted fashionable white-collar workers. The Beijing Chateau Changyu AFIP, with financing from China, the U.S., France, Italy and Portugal, blends brewing, wine knowledge, training, travel and leisure services, and caters to the social elite. Located overseas, the New Zealand Kely Chateau Changyu, the only top winery with golf-course facilities, has identified high-end white-collar workers and fashionable people as its target consumer group.

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Case study
Changyu: a bright touch of wine
China's economy consists of numerous dichotomies: state-owned versus private economies, economies of eastern versus western regions, urban versus rural markets and so on. The export-dependent model that has long fueled China's economic development has produced an "inward-looking" and an "export-oriented economy, which exist side-by-side. Many manufacturing companies serve overseas customers in the form of OEMs. Their business and operating models differ from those of inward-looking enterprises, and they operate in a different business environment.

At the onset of the financial crisis, these export-oriented enterprises were the hardest hit. The root problem was that they were just export-oriented businesses located on the Chinese mainland, rather than businesses stepping beyond national borders to globalize. They had strong manufacturing capacities and excellent quality management systems, but they lacked sales channels and marketing experience. Without command of key links in the value chain, they did not have localized operations for overseas markets either. When the downturn came, they turned to look at the domestic market, only to discover that it operated with an entirely different model. They found it very difficult to gain a foothold there.

However, recent data show that 70% of China's foreign-trade enterprises have begun to plan (or proceed with) the expansion of their domestic operations to handle exports as well as domestic sales. Many foreign-trade enterprises that had entered the domestic market were apparently under less pressure in the face of financial crisis. On the other hand, the traditional inward-looking enterprises started to set their sights on globalization to actively seek new market opportunities for brand expansion, supply chain expansion and so on. In the post-recession era, more and more companies with multinational operations will likely expand their global footprint. In addition to bringing about revolutionary changes to business models, this integration will also drive fundamental changes in consumption patterns and demand.
b) Unification of the national market

In 2004, China's Ministry of Commerce launched a nationwide study on the issue of "breaking regional blockades and building a unified national market." Ministry leaders knew that China's economic development had long been constrained by the fragmented national market—a result of local protectionism and trade barriers. A study by the business administrative departments in 22 provinces, municipalities and autonomous regions showed that products or services in 20 provinces and cities suffered from regional trade barriers. The study also showed that different areas and regions were affected by regional blockades to varying degrees. For example, those industries subject to higher taxes—such as alcoholic beverages, cigarettes, automobiles and meat and meat products—were more vulnerable to blockades. Of nearly 4,000 companies that received and responded to a questionnaire sent by the State Council Development Research Center, two thirds believe that local protectionism affects enterprises' operations. The fragmented market has greatly increased these companies' costs.

Take logistics. For every return trip by truck from Guangzhou to Beijing, miscellaneous charges amount to an estimated RMB 7,000—and that's in addition to normal transportation costs. For a 40-foot container shipped from China to the United States, the total freight costs only about RMB 20,000. Clearly, the unit freight from Guangzhou to the U.S. is cheaper than that to Beijing. Although the proportion of the Chinese logistics industry in GDP dropped from 19.4% in 2000 to 18.3% in 2008, it was still twice as high as that in developed countries.

Eliminating trade barriers to overcome market fragmentation and establishing a unified national market are the best ways to optimize allocation of resources, encourage competition, protect consumer interests and improve market efficiency within China. The impact of the financial crisis sharpened executives' awareness of the need for such "nationalization." Businesses, trade associations, management academics and government leaders should be able to understand the necessity of creating a unified national market to stimulate domestic demand and boost China's next round of economic growth. We expect high performance businesses to seize the opportunities presented by industry consolidation and the emerging unified national market to pursue nation-wide operations. In a sense, "nationalization" is a pre-requisite for globalization.

c) Increased industry concentration

In addition to integrating China's inward-looking and export-oriented economy and unifying the national market, enhancing industry concentration through market-driven practices will help to further pump up China's economy. Low industry concentration closely relates to the fragmented market, but it also stems from a weak private sector. Except for a handful of monopolistic industries characterized by a high degree of concentration (such as oil and gas, telecommunications, electricity and to a lesser degree the financial sector), most sectors in China are extremely fragmented. They can seldom take full advantage of economies of scale, save resources and improve capital efficiency and labor productivity.

After the worst of the global financial crisis had eased, concentration intensified in some industries in China. For example, in September 2009, Tangshan Steel Holdings, a listed subsidiary of Hebei Iron and Steel Group, took over two other listed subsidiaries, Handan Iron & Steel and Chengde Titanium, through stock exchange. The merging of the three companies made the new Tangshan Iron and Steel the only listed iron and steel subsidiary of Hebei Iron & Steel Group; its crude steel production rose from 11.37 million tons to 21.19 million tons, an increase of 86.37%, and production of construction steel increased by 123%. The coal industry in Shanxi has also recently begun consolidating.

So far, however, such integration has occurred primarily in resource-intensive industries, such as minerals and metallurgy. Also, the government is still the major agent behind this concentration. Ideally, we will see more spontaneous, market-driven integration in consumer goods industries in the days ahead. Industry concentration should no longer rely only on government decisions. While proper industry concentration facilitates economies of scale and improves efficiency of resource usage, an enterprise's size is by no means the determining factor behind excellent performance.

iii) A move upward on the value chain

Since reform and open-door policy were implemented in China, the nation's economy has made remarkable achievements. Nevertheless, it still depends too much on external markets and on low-cost advantages. Moreover, much of the manufacturing sector is process-based, with relatively few independent brands, and lacks core technology as well as control over the whole value chain.

To solve these problems, the Chinese government has made changes to stimulate domestic demand to strengthen the manufacturing sector. Through direct industry planning, it is trying to change the conventional low-end processing-manufacturing model. If these changes deliver their promised benefits, we will see the spontaneous formation of industry clusters and a shift away from the heavy reliance on mining, metallurgy, electricity and so forth. We will also see an extension upstream and downstream of the value chain, as demonstrated in the so-called "6+1" model. That is, the proportion of R&D, design, logistics and marketing services in the entire value chain should significantly increase toward the high end of the value chain.

Consider the example of Chinese apparel maker Erdos. As the overseas market stumbled, Erdos turned to the domestic market and tried to extend toward the high end of its industry's value chain by opening up new markets with a luxury brand. (See the Erdos case study.) Haier offers another apt illustration. A leader in the household appliances industry, Haier has pursued both product management and brand management. To further integrate into the world market, it has shifted its attention from enlarging manufacturing scale to better managing its resources and capital. By working with professional OEM manufacturers, it has taken the first step in "de-manufacturing." Haier's production of notebook computers has been handed over to Taiwan
China produces the world’s finest cashmere. As China’s cashmere companies are at the low end of the value chain, their design and brand marketing do not match those of international companies. They have a strong competitive advantage only in low-priced cashmere raw materials and low-end apparel manufacturing. Profits in this industry flow largely to foreign high-end brands.

To change the situation and extend toward the high end of the value chain, Erdos has set out to make branding its core strategy for business development. For a long time, Erdos has been committed to using high-tech to increase its brand value. Now that the company has leading technology, it has a say in cashmere resources. To create high-value-added products to fill the brand vacuum in domestic luxury goods, Erdos launched in 2007 the luxury brand “1436” (a grade of cashmere product with fineness at 14.5 microns or less and a length of 36 mm or more, produced by a pollution-free textile dyeing method using Swiss dye).

Erdos’s exports account for nearly half of its apparel products. Exports of cashmere sweaters plunged from 6.8 million pieces in 2006 to 4 million in 2007, dropping further to 2.7 million in 2008. The figure for 2009 plunged to 2.3 million. Compared with previous years, goat fiber, cashmere yarns and cashmere sweaters in 2008 saw substantial reductions in orders, with an average decrease of 36%. Owing to appreciation of the RMB, reduced export tax rebates and rising labor costs, Erdos saw a sharp deterioration in its export revenue. In 2008, it recorded RMB 3.13 billion in operating income from cashmere garments, down 3.8%, and its gross profit margin fell by 4.81%.

China’s luxury market is markedly inelastic, compared with consumption patterns in foreign markets. For that reason, Erdos decided to fully launch “1436” to the domestic market in 2009. To position “1436” to compete with foreign luxury brands in the super-high-end market, the company has set out to make cashmere clothing fashionable and trendy. It has gradually set up product design centers in Paris, Milan, New York, London and Tokyo - the world’s five fashion capitals. Erdos has also forged alliances with world-class fashion design companies, and has incorporated overseas design elements in its product designs. In addition, it has appointed Mr. Gilles Dufour, former director of French luxury brand Chanel, as art director of the “1436” brand. Mr. Dufour’s responsibilities will include personally designing clothing lines slated for launch in the autumn and winter of 2009. In the long run, “1436” clothing will be positioned as high-end products, with constant upgrading to enhance sales margins. Thus the intrinsic value of cashmere will be fully realized.
OEM manufacturers such as Quanta, Foxconn, Allreach and Pouchen. In the LCD TV sector, Haier has also outsourced part of its production to Taiwan professional OEM manufacturer TPV. This shift in manufacturing can reduce a company’s operating costs so that it channels limited funds into the most profitable areas, such as exploring user needs, strengthening innovation and application of core technologies to meet consumer demand and brand management, in an effort to move upward on the value chain.75

Extending upward on the value chain not only presents an opportunity for transformation, but is also a major component of economic structure readjustments. Hence, it will play a significance role in enhancing China’s economy. However, two issues need to be clarified. First, industry upgrading is by no means equivalent to giving up the manufacturing industry. Rather, Chinese businesses should strike a balance. After all, the manufacturing industry is an indispensable link in the value chain, without which any brand assets or marketing activities are useless. Second, that is why we stress an expansionary type of “upward movement along the value chain” instead of a mutually exclusive type of “value chain shift.” Expansion enables consolidation and value addition, while a shift may weaken the foundation. Given the characteristics of the Chinese market -- huge size, abundant workforce, imbalanced development, differentiated competitiveness and versatile socio-economic culture -- without doubt it can accommodate different business and operating modes. We don’t believe that everybody should toe the same line, either going for low-end markets or concentrating on high-end markets. Diversity should feature prominently in the Chinese market.

“In building a complete industry chain, we should be aware of the suitable time and place, make the right choices, know when to stop and, most important, change our strategies and business models. We should do a good job of reducing capacity and expand both up- and downstream and toward supporting industries. This should be the future direction of development of a privately run iron and steel enterprise.”  
– Zhou Furen, Chairman, Xiyang Group76

4. Opportunity for globalization

The global financial crisis has eroded demand as well as customers’ ability to pay in all countries, in particular Western developed countries. Thus Chinese companies, especially export-oriented enterprises, suffered major setbacks in their efforts to expand overseas. Many firms faced operational difficulties and even bankruptcy. Economic development of export-intensive regions suffered, leading to unemployment among migrant workers, which in turn hampered efforts to increase rural household incomes and stimulate rural consumption.

Meanwhile, trade protectionism has been on the rise globally, difficult news for China’s export enterprises. At the same time, many people view the worldwide recession as a consequence of globalization. Thus, resistance to globalization is arising in some countries and regions, as hostility to foreign capital and investment intensifies. Cross-border mergers and acquisitions by Chinese enterprises have also met with increasing resistance.

Chinese enterprises relying heavily on the domestic market were relatively unaffected during the downturn. The nation’s financial industry also suffered minor losses, because it is relatively young and subject to stringent state regulation. This prompted us to ask: Is globalization necessary? Should China further open up its financial and capital markets? Should it draw on Western market rules and economic systems? In short, is globalization the right path to pursue?

We strongly believe that globalization has become an irreversible trend in today’s world. Chinese enterprises are still lagging behind in the process of globalization. In September 2009, the China Enterprise Confederation released a list of the top 500 Chinese enterprises. According to this research, 70% of these companies’ revenue comes from domestic sales, while the domestic sales of the U.S. Fortune 500 accounted for only 37.5% of total revenue.78

The financial crisis has created a power shift in the world economy that presents Chinese businesses with new opportunities for globalization. During the downturn, many enterprises in developed countries faced financial and operational difficulties, and external funding sources dried up. Asset prices around the world dropped, creating opportunities for Chinese companies, which were relatively less affected by the recession, to accelerate development through cross-border mergers and acquisitions. In developed economies, the crisis also reduced financial institutions’ capacity to provide trade financing. This presents an opportunity for China’s exports, especially of capital goods. Enterprises should fully evaluate their industry’s competitive position on the international stage and develop globalization strategies that leverage their own strengths. However, globalization is an integral part of a company’s overall strategy. An enterprise should proceed with globalization only if it supports its strategy. It should not insist on globalization for its own sake. Some Chinese enterprises that excel in their own industries (including telecommunications equipment and transportation equipment such as locomotives) have already started talking with the country’s major financial institutions about ways to expand their overseas market share through China’s export credit facilities.
Once a company has formulated a globalization strategy, it should prepare to implement the strategy by cultivating a globalized way of thinking, acquiring the right talent and developing globalization capabilities (especially knowledge and expertise in language, culture, customs, legal systems, personnel management and labor law). Because of the relatively short history of China’s market economy and low degree of marketization, Chinese enterprises have a relatively weak globalization process. In the rush to globalize, these companies made major mistakes. Some leading domestic enterprises even suffered major setbacks in the process. They were forced to suspend their globalization efforts or had to use profits in subsequent years to write down the financial consequences.

After experiencing the last round of setbacks, Chinese enterprises have acquired a deeper understanding of the difficulties inherent in globalization. These companies, especially HPBs, have begun taking a more pragmatic approach to going global. High performing businesses have succeeded in striking a balance between maintaining a long-term strategic vision and delivering short-term performance. Indeed, HPBs are more optimistic about the trend of globalization, because they believe that the financial crisis has created more opportunities for globalization. In contrast, other enterprises have focused more on the challenges posed by the recession. (See Figure 35.)

"Enterprises should think thoroughly about the underlying purpose of going out to the overseas market. The financial crisis has made a lot of export-oriented enterprises realize that they have a good chance to grow only when there’s a market. Many foreign companies are flocking to China, which indicates there is a market in China. Chinese enterprises may not have to go for the overseas market and abandon the domestic market. Conversely, they should consolidate the domestic market first before seeking overseas development."

- Liu Chuanzhi, Chairman, Lenovo Group

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**Figure 35 How has the current financial crisis affected your company’s globalization strategies? (n=95)**

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>% =Strongly agree+Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>New opportunity: better talent supply in the market</td>
<td>75%</td>
</tr>
<tr>
<td>New opportunity for extensive growth: reduced asset prices</td>
<td>74%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Challenges</th>
<th>% =Strongly agree+Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Put more risks on our globalization</td>
<td>74%</td>
</tr>
<tr>
<td>Limited sources forced the globalization process to slow down</td>
<td>74%</td>
</tr>
</tbody>
</table>

Source: Accenture survey, 2009
While most Chinese enterprises see globalization as a means to access foreign resources and penetrate overseas markets, Chinese HPBs have a broader view. They view globalization from the perspective of long-term strategy and focus more on the intangible competitive advantages globalization offers, such as the establishment of global brands, the building of global organizational networks and the opportunity to recruit employees knowledgeable about cross-border operations. (See Figure 36 and Figure 37.)

Finally, HPBs in China better balance globalization and short-term performance. When the immediate demand in overseas markets is low, they lean toward the domestic market in their resource allocations. This enables them to ensure business performance while continuing to nurture their globalization capabilities. In addition, they are becoming more adept at using global resources to build competitive advantages in their domestic market. In particular, they are increasingly adroit at using intellectual and technical resources to serve the domestic market.
VII. What lessons can Chinese enterprises learn from the crisis?
Our research indicates that Chinese enterprises have different views of the worldwide economic downturn than their Western counterparts and have drawn different lessons from it. For some Chinese executives, the fact that some Western multinational corporations stumbled badly in the crisis suggests that Western management ideas and practices no longer apply in China. Some Chinese business leaders insist that the reason China was not hit as hard by the crisis was that it had maintained its own management approaches. They point to Chinese firms that proudly ranked among the global Fortune 500. Other observers have even argued that reform of state-owned enterprises in China lost momentum because of inherent flaws in the market economy.

Some Chinese companies reacted to the recession by merely striving to keep themselves intact with minimal losses. They lack a long-term vision and will remain lethargic until the crisis has subsided.

Yet others have responded by engaging in self-reflection and focusing on lessons they can learn to avoid future crises. They are also searching for new opportunities to forge ahead and build their own future. With an outward looking mindset, they will proactively seek more opportunities for growth after the crisis. Moreover, they are rethinking assumptions about globalization and taking part in rewriting rules of the game, thereby contributing to the development of management philosophy and practice.

Although the financial crisis did not originate in China, the Chinese economy and Chinese enterprises felt the effects. China's growth model, built on heavy reliance on exports, low-cost but high energy consumption and high-pollution manufacturing, was already showing signs of trouble before the crisis. Years of rapid growth have masked problems in corporate strategy, organization, management and efficiency, thereby impeding long-term development of enterprises. China should seize the opportunity presented by the crisis to speed up macroeconomic reform, including reform of state-owned enterprises, to ensure sustained healthy economic growth.

The reason China emerged from the crisis relatively unscathed was not that Chinese companies had a long-term vision, sound management or excellent risk-mitigation expertise. It was that China's financial sector was not fully open and Chinese firms had achieved a relatively low degree of globalization. However, as opening up of financial markets and globalization are both irreversible, inaction and complacency may make China more vulnerable to the next crisis.

During crises, companies should learn the right lessons, remain calm, combat complacency and discern the opportunities and pitfalls presented by the situation. By doing so, they can continue to push reform and improve management. Among the three building blocks of high performance, performance anatomy reflects business leaders' mindset and the firm's culture, which strongly influence whether one company's strategies prove superior to its rivals'. In our view, if Chinese enterprises avoid complacency, transcend self-protection and learn the right lessons, while persisting in reform and accumulating global management experience, they can circumvent setbacks sustained by their international counterparts and build their own future.
VIII. Looking beyond the crisis – concluding remarks
As we developed this report, the National Bureau of Statistics revealed that China’s GDP growth for 2009 was 8.7%. China’s economy is heading toward a “post-crisis era.” The fact that China led the global recovery has garnered worldwide attention. At this critical juncture, seizing opportunities to revitalize China’s economy and ensure a smooth and sustained recovery is of vital importance. Amid the uncertain global economic situation and future, we recommend that Chinese enterprises do the following:

1. Understand the difficulties that could arise in the recovery’s initial stages.
   But don’t be overly optimistic. For some industries, these early stages will be extremely difficult. They may even face greater risks than they did during the crisis. Any inappropriate measures may negate efforts undertaken in the early stages of the crisis.

2. Regularly review your company’s responses to the crisis.
   Strategies designed to sustain competitiveness should be transformed into long-term strategies. On the other hand, moves that were made to ensure survival and maintain operations but that are detrimental to long-term development should be rectified as soon as possible, so they do not impede long-term sustainable growth and competitiveness.

3. Assess your industry’s ecosystem/value chain.
   Today, market competition no longer takes place between individual enterprises, but between industry ecosystems. Enterprises must maintain the integrity of their ecosystems as they shift focus from tackling the crisis to fostering the next round of growth.

4. Rethink consumer needs.
   The global financial crisis has affected consumers in complex ways, including prompting changes in consumer demand, purchasing behavior and ability to pay. Understand these changes, but also anticipate what consumer desires and behaviors will look like during the recovery. As a new growth cycle dawns, you can take the lead in developing strategies to differentiate your company from rivals and gain competitive advantages.

5. Embrace new challenges during prosperity.
   As the economic downturn eases, new challenges will arise, such as a general increase in operating costs caused by inflation, higher borrowing and financial costs induced by higher interest rates, lack of financing channels (especially for small and medium sized enterprises) and intensified competition for talent. Take precautions against all these possibilities.

   An in-depth review of Chinese enterprises’ efforts to tackle the current financial crisis—including how they respond to challenges, how they balance short-term imperatives with long-term development, how they seek opportunities and what lessons they should learn—will have far-reaching benefits. These include a stronger Chinese economy, more dynamic Chinese enterprises China’s ability to become a world leader in innovation and management ideas. We believe that through profound reflection by Chinese enterprises, the government and every other party interested in China’s economic development, this vast nation will embark on the road to greater economic development and become a major contributor to the global economy.
74. The "6" refer to the soft links of design, procurement, logistics, order processing, sales and distribution, and retail, while the "1" refers to the hard link of manufacturing. The model advocates that an enterprise should focus not only on manufacturing, but also on other links in the value chain.

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