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Going global

*Prospects and challenges
for Chinese companies on
the world stage*

Strategy and
Change



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IBM Institute for Business Value

IBM Business Consulting Services, through the IBM Institute for Business Value, develops fact-based strategic insights for senior business executives around critical industry-specific and cross-industry issues. This executive brief is based on an in-depth study by the Institute's research team. It is part of an ongoing commitment by IBM Business Consulting Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to iibv@us.ibm.com for more information.

School of Management at Fudan University

Fudan University was the first institution of higher learning in China to set up a department of business education, and was also the first in the country to resume its business education program after the reform and open-door was implemented in China. Over the past two decades, the School of Management at Fudan University has developed into an internationally well respected business school. This joint project with the IBM Institute for Business Value fulfills our mission to analyze business operations and national economic activities using advanced management theories, systematic methods, mathematics models and information technology. It is part of our commitment of timely research for enterprise practitioners with insights into important strategic, tactic and operational business issues that can help firms make informed sound decisions.



Going global

Prospects and challenges for Chinese companies on the world stage

Introduction

Over the past quarter-century, China has achieved phenomenal economic growth – primarily through a combination of exports, massive infrastructure spending and gradual market liberalization – culminating in China's entry into the World Trade Organization (WTO) in 2001. Many economists now project China's economy will surpass the size of the U.S. economy by 2035.¹

Chinese companies will undoubtedly accelerate their global activities in line with China's ascent as a major economic power. By "global," we mean much more than simply exporting – companies need to possess the right combination of management capabilities, innovation, market savvy and an overseas footprint to compete on a worldwide scale and extend their presence across industry value chains. While some Chinese companies will globalize organically, we anticipate many others will pursue joint ventures, strategic partnerships, or mergers and acquisitions (M&A) to accelerate their global presence. Lenovo's recent purchase of the IBM Personal Computer (PC) Division, SAIC's 50.6 percent acquisition of Korea's Ssangyong,² China National Petroleum Corporation's (CNPC) US\$4.2 billion acquisition of PetroKazakhstan³ and Haier's unsuccessful bid for Maytag in 2005 highlight Chinese companies' ambitions to expand globally by securing assets and capabilities that can enhance their competitiveness – not only in foreign markets, but also in China.

Which Chinese industries and companies hold the best prospects for becoming global players? What parallels and "lessons learned" can be drawn from Japan and Korea? What are the challenges facing Chinese companies going global? What strategies and operational capabilities must companies have in place to succeed? These and other questions were the focus of our research on the globalization of Chinese companies over the next decade.

The IBM Institute for Business Value, in partnership with Fudan University, assessed the globalization trends, aspirations, motivations and challenges of Chinese companies primarily in high-potential manufacturing and natural resources industries. Over 40 interviews were conducted with Chinese companies, M&A specialists and global subject matter experts.

This study provides a strategic framework for Chinese companies to assess their global readiness and identify innovative ways to move up the global value chains in their respective industries. At the same time, foreign companies – whether active in China or not – will benefit from this study by factoring our insights into the formulation of their business strategies.

China's integration into the global economy

China's integration into the world economy is being driven by four key forces: Rapid economic growth, booming global trade, foreign direct investment in China and Chinese investments abroad.

Rapid economic growth

During the past twenty-five years, China achieved an average annual gross domestic product (GDP) growth rate exceeding 9.6 percent,⁴ with total GDP reaching US\$2.35 trillion in 2005.⁵ China's economy has grown by 7 times in the past 20 years, faster than the U.S. and Japan grew during their early stages of economic development. Japan took 25 years to grow 6 times from 1960 to 1985 and the U.S. took over 60 years to grow 3.5 times from 1870 to 1930.⁶ China's GDP growth is projected to continue at annual growth rates of at least 7 percent through the next decade and beyond.⁷

Booming global trade

China's exports reached US\$760 billion in 2005,⁸ making it the fourth largest exporter globally⁹ – with high-technology products such as telecommunications equipment, computer and electronic products and electronic components accounting for 43 percent of total exports.¹⁰ In fact, China is now the largest exporter of information technology products in the world, surpassing the United States in 2004.¹¹ But foreign funded firms and those from Hong Kong and Taiwan are driving China's massive export trade. These companies accounted for 57 percent of total exports in 2005 while Chinese companies only accounted for 43 percent.¹²

Foreign investment in China

Foreign companies have invested a staggering US\$621 billion in China with US\$60 billion in 2005 alone, making China the third largest recipient of foreign direct investment (FDI) in the world.¹³ Much of this FDI can be attributed to China's entry into the WTO, which offers unprecedented access for foreign companies in many industries. Ironically, while WTO has helped to spur economic growth and market liberalization, it is also driving Chinese companies overseas to build capabilities that can help them compete more effectively against domestic and foreign competitors in China.

Chinese investment abroad

By comparison, China's outward direct investment (ODI) and cross-border M&A is tiny by global standards. In 2004, China accounted for only 0.25 percent of global ODI (excluding M&A), ranking 28th among all countries.¹⁴ Government-imposed financial controls have historically capped China's total ODI at about US\$5 billion per year and require companies investing more than US\$10 million to gain special approvals.¹⁵ However, this may change in the near future. China has announced that it will relax or abolish these controls in 2006, which would undoubtedly lead to a sharp increase in ODI and M&A activities. In fact, China's Ministry of Commerce predicts outward investment will maintain an average annual growth rate of over 22 percent during the next five years and exceed US\$60 billion by 2010.¹⁶

Is China another Japan or Korea?

In many respects, China's globalization drive is similar to that of Japan in the 1980s and Korea in the 1990s. Like Japan and Korea, Chinese companies are making efforts to transition from low-cost manufacturers to providers of higher value-added products and services. Chinese companies are gradually acquiring the necessary technology and skills, and in some cases, experimenting with their own branded products in foreign markets. In terms of outward investment, Chinese companies are primarily focusing on nearby Asian countries, but also investing in the United States and European Union to globalize their operations and, in some cases, avoid trade barriers.

However, there are major differences that make China's globalization efforts unique. First, China has the distinct advantage of sheer size and rapid growth in its early stages of economic development. Second, China opened its market to foreign competition much earlier than Japan or Korea, which both adopted protectionist policies to allow their companies to develop scale and experience before competing head-on with foreign companies in their home markets. While China's WTO entry has meant increased foreign competition in many industries in China, it has also helped Chinese companies gain access to global management concepts, overseas talent, technologies and best practices provided by thousands of large foreign companies investing in China.

Finally, unlike Japan and Korea's carefully orchestrated industrial policies that nurtured global champions such as Samsung, Sony and Toyota, China does not have a centralized government body driving China's globalization efforts. Although the government is encouraging selected Chinese companies ("national champions") to globalize, much greater emphasis has been given to industry restructuring as part of China's gradual transition to a "socialist market economy." These and other differences suggest that Chinese companies will face a much more challenging environment than their Japanese and Korean peers did during their early stages of development.

Which industries, which companies?

The IBM Institute for Business Value analyzed Chinese industries and companies to determine those that are favorably positioned to become global players over the next decade. We used three “filters” – company size, industry characteristics and company characteristics – to identify Chinese companies, primarily in manufacturing and natural resources industries, with strong globalization potential (see Figure 1). Our analysis included both state owned enterprises (SOEs: companies with more than 50 percent ownership by either central or provincial governments) and privately owned enterprises (POEs: companies with 50 percent or more ownership by private investors).

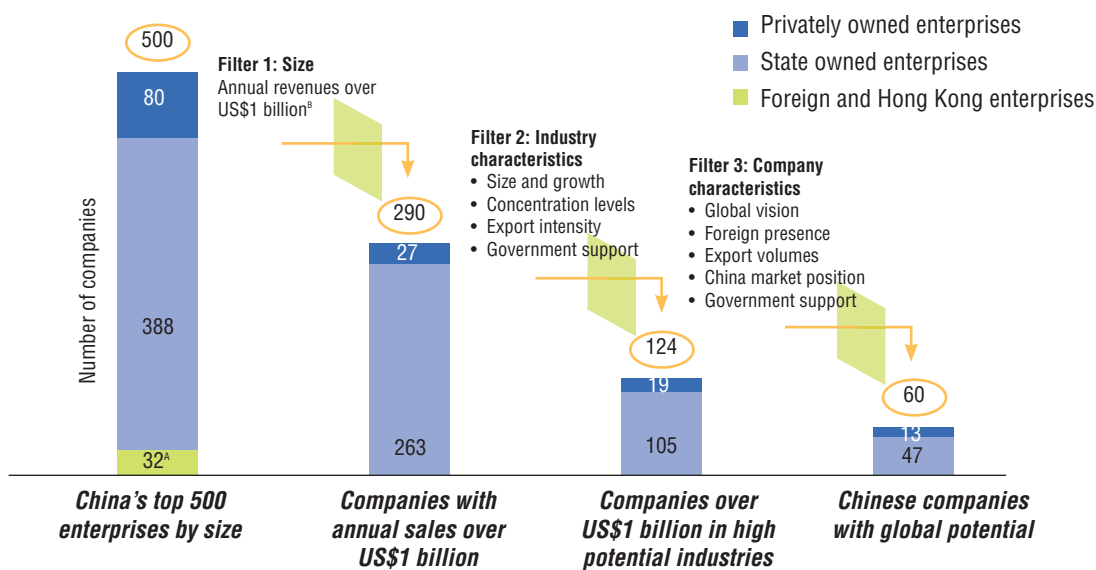
Most Chinese companies remain small by global standards. Among China’s top 500 enterprises, only 290 companies met our initial filter of *annual revenues over US\$1 billion* and only 14 have annual revenues over US\$15 billion. By comparison, the U.S. has over 143 companies with annual revenues exceeding US\$15 billion.¹⁷

Our second filter identified Chinese industries with strong globalization potential based on criteria such as *industry size as a percentage of GDP, degree of industry concentration, export intensity and government support*. For instance, we included the home appliances industry, where Chinese companies are the largest global manufacturer in 28 out of 32 product categories. Air conditioners and refrigerators made in China accounted for 67 percent and 34 percent of global production in 2005, respectively.¹⁸

A total of 124 industries met our second filter criteria, including consumer electronics, computer products and components, telecommunications equipment, automotive, steel, logistics and petrochemicals. This narrowed our list to 124 companies (105 SOEs and 19 POEs).

Our final filter identified among the 124 companies those that met additional criteria, such as *a leading market position in China, over 15 percent of revenues from either exports or foreign operations and a strong global vision*.

Figure 1. Determining Chinese industries and companies with globalization potential.



Note: *The 32 companies include 100 percent wholly foreign enterprises, joint ventures and Hong Kong based companies investing in Mainland China. *Several companies were just under the US\$1 billion threshold but passed our size filter due to their rapid growth and global ambitions.
 Source: “China Top 500 Enterprises,” China Enterprise Confederation & China Enterprise Directors Association, IBM Institute for Business Value China analysis 2005.

This narrowed our final list to 60 companies, of which all but 13 are SOEs.

Among these 60 companies, relatively well known players such as Huawei, CNPC, CNOOC, Haier, TCL, Lenovo, SAIC and Baosteel met our criteria but so did less well-known companies such as Galanz (home appliances), Wanxiang Group (auto parts), Midea Group (consumer electronics), Chery (automobiles), Lifan (motorcycles) and Ningbo Bird (mobile devices). It is primarily among these 60 companies that China's global leaders are likely to emerge, but in our view only those with a clear management vision, strategy and strong execution capabilities are likely to succeed. Figure 2 show all POEs and a partial list of the SOEs that passed our three-filter test for globalization potential.

Motivations for going global

Chinese companies we surveyed are motivated to expand globally for a range of reasons, including tapping new growth markets, securing natural resources, and acquiring advanced technologies and management skills (see Figure 3).

Seeking new markets for growth

Seeking new markets for growth was the key reason cited by surveyed Chinese companies when asked why they wanted to expand globally. In aggregate, the majority of profits in China disproportionately flow to highly regulated, highly concentrated industries such as oil and gas, mining and telecommunications services that are primarily controlled by SOEs. In contrast, many manufacturing sectors are deregulating, hindered by overcapacity

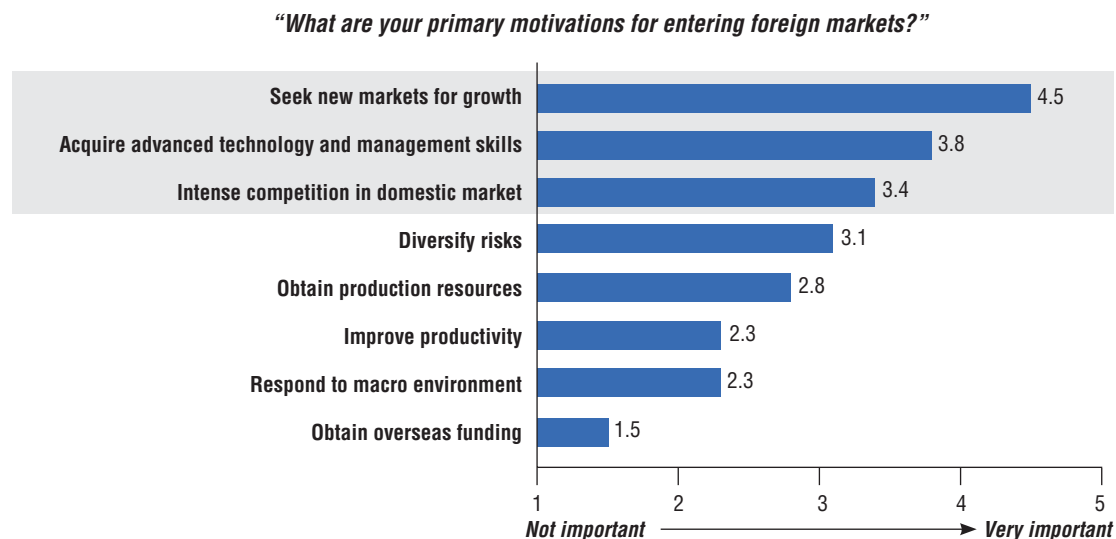
Figure 2. Meeting the test: Selected Chinese companies with globalization potential.

Selected SOEs with globalization potential (Total: 47, 13 highlighted)			POEs with globalization potential (Total: 13)		
Company	Industry	2004 Revenue (US\$ Billion)	Company	Industry	2004 Revenue (US\$ Billion)
Sinopec	Energy	76.7	Midea Group	White goods	3.9
CNPC (PetroChina)	Energy	69.1	Huawei	Telecom equipment	3.8
BaoSteel	Steel	19.6	Wanxiang	Auto parts	2.5
Haier	White Goods	12.2	SVT Group	Electronics	2.3
SAIC	Automobiles	12.1	Younger	Textiles	1.7
Cosco	Logistics	11.3	CHINT Group	Electronics	1.4
CNOOC	Energy	8.6	Wahaha	Beverage	1.4
BOE	Electronics	5.5	Galanz	White goods	1.3
Lenovo*	Computers	5.1	Skyworth	Brown goods	1.3
TCL	Electronics	5.1	People Electric	Electronics	1.2
Hisense	Brown goods	3.3	Aux Group	White goods	1.2
ZTE	Telecom equipment	2.6	Lifan	Motorcycles	0.8
Chery	Automobiles	0.6	Geely	Automobiles	0.6

*Note: Lenovo revenues are prior to acquisition of the IBM PC Division, Lenovo's March to September 2005 revenues (including the former IBM PC division) were US\$6.2 Billion.

Source: Company Websites, IBM Institute for Business Value analysis 2005.

Figure 3. Primary motivations for Chinese companies considering global expansion.



Source: IBM Institute for Business Value and Fudan Globalization survey, 2005 (n = 25).

and facing intense profit pressures. As a result, Chinese manufacturers are naturally looking abroad for new markets with less competition and higher profit potential.

The automotive industry illustrates the intense competition facing both foreign and domestic companies battling for market share in China's rapidly growing market. In 2004, the automotive industry had overcapacity of 3 million units,¹⁹ which contributed to year-on-year price reductions by as much as 9 percent in certain segments, leading to declining profits for the entire industry, especially for low-end models.^{20, 21}

Acquiring advanced technologies and management skills

Innovation is on the top of CEOs' minds as the only way to survive and grow in an increasingly competitive world, as highlighted in the IBM Global CEO 2006 study.²² However, many Chinese manufacturers still compete on low-cost labor and aggressive pricing, rather than on innovative, branded products and services with higher profit margins. For Chinese original equipment manufacturers (OEM) exporters, the majority of the product's value

is captured by their customers: foreign companies with strong research and development (R&D), brands and deep relationships with end consumers, often leaving Chinese manufacturers with razor-thin profit margins well below 5 percent.²³ While an increasing number of Chinese companies are developing the technologies and management capabilities to improve their global competitiveness, others view global partnerships and foreign acquisitions as a more attractive, viable alternative.

Government support for Chinese companies going global

The government is becoming more supportive of Chinese companies expanding globally. Over the past five years, various government agencies such as the National Development and Reform Commission (NRDC), the Ministry of Finance, the Ministry of Commerce and the State Administration of Foreign Exchange (SAFE) have all developed policies encouraging Chinese companies to expand overseas.

More recently, in March 2006, Chinese Premier Wen Jiabao reaffirmed the government's commitment to support globalization by offering various types of support, including new policies and services to coordinate overseas investments and manage risks.²⁴ Furthermore, financial institutions such as the Bank of China, China Development Bank and Sinosure are planning to offer foreign exchange, financing and insurance services to Chinese companies expanding abroad.

“We will support qualified enterprises in going global, making overseas investment..., establishing processing centers, marketing and service networks and R&D centers in other countries”

– Wen Jiabao, Chinese Premier, March 5, 2006²⁵

Another type of support that selected SOEs and POEs are already enjoying is favorable financing in the form of credit lines and low-interest loans. Huawei, for example, has received a US\$10 billion line of credit from the China

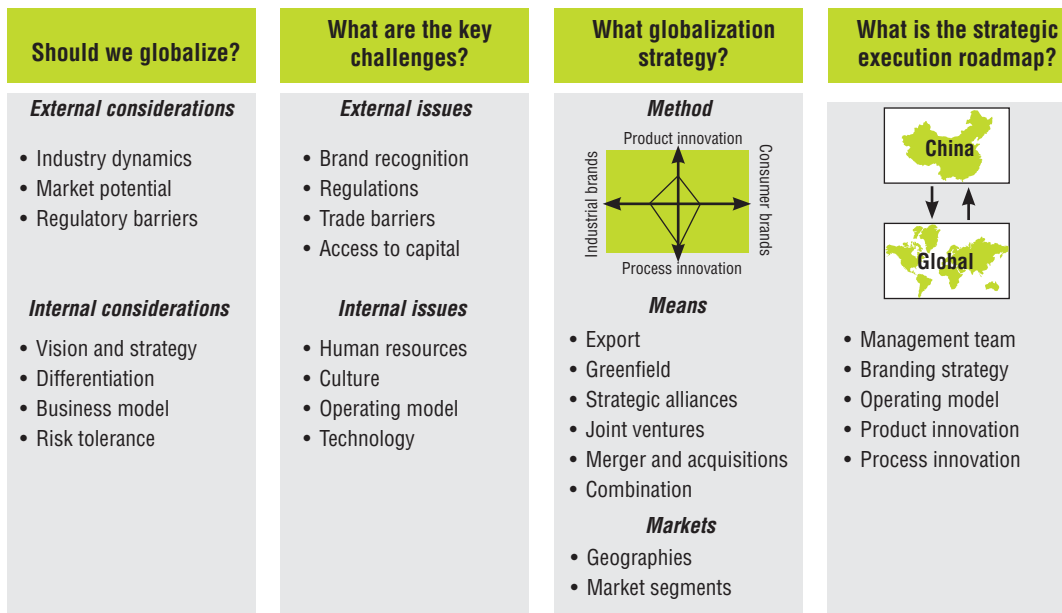
Development Bank to help fund its global expansion efforts.²⁶ Chinese companies such as ZTE are also indirect beneficiaries of Chinese foreign aid programs to African and other developing countries.

Nonetheless, many companies we interviewed felt the Chinese government could do more to help facilitate companies expanding overseas. Interview respondents felt that the government should encourage healthy competition in the domestic market, punish illegal export activities and resolve trade disputes in order to help improve the overall image of Chinese companies operating globally. Smaller POEs also indicated they lacked the global networks and resources to conduct basic research on regulations and trade requirements in foreign countries.

Strategic imperatives for Chinese companies going global

Chinese companies need to address a broad range of issues to develop and execute their globalization strategies successfully (see Figure 4).

Figure 4. Chinese companies going global need to answer four key questions.



Source: IBM Institute for Business Value analysis, 2005.

Should we globalize?

Surprisingly, we interviewed many Chinese companies that had begun to expand overseas (and in several cases, retreated) without first asking the basic questions of whether or not they need to expand globally and, if so, whether they are truly ready. Companies with the best prospects of succeeding in global markets are those expanding from a position of strength, rather than weakness. While foreign markets may appear attractive to Chinese companies struggling with low profit margins, they will undoubtedly face new and even greater management challenges as they expand overseas.

Overcoming the challenges

Once Chinese companies make the decision to globalize, they need to overcome a myriad of challenges such as human resources, branding, global operations, financing and regulatory barriers. Overcoming the lack of qualified human resources and building global brands were overwhelmingly identified by interviewees as their top key challenges.²⁷

Lack of qualified human resources

Chinese companies are struggling to develop a senior management team with the skills necessary to operate effectively on a global scale – such as familiarity with foreign markets, foreign language skills and experience managing global operations. Companies can adopt three main strategies to overcome such challenges. First, companies can internally groom a Chinese management team by providing appropriate training and development to acquire the skills needed to manage a global business. Second, companies can recruit overseas Chinese or foreigners, but interviewees indicated it is often difficult to integrate these experienced managers into the culture and daily operations of the parent company. The third option is M&A, which, despite significant integration challenges, can dramatically shorten the time required for Chinese companies to build a critical mass of management talent capable of running a global enterprise.

“We are still students trying to learn global management. Our overseas workforce is sometimes qualified to be our teachers in this area. It is very difficult for ‘students’ to manage ‘teachers’ as we go global.”

– Tong Hai Bin, Shanghai Machine Tool Group²⁸

Building global brands

Many Chinese companies consider brand ownership critical to their success overseas, but they may not fully appreciate the sustained investment required for brand building and management. Global companies such as Coca-Cola, Nike and Philips invest heavily in their brands, as suggested by their high rankings among the 2005 *BusinessWeek*/Interbrand list of the top 100 global brands. It is striking that no Chinese companies are mentioned in the list.²⁹

Huawei works to strengthen its global reputation

It takes significant time and investment to create a global brand. Huawei, a large manufacturer of wireless telecommunications and networking equipment, made its initial foray into global markets in 1996, initially targeting emerging markets in Asia and Africa.

In 1999, Huawei lost several bids in Yemen and Laos, due in part to customers’ perception of Huawei as a new and untested company from China. In response, Huawei initiated a “New Silk Road Tour” program whereby Huawei hosted potential overseas customers on tours of China to provide them with a first hand appreciation for China’s technology capabilities, rapid economic development and Huawei’s proven track record with Chinese telecommunications operators.

In Europe and the U.S., Huawei heavily promoted its products and solutions through media campaigns, conferences and road shows.³⁰ However, Huawei also faced some obstacles

along the way. For instance, in the U.S. it changed its name to “FutureWei,” in part to make it easier for Americans to pronounce. However, U.S. customers may be confused by the use of the name FutureWei in the U.S. and Huawei in other parts of the world.³¹

Huawei’s efforts to establish a global reputation of offering technically advanced and cost-effective telecommunications solutions are paying off. In 2005, overseas sales exceeded 50 percent of total revenues. Huawei has also made its way onto the preferred supplier list of major telecommunications operators such as British Telecom – a major breakthrough and recognition of the growing influence of its brand.³²

Interestingly, some Chinese interviewees viewed China’s image as a country as being critical to their company’s ability to build a successful global brand. But the relationship may not be as strong as some Chinese executives believe. A recent survey by Ogilvy & Mather in the U.S., U.K. and France suggests consumers in those countries are willing to buy Chinese branded products, even though they may have mixed perceptions of China as a country. As shown in Figure 5, over 40 percent of consumers in the survey were “very or quite likely” to choose a Chinese product in certain categories where they felt the products offered reasonable quality at low prices.³³

Figure 5. Would you buy a Chinese product?

Percentage of Western consumers who were “very or quite likely” to choose a Chinese product in selected categories.

	UK (n = 100)	U.S. (n = 100)	France (n = 103)
Electrical goods	34	41	39
Computers	24	28	42
Clothing	21	38	35
Mobile phones	20	33	47
Food	33	32	24
Cleaning products	19	28	28
Personal care	14	24	10
Beer	14	15	10
Airlines	12	16	16
Financial services	4	5	7

Source: Ogilvy & Mather survey of 303 consumers in France, UK and U.S., 2005.

Develop a globalization strategy

Before venturing overseas, Chinese companies need a globalization strategy to determine how they will differentiate themselves to capture value, identify the right business model for global expansion and prioritize target countries for market entry.

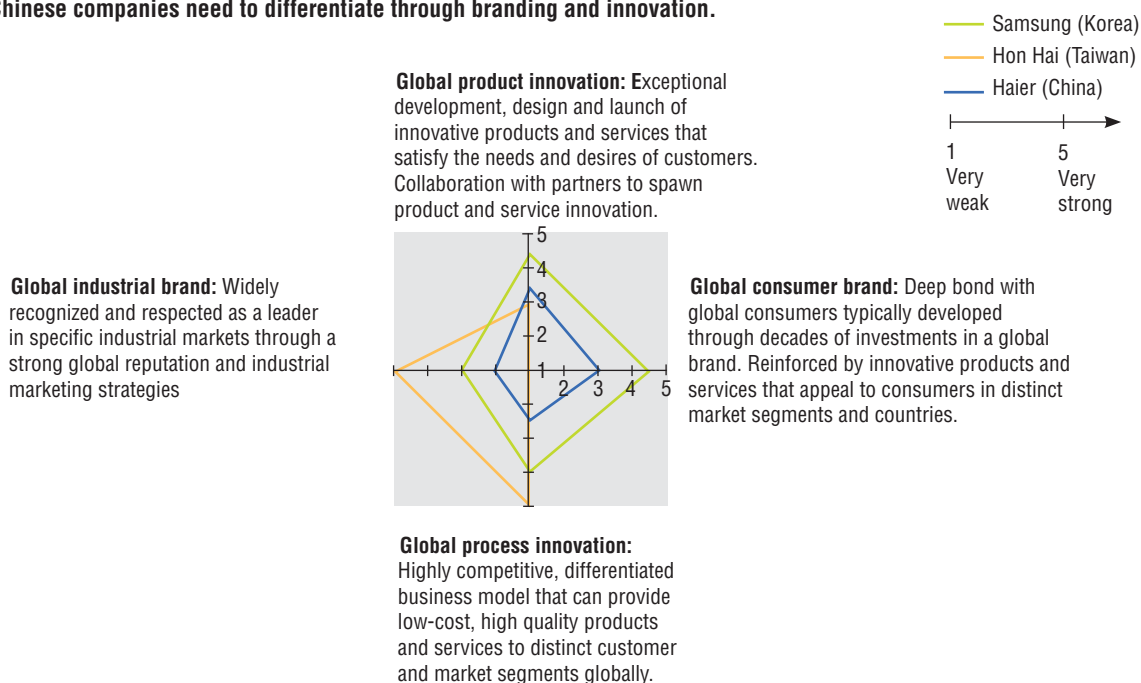
Differentiation strategy

In today’s global marketplace, Chinese companies need to differentiate themselves beyond just price to move up the value chain and enhance profit margins. Virtually all successful global companies differentiate themselves in terms of brand and innovation. Excellence in at least two dimensions - product or process innovation, and industrial or consumer brand- is almost always required. To help companies understand their relative positioning vis-à-vis competitors and create differentiation strategies, IBM has developed a maturity model which scores companies across various branding and innovation attributes. The model measures companies on a scale of one to five (with five representing very strong) on four dimensions: industrial brand, consumer brand, process innovation and product innovation (See Figure 6).

While most Chinese companies remain anonymous contract manufacturers with little or no global consumer branding power, some companies are building from their origins as low-cost leaders to become innovative, branded players. For example Haier, widely regarded in China as a role model for Chinese companies, is gradually building its global brand with an initial focus on the U.S. and invests heavily in R&D in order to develop new, innovative products such as three-temperature zone, environmentally friendly, dual-drive washing machines.³⁴

Chinese companies are also looking to Asian companies, such as those in Taiwan and Korea, to learn how they have gradually built up their innovation and branding capabilities. For example, Taiwan’s Hon Hai is unknown to consumers (not a consumer brand), but it is highly respected within the electronics industry (strong industrial brand). Its relentless focus on process and product innovation allows the company to maintain its leadership as a low cost, high quality OEM and original design manufacturer (ODM) supplier to companies such as Apple Computer which possess strong consumer brands.

Figure 6. Chinese companies need to differentiate through branding and innovation.



Source: IBM Institute for Business Value analysis, 2005.

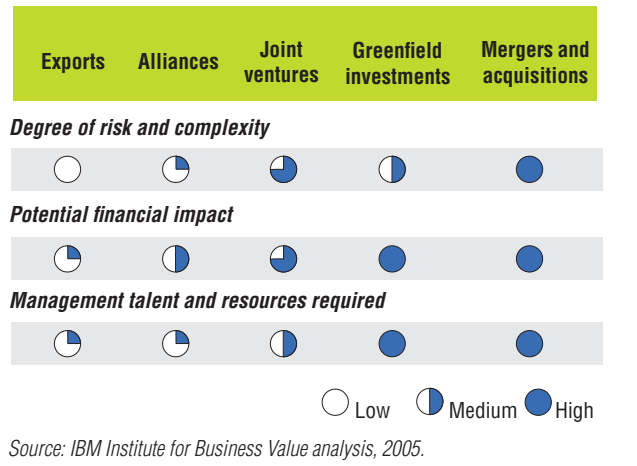
Many Chinese electronics companies we interviewed identified Korea-based Samsung as a company they can learn from in terms of product innovation, process innovation and branding. Starting from its humble origins as a “second-rate manufacturer of electronic goods targeting price-sensitive users,”³⁵ Samsung now has total sales of US\$55.26 billion with nearly 80 percent coming from abroad.³⁶ Samsung consistently invests in R&D (at 8 percent, the fourth highest in the global electronics industry) and produces a broad array of consumer and industrial products of high quality at reasonable prices.³⁷ Samsung has also emphasized process innovation as a basis for competitive advantage. One division, Samsung Electronics Corp., has realized bottom-line improvement of at least US\$1 billion by adopting Six Sigma as a tool for innovation, efficiency and quality.³⁸ In terms of branding, Samsung also manages its brand centrally while localizing marketing activities at regional levels.³⁹ Samsung is now the fastest growing and 20th most valuable brand in the world.⁴⁰

Business model strategy

Business model innovation is emerging as a new strategic differentiator for high performing companies. As illustrated in Figure 7, there is a continuum of investment options, ranging from simple exports to M&A that companies should consider when developing the appropriate business model to globalize. Most companies adopt a combination of investment options (for example, *greenfield* investments) in certain countries and strategic alliances in others), depending on the company’s tolerance for risk, ability to manage complexities, financial resources and management capabilities.

Mergers and acquisitions obviously shorten time for global expansion, but the failure rates are historically high (as many as 61 percent of cross-border M&A deals fail globally).⁴¹ But for rapidly growing companies with strong management skills, the rewards can be worthwhile. In fact, a recent IBM Institute for Business Value global study

Figure 7. Weighing the trade-offs of globalization business models.



indicates that companies that have grown successfully are twice as likely to acquire companies as others.⁴² What distinguishes these “successful growers” are their skills in leveraging acquisitions to drive their growth agendas, such as finding better deals and executing them more effectively.⁴³ Strong management of the post-merger integration process is critical, as shown in the case of Lenovo’s acquisition of the IBM PC division.

Lenovo: Managing post-merger integration successfully

Lenovo’s US\$1.75 billion acquisition of the IBM PC division is one of the highest profile deals made by a Chinese company to date. The deal included a five-year brand licensing agreement; the acquisition of globally-recognized trademarks such as the ThinkPad; a long-term strategic alliance whereby IBM sells Lenovo products to corporate customers globally; and an arrangement for IBM to provide Lenovo with various support services worldwide.⁴⁴ The deal immediately provided Lenovo with the additional technologies and capabilities required to transform itself into a global player in the PC industry – including global management talent, a valuable brand, access to global channels and customers, a well-established global management system and a global operations footprint.

Managing post-merger integration complexities such as Lenovo’s acquisition requires the establishment of a dedicated project management office (PMO) to integrate across business units and geographies. A PMO typically addresses a wide range of global integration challenges, including clearly defining the new organization structure and its responsibilities, managing relevant stakeholders through clear and frequent communications, and addressing cultural differences between the two companies.

The “new” Lenovo Group has achieved solid financial results to date. In August 2005, Lenovo Group announced its first quarter results for the merged entities, reporting that consolidated revenues increased 234 percent to HK\$19.6 billion (approximately US\$2.5 billion), and overall gross margins increased by 1.2 percent from the prior year.⁴⁵ The company also reported accelerated benefits from the acquisition in numerous areas, such as savings from procurement and supply chain efficiencies.⁴⁶ Lenovo’s stock price increased by over 60 percent between July and December 2005 – viewed as an indication of investors’ endorsement of the deal.⁴⁷

Market entry strategy

There is no single “right” market entry strategy for Chinese companies pursuing global expansion. For OEM manufacturers with significant exports, a strategy may be to gradually build up their globalization capabilities by maintaining their OEM relationships with U.S. and European customers while pursuing emerging niche markets in Asia, Africa and Latin America with their own brands. Africa, in particular, is becoming a destination of choice for Chinese companies that are strong financially (and sometimes have government support) but may lack the management capabilities to compete effectively in developed countries.⁴⁸

For companies with limited global experience, they may first consider developing countries before trying to enter advanced markets such as the U.S. and Europe. For example, Chinese automakers such as Geely and Chery are exporting and assembling low-end models in Latin America and the Middle East. By doing so, they can gain experience in less competitive emerging markets and

prepare for product launches in advanced ones.⁴⁹ Chery is currently developing low-priced models for Latin American countries⁵⁰ and has ambitious plans to launch five models especially for the U.S. within the next two years.⁵¹

On the other hand, companies such as Haier are initially targeting advanced markets in the U.S., Europe and Japan to build up their capabilities and establish a market presence in lower-end product categories. We believe manufacturers pursuing M&A strategies will likely focus on Europe and the U.S., where acquisitions can provide access to brands, management talent, R&D capabilities, distribution and sales channels that would likely take decades to develop organically.

Strong execution is the key to success

With the appropriate globalization strategy in place, a clear plan for execution is critical for success. We believe Chinese companies must execute in at least five key areas, as shown in Figure 8.

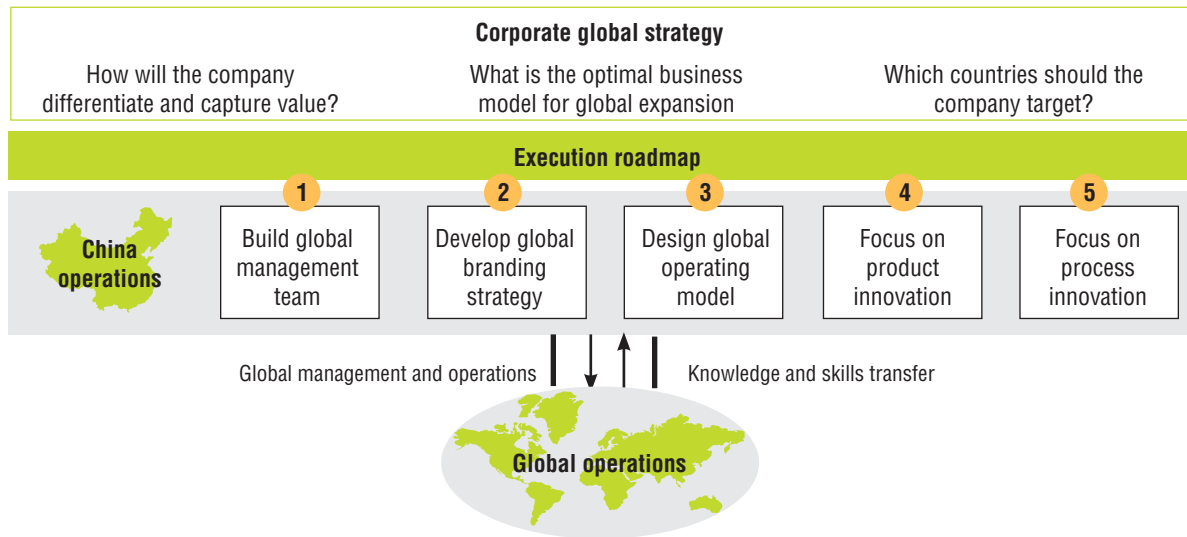
Build a global management team

The first requirement for companies is to develop a strong global management team. Without this, failure is virtually assured. To help overcome the current shortage of experienced global managers in China, companies can pursue a combination of training, external recruitment and external partnerships (such as leveraging consultancies or strategic alliances). For example, Huawei has selectively applied all of these strategies to accelerate the development of its global management team.

Develop a global branding strategy

Chinese companies need to decide whether or not to pursue a global consumer brand and if so, how. At the same time, the relationship between their brand strategy in China and overseas should be considered. For example, Li-Ning, a top athletic footwear and apparel company in China, recently recruited an American NBA player (Damon Jones of the Cleveland Cavaliers) to endorse its brand. The endorsement deal helps to

Figure 8. Strong execution is the key imperative for Chinese companies going global.



Source: IBM Institute for Business Value analysis, 2005.

increase Li-Ning's international recognition and, at the same time, raises the brand's profile among Chinese consumers.

In many cases, Chinese companies will need to adapt the branding practices they use in China to appeal to consumers in sophisticated markets. Chinese companies must realize that brands are much more than just a logo. Brands require sustained investment in marketing and, of course, resonate with customers who trust the company's products and services.

Design a global operating model

Global governance and management systems – which determine how global enterprises will be managed and controlled – must be in place to manage operations effectively across countries, including China. Our interviews suggest most Chinese companies are not yet capturing the full benefits of globalization by managing operations consistently across countries in areas such as finance, R&D and marketing, where centralization is often important. Some companies tend to run global operations independently with limited linkages with headquarters while others have yet to obtain full operational synergies from foreign acquisitions.⁵² While independent country operations may work in the short term, ultimately they impede economies of scale and prevent global synergies from being fully realized.

Focus on product innovation

To compete globally, Chinese companies need to improve their product development capabilities, product designs and ability to collaborate with business partners. Leading companies adopt systematic and innovative approaches to understand customers needs, identify products to bring to market, launch new products quickly and keep pace with rapid changes in technology. They recognize the value of collaborating with partners who are in tune with the needs and desires of specific customers in different markets. For example, Samsung improved its product development and design capabilities by investing in R&D centers in foreign countries and collaborating with foreign product designers.

Focus on process innovation

Both core processes (areas such as manufacturing, procurement, logistics, marketing and sales) and non-core processes (areas such as finance, accounting and human resources), along with supporting IT systems, must be integrated globally in a way that drives standardization, yet also helps ensure sufficient flexibility to meet country-specific market conditions. Through such integration, companies can work to achieve economies of scale, improve management control, rationalize costs and enhance customer service levels throughout their global operations. Leading Chinese companies are in the early stages of realizing this vision and understand the importance of process innovation to their long-term growth and competitiveness.

Conclusion

China's ascent as a global economic power is giving rise to a small, but growing, group of Chinese companies with the potential to become global players in their industries over the next decade. However, success will not come easily. Chinese companies operate in a new era with intense competition, open markets, instant communication and an apprehensive world often fearing – rather than embracing – the notion of companies from emerging countries expanding into global markets. Only those companies with clear, focused strategies and strong execution capabilities can hope to become future global leaders in their industries. The potential rewards are great – not only for Chinese companies, but also their foreign partners with whom they may form alliances to win in the global marketplace, including within China.

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