China's Emerging Mid-Market – Where "Good Enough" Just Isn't

It's no secret that China is, or soon will be, the world's largest market for numerous products, ranging from luxury consumer goods, such as Gucci handbags and Mercedes sedans, to more mundane industrial goods, including steel, paper, and heavy machinery. In fact, China's economic miracle is in no small measure due to its success in bargaining away access to the world's largest market against huge amounts of foreign direct investment, advanced technology, and managerial expertise.

However, China's enormous size doesn't just represent a unique profit opportunity to the MNCs from developed countries, but, in many sectors, will also become a serious, even existential, threat - and not just in China itself, but also around the world. The reason is that much of the country's growth will actually come from its vast mid-market of "good enough" products.

Unfortunately, many MNCs misinterpret "good enough" as inferior, low-quality, products, and mistakenly believe that they can succeed by simply decontenting and "dumbing down" the world-class products they sell elsewhere. In reality, it often requires products that have been specifically designed from the ground up to meet Chinese mid-market customers' unique needs, and must be supported by completely different business models. In this sense, "good enough" isn't good enough at all, and many MNCs will, in fact, find it quite challenging to become competitive in the Chinese mid-market.

Conversely, when left unchecked, their local Chinese competitors may, over time, use that same mid-market as a launching pad for becoming global leaders, even when they initially don't have any firm-specific advantages of their own. The defining moment typically occurs when a local mid-market competitor manages to gain a dominant position in China and starts leveraging its resulting scale and other cost advantages to become the global low-cost provider. The best firms then become "Mid-Market Innovators" by relentlessly driving cost out of every function, before moving up-market and expanding internationally by heavily reinvesting their profits into R&D and making strategic technology acquisitions to become world-class players everywhere. This is, in fact, exactly the process by which Mid-Market Innovators, such as CIMC and Sany, have become such a threat to their world-class competitors from the US, Europe, and Japan.

While every firm will have to develop its own mid-market strategy – preferably before local competitors achieve a dominant position, after which they may be difficult to stop - there are a few universal principles that will apply to MNCs in most industries:

1. **Low-Priced Products** – It is important to make a clear distinction between low-cost versions of already existing products that were originally designed for customers in developed market versus low-priced products that were specifically developed for the, often unique, requirements Chinese customers. More often than not, merely introducing low-cost products will not be sufficient to compete successfully in the Chinese mid-market.

2. **Mid-Market Business Model** – Many MNCs will have to completely rethink their existing business models to support mid-market products, including focusing on acquisition price

and near-term operating costs versus productivity and lifetime cost of ownership, will-fit instead of proprietary replacement parts, and after-sales service through independent distributors instead of company-owned stores.

3. **Extensive Localization** – It will almost always prove necessary to transfer core value chain activities to China to narrow the cost gap with domestic mid-market competitors to acceptable levels through local manufacturing, sourcing, and supply chain management. In addition, many MNCs will have to develop significant local innovation capabilities, as Western engineers are seldom capable of the frugal engineering required in China.

4. **Selective Partnerships** – Due to China's complexity and size, most MNCs will need to acquire, or partner with, one or more local players to fill gaps in their "good enough" product portfolios, develop the optimal channel footprint, negotiate with regulators at the local, regional, and national levels, or, in some sectors, merely to gain market access.

5. **Multi-brand Portfolio & Architecture** – Virtually all MNCs should consider developing a comprehensive multi-brand strategy to successfully operate across premium and mid-market price points as well as multiple product categories.

6. **Local Organization** – In addition to localizing the firm's operations, it will likely be necessary to localize management as well. At a minimum, MNCs should clarify decision rights and put in place a strong governance structure. In addition, many MNCs should consider treating China as a stand-alone entity with its own P&L to make sure it gets properly resourced.

7. **Global Mindset** – It will be important to ensure that headquarters has at least a basic understanding of China's opaque, and often misunderstood, business and regulatory context.

Many MNCs will find it exceptionally difficult to defend their market positions against attacks from Chinese Mid-Market Innovators, especially smaller- and medium-sized firms who lack the financial and managerial resources to develop and implement a comprehensive "Win-In-China" strategy as well as those firms who produce basic industrial goods that are sold primarily on the basis of their relative price/value position. However, the vast majority of MNCs will have no choice but to somehow find a way to win in China, if they want to survive, or at least remain independent, in the long-term.