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# The Coming Globalization of Chinese Multinationals: Threat or Opportunity?

BY JOHN JULLENS

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**W**hen China's largest automaker, Shanghai Automotive Industry Corporation (SAIC), opened its new U.S. headquarters in suburban Detroit last year, even General Motors—SAIC's joint venture partner in China—was caught off guard. It seems that no one on the Chinese side had bothered to tell them. And SAIC isn't the only Chinese firm with global ambitions: Chinese outbound foreign direct investment (FDI) has more than quintupled over the last 10 years.

Although these new Chinese multinationals have tried to tread quietly, many observers in the West have taken notice, and are beginning to get worried. Indeed, some even talk of a new economic cold war, suggesting China's unique brand of state capitalism is poised to decimate the traditional *laissez-faire* capitalism of the West.

In reality, few Chinese firms are ready to compete with their Western counterparts, at least in developed markets. Many remain contract manufacturers of labor-intensive, low-added-value products for Western consumers. Others, such as China's automakers (including SAIC), remain far behind their Western competitors from Detroit, Wolfsburg, and Tokyo—lacking not only core powertrain and other technologies, but also advanced management systems, decision-making routines, and, in the case of China's state-owned firms, even

the governance and incentives systems to become world-class competitors anytime soon.

If most Chinese firms aren't even close to being globally competitive, what in the world are they doing in places like Detroit? Why do they think they can be successful in faraway developed markets without the cutting-edge technology, strong brands, and other firm-specific advantages required to overcome their "liability of foreignness," instead of simply expanding first into other emerging markets in neighboring Southeast Asia?

The surprising answer is that many Chinese multinationals are investing overseas not to gain access to new markets, but rather to become more competitive at home. China's economic development strategy of trading off access to its seemingly inexhaustible supply of cheap labor and billions of new customers for vast amounts of FDI and the transfer of Western technology hasn't been consistently successful. It's worked very well for high-speed rail, but not at all in, for example, automotive assembly, as Western firms have been reluctant to share their most advanced know-how with their Chinese partners.

Chinese firms have thus increasingly turned to overseas markets to acquire the knowledge they need to survive at home. This behavior goes a long way toward explaining why they have been unusually focused on acquisitions as opposed to organic expansion, especially

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compared to the Japanese and Korean firms that preceded them, and why most of their M&A deals have been concentrated in the seven industries where the domestic competition between Chinese and global firms is particularly intense: automobiles, electronics, energy, home appliances, machinery, resources, and telecommunications. Other factors favoring acquisitions include the large number of Western targets following the '08 financial crisis, as well as generous financing and other support from the Chinese government.

However, although certainly sensible in theory, this strategy too has been unsuccessful in practice, primarily because it requires another set of world-class capabilities that most Chinese firms simply don't yet possess, including turnaround management (the acquired firms are often financially and strategically distressed), integration management (Chinese firms typically have limited PMI experience and only a basic understanding of the know-how to be transferred), and international experience.

Despite these setbacks, Chinese companies' desire for international expansion can create real opportunities for win-win partnerships with Western firms, which often urgently need to capture new growth opportunities in emerging markets but may lack the critical capabilities to do so. And the best Chinese firms actually do possess distinctive capabilities that could be quite useful to Western firms in other emerging markets. For example, Chinese firms are often skilled at reducing product complexity and redesigning manufacturing processes to take out costs, and potentially have a greater ability than most Western firms to work around the institutional voids that characterize the business and regulatory environments typical of most emerging markets.

Perhaps most obviously, Chinese and foreign firms could jointly develop "good enough" versions of existing world-class products for other emerging markets by removing nonessential features to make them more affordable to emerging market customers. Alternatively, they could add features to existing low-end products to make them more attractive to mid-market customers, or, of course, design entirely new low-priced products from the ground up. Either way, such mid-market products will typically have to be supported by completely different business models and specialized capabilities. Huawei's recent partnership with Microsoft to sell smartphones in Africa is a good example. Microsoft leverages its Windows 8 operating system and technical expertise, while Huawei contributes its low-cost manufacturing capabilities and extensive experience in African countries.

Once the partners have developed a product for emerging markets, they may discover latent demand for such a product also exists in developed markets. Firms in developed markets may not have introduced such low-cost products before to avoid cannibalizing existing sales of more profitable high-end products or because anticipated volumes may not have been large enough to justify the required investment. A well-known example is Mahindra's discovery that its small tractors, which were originally developed for farmers in India, also appeal to recreational gardeners in the United States.

Less obviously, there may also be win-win opportunities for Sino-foreign partnerships in sunrise industries—especially when there exist "leapfrog" opportunities in emerging markets to adopt next-generation technologies from developed markets without having to overcome an installed base of users and investments in the old technology. Occasionally, there may even be true breakthrough opportunities to jointly develop entirely new products and technologies in an emerging market, even though the initial sales potential may be higher in developed markets. This may very well happen with electric vehicles in China through partnerships such as that between Daimler and BYD, a local Chinese automaker, which also happens to be the world's leading producer of lithium ion batteries.

Opportunities for Sino-foreign partnerships abound, precisely because the two sides often possess complementary capabilities. Each can achieve its own objectives by addressing the other's challenges, and, in the process, develop new competitive advantages for themselves and their home countries. +

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