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Sino-Finnish Paths to International Competitive Advantage

Media Launch

Opening Words (5 minutes - Sari Arho Havrén)

Introduction (10 minutes - John Jullens)

Summary of Key Survey Results (25 minutes - Tony Tang)

Implications to Finnish and Chinese Companies (20 minutes - John Jullens)

Introduction



Booz & Company is a leading global management consulting firm focused on serving and shaping the senior agenda of the world's leading institutions. The company operates globally with more than 3,000 people in 57 offices around the world.



Tekes is the most important publicly funded expert organization for financing research, development and innovation in Finland. We boost wide-ranging innovation activities in research communities, industry and service sectors.

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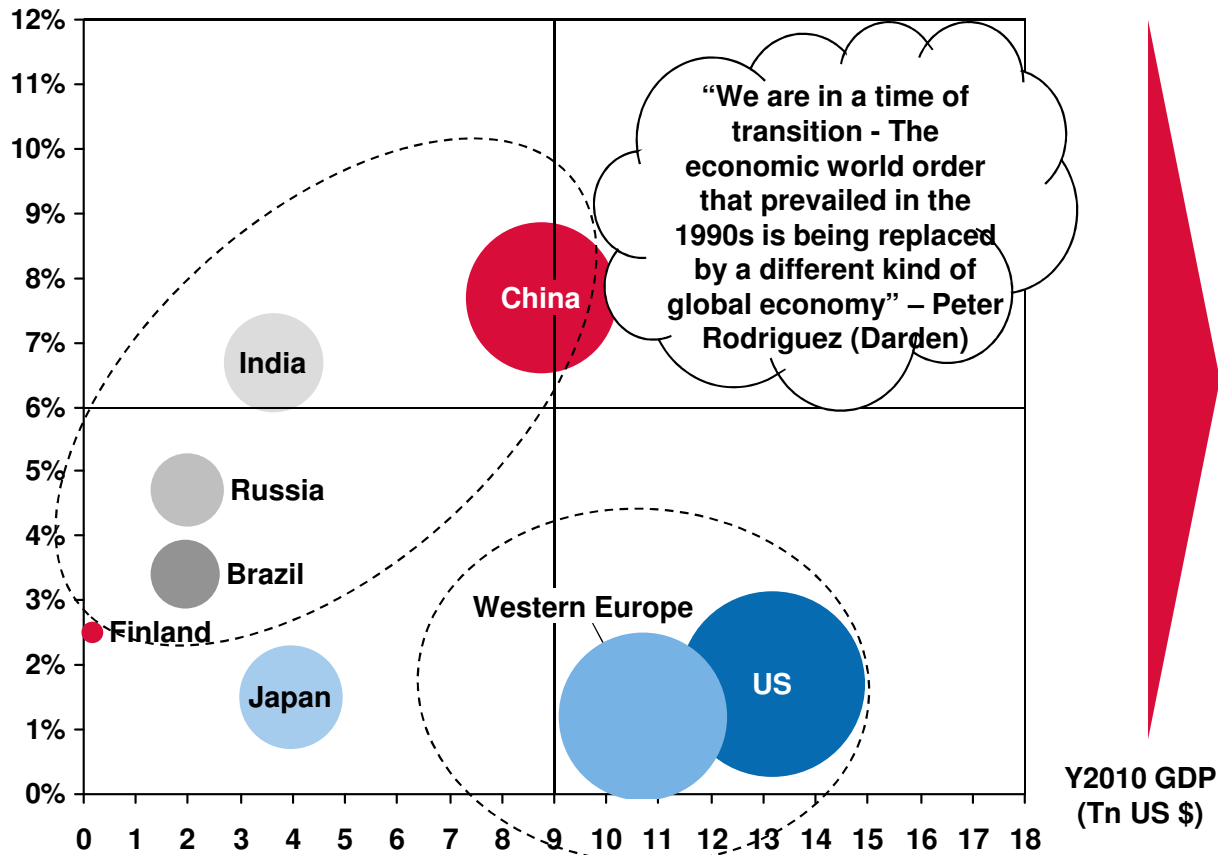
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It's no secret that the world's economic center of gravity is rapidly shifting back towards the East, and especially China

The Global Economy In Transition

Y2010-Y2020
Expected Growth Rate



From Divergence to Convergence

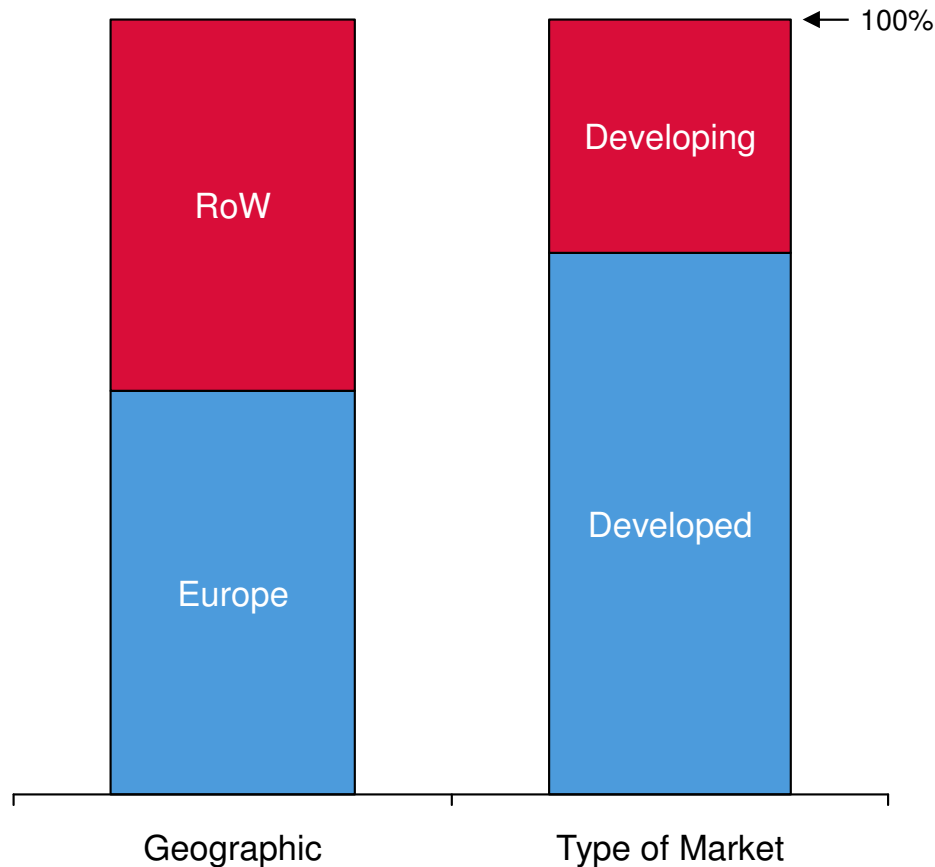
- Convergence between developed and emerging markets
 - China's renaissance and long tail of other emerging markets in SE Asia, Africa, and elsewhere
 - Around 2050, perhaps 75% of the world's population will live in economically advanced countries, as opposed to a mere 15% today

- However, economic convergence doesn't mean that "the earth is flat"
 - Competing political systems
 - Heterogeneous customer demand and business environments
 - Vastly different cultural values

Source: Global Insight, CEPII, Literature research, Booz & Company analysis

This represents a significant challenge for many Finnish Firms, who currently still rely on Europe and other developed markets

Finnish Firms - Regional Sales Mix¹⁾
(Estimated %, 2012)



Future Challenges

- Finnish firms still rely on Europe and other developed markets as their main source of revenues
- To remain competitive, Finnish firms will have to internationalize to compensate for slower growth at home
- This will be a formidable challenge, as many Finnish firms lack the required resources and capabilities, especially in emerging markets
 - Low-cost product design, manufacturing, and supply chain capabilities
 - Ability to navigate local regulatory environments and other institutional voids
 - Compete against low-cost local competitors

1) Top ten companies by market value; others include one in insurance industry and one company in energy sector
Source: Annual reports; Literature research; Booz & Company analysis

At the same time, Chinese companies face their own challenges in expanding into international markets – albeit for different reasons

Internationalization Drivers

- *Domestic market growth slowing down*
- *Increased competition from domestic and foreign players*
- *Domestic upgrading efforts not entirely successful*

China ODI / Outbound M&A

- 1. Gain Market Access and/or**
- 2. Acquire Technology**

Internationalization Challenges

- *Lack of international experience*
- *Limited turn-around and integration capabilities*
- *Country-of-origin penalty*

Source: Booz & Company analysis

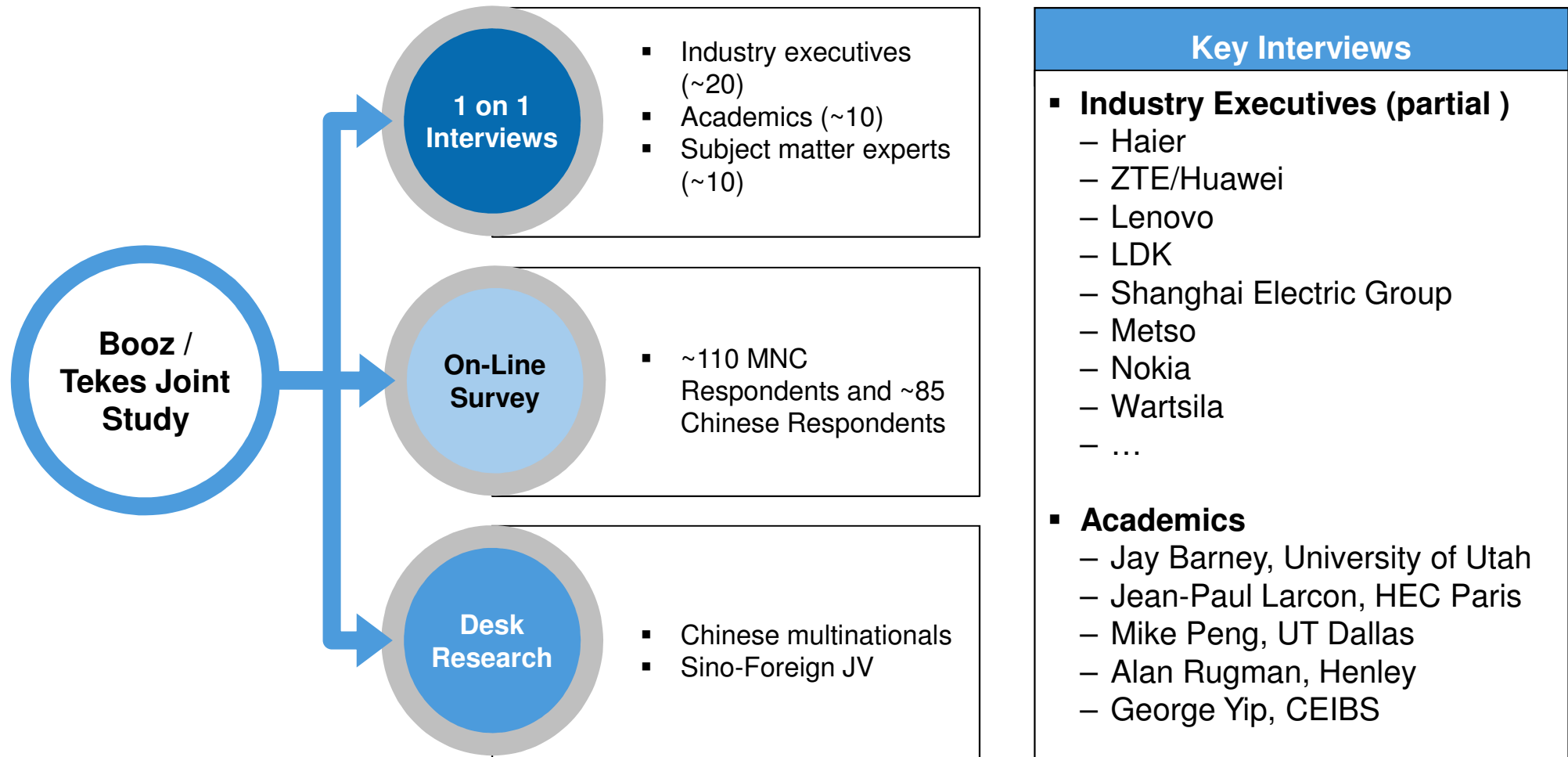
We conducted this study with Tekes to better understand the potential for Sino-Finnish partnerships in third markets



Study Objectives

- **Internationalization of Finnish and Chinese firms**
 - Rationale / objectives
 - Strategies / geographic focus
 - Key Success / Failure factors
- **Potential collaboration between Finnish and Chinese firms**
 - Type of win-win opportunities
 - Potential synergies / key success factors
 - Potential risks and mitigation strategies

We combined in-depth interviews with numerous industry experts with an on-line survey and extensive desktop research



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MNC

Chinese Companies

Summary

Our findings point to several factors that underlie Sino-Foreign cooperation opportunities - Finnish companies should take note

Where

- The number of Sino-foreign partnerships in third markets will increase significantly in the future, especially in the BRIC countries
- Chinese companies already have a sizeable presence in many developing markets, including Brazil and Africa

Why

- MNCs in developing markets seek local market and distribution access as well as low-cost products and manufacturing
- Chinese companies enter other developing markets to compensate for slower growth at home and achieve maintain low-cost leadership

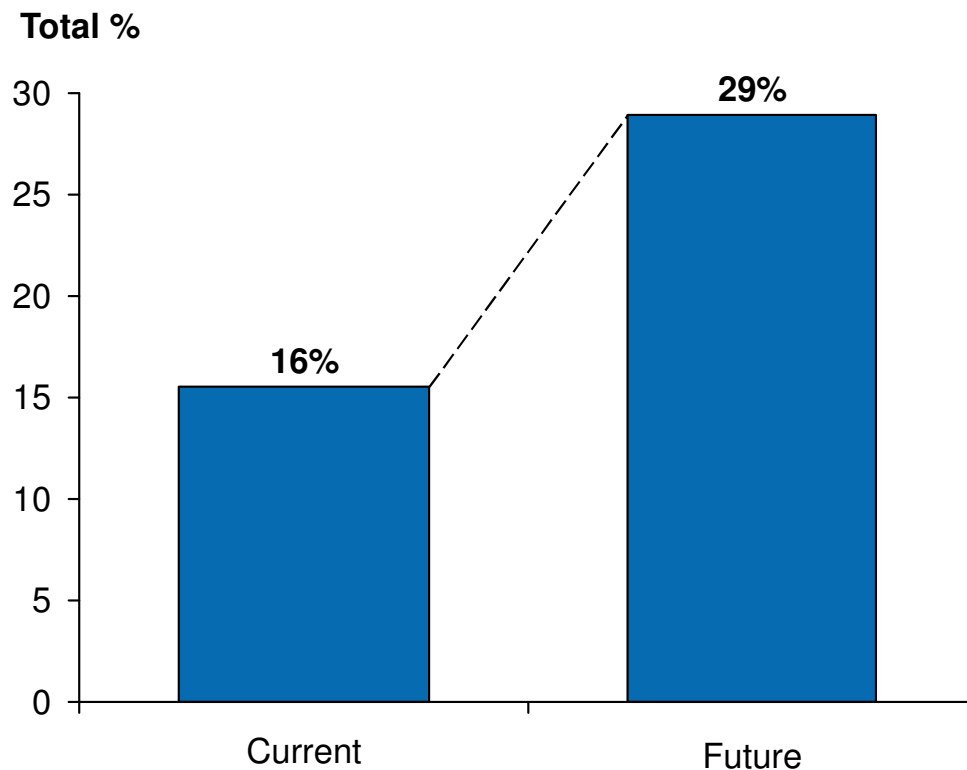
How

- Low-cost manufacturing and R&D will continue to be important reasons for Sino-foreign partnerships, but Chinese firms may not be as strong in navigating developing countries' regulatory environments as MNCs believe
- Senior management and strategy are critical talent gaps for Chinese companies

Source: Survey data; Booz & Company analysis

MNCs expect to significantly increase their cooperation with Chinese companies in other developing markets

MNC Operations in Emerging Markets



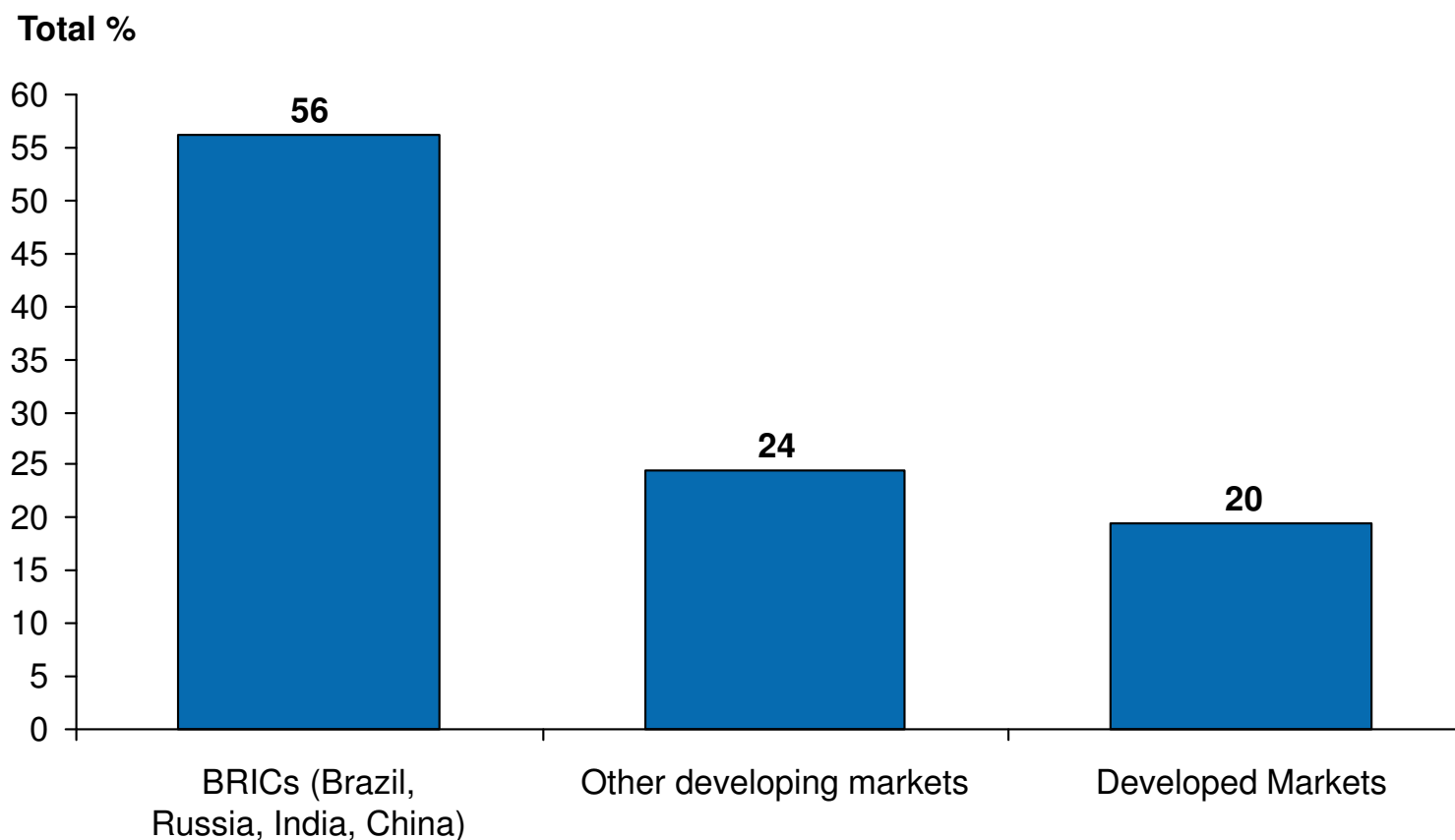
Key Observations

- All surveyed MNCs have cooperated with Chinese companies in China
- Sino-foreign partnerships are expected to increase significantly, especially in other developing markets

1) Based on survey of 100+ MNC
2) Based on survey of 85 Chinese companies
Source: Survey data; Booz & Company analysis

Not surprisingly, MNCs believe the BRIC markets offer the greatest potential for future partnerships with Chinese companies

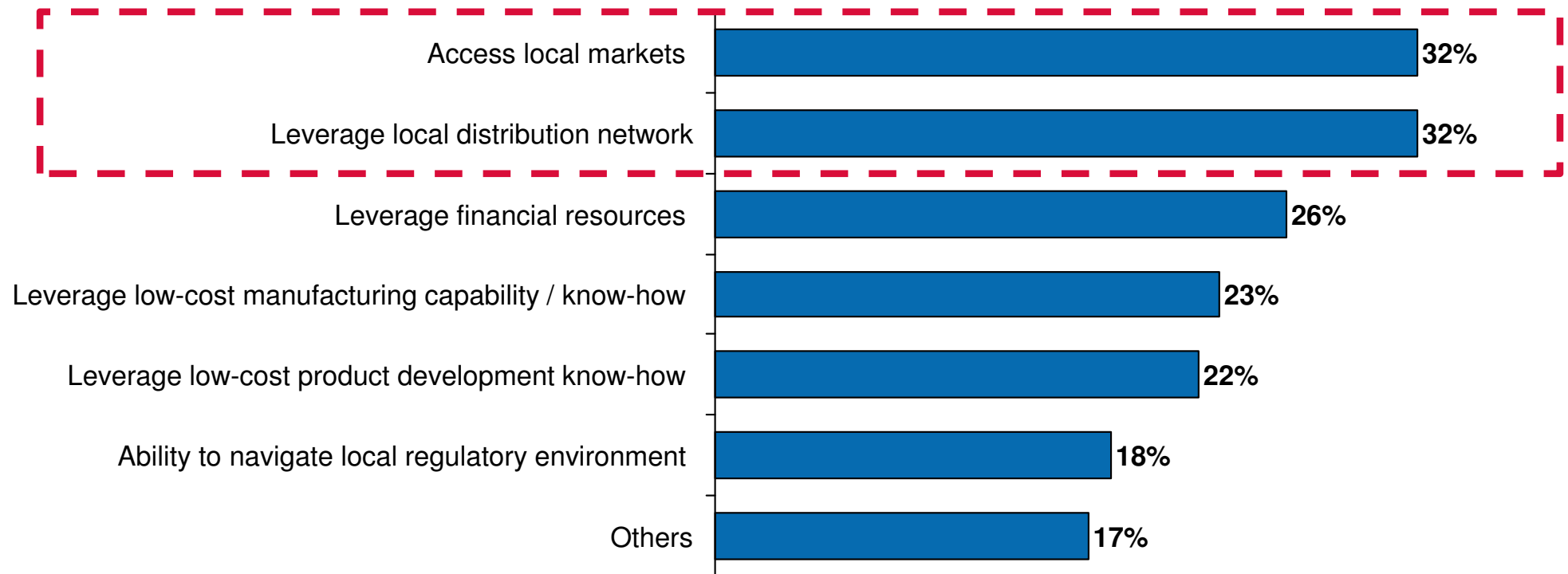
Potential Markets for Successful Sino-Foreign Partnerships



Source: Survey data; Booz & Company analysis

MNCs are most interested in Chinese companies' go-to-market capabilities in other developing markets

Primary Reasons of MNCs to Cooperate with Chinese Companies in Developing Markets¹⁾



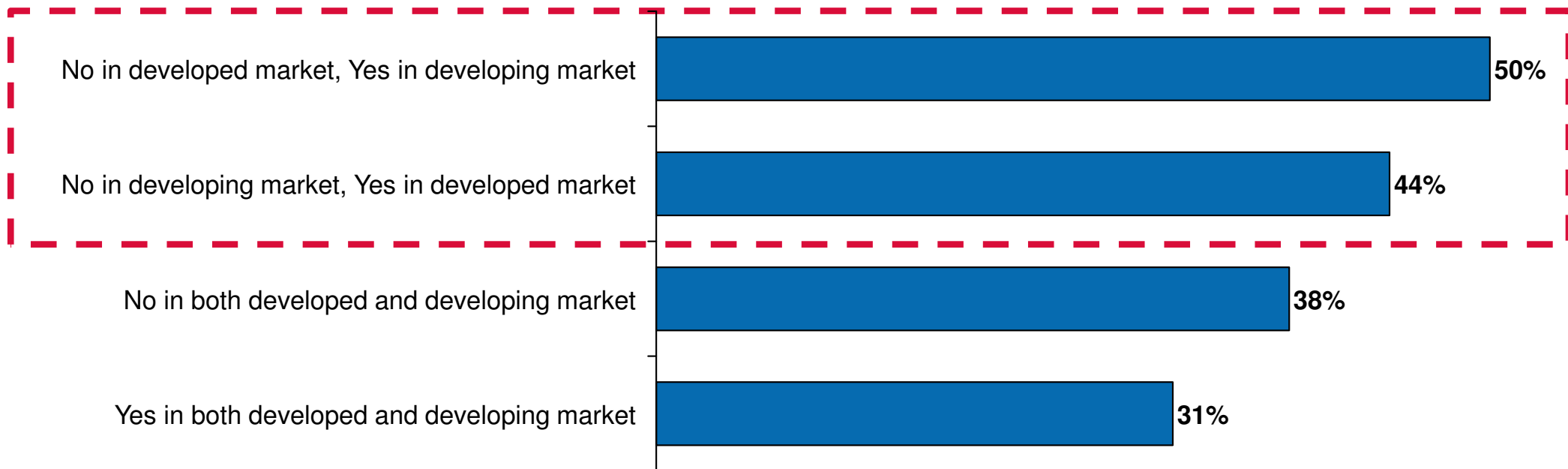
1) Based on survey of 100+ MNC companies

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Source: Survey data; Booz & Company analysis

Most MNCs believes Chinese companies are better at navigating local regulatory environments, especially in developing markets

Navigate through the Local Regulatory Environment More Effectively than Chinese Companies¹⁾



* % of respondents rank it as top factor

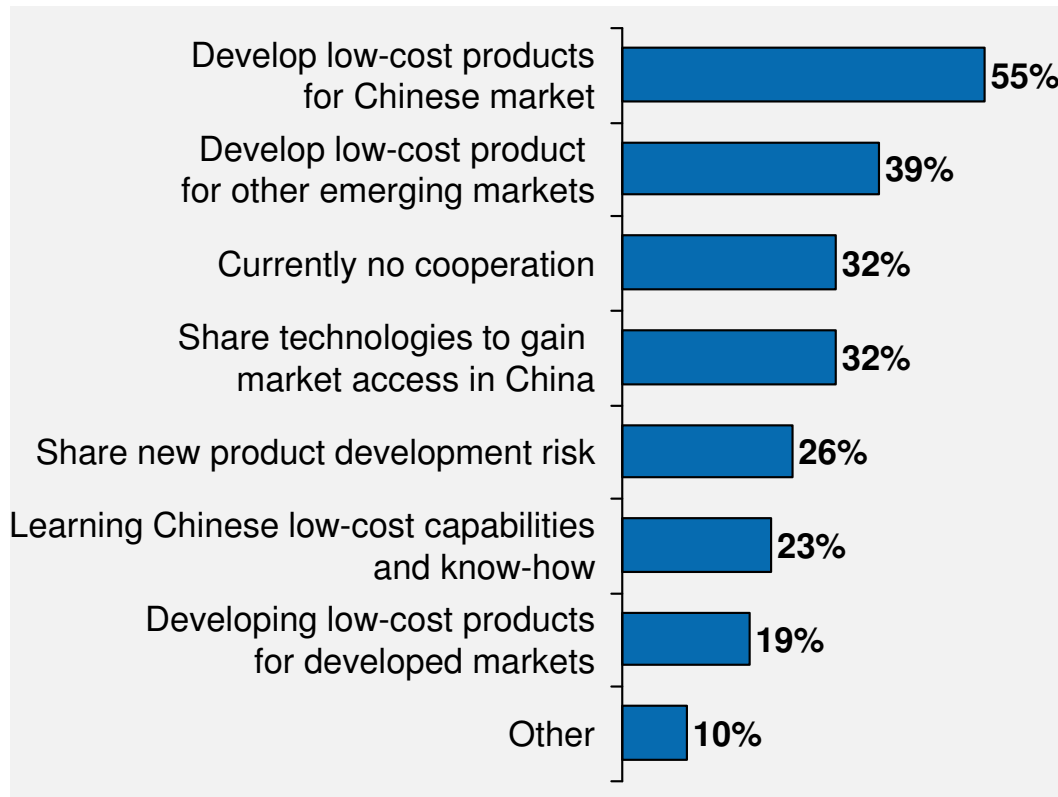
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Developing low-cost products for China and other emerging markets is the biggest reason for cooperation in R&D

Major Reasons to Cooperate in R&D



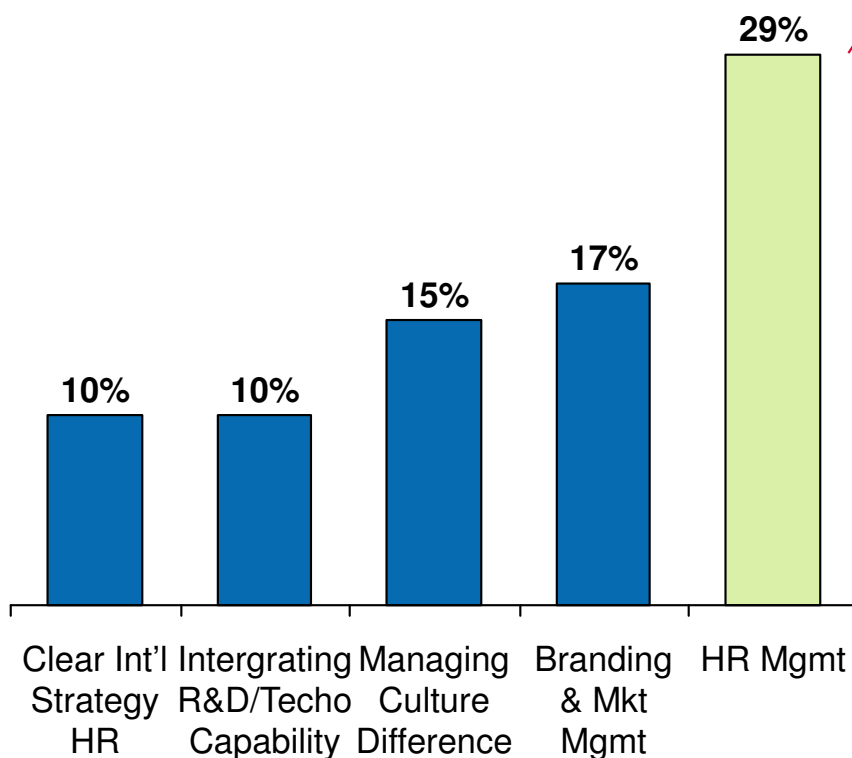
Key Observations

- More than 50% mentioned developing low-cost products for Chinese market as a major reason for R&D cooperation
- Nearly 40% mentioned developing low cost products for other emerging markets
- Yet, MNCs are not truly interested in learning low-cost capabilities themselves, nor do they see great potential for developing low-cost products in developed markets with Chinese companies

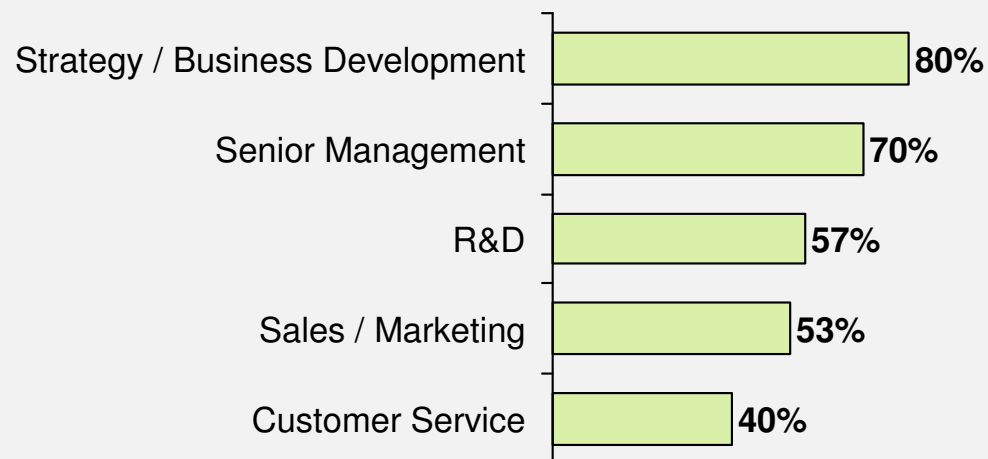
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Source: Survey data; Booz & Company analysis

However, MNCs are concerned with the shortage of Chinese talent, particularly for strategy & senior management roles

MNCs' Perception of Chinese Companies Top Weaknesses¹⁾



Function with Largest Talent Gap



1) Based on survey of 100+ MNC companies
Source: Survey data; Booz & Company analysis

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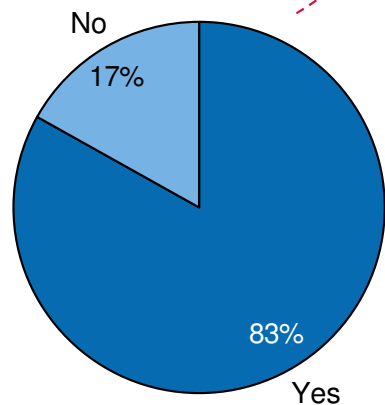
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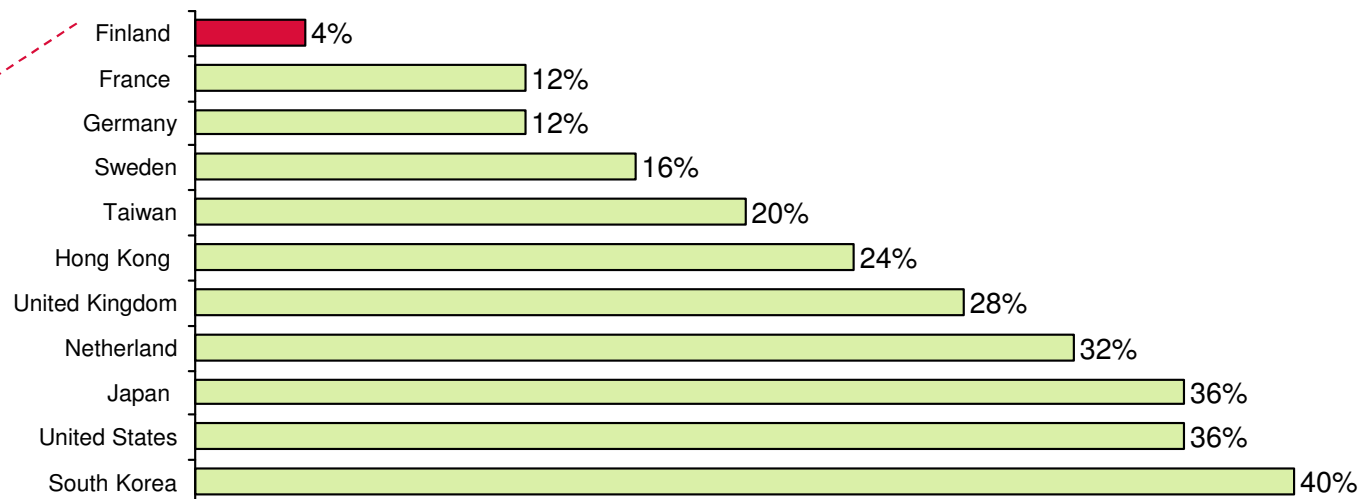
The vast majority of Chinese companies already have operations outside Mainland China - mainly in SE Asia, Brazil and Africa

Chinese Companies' Operations Outside China²⁾

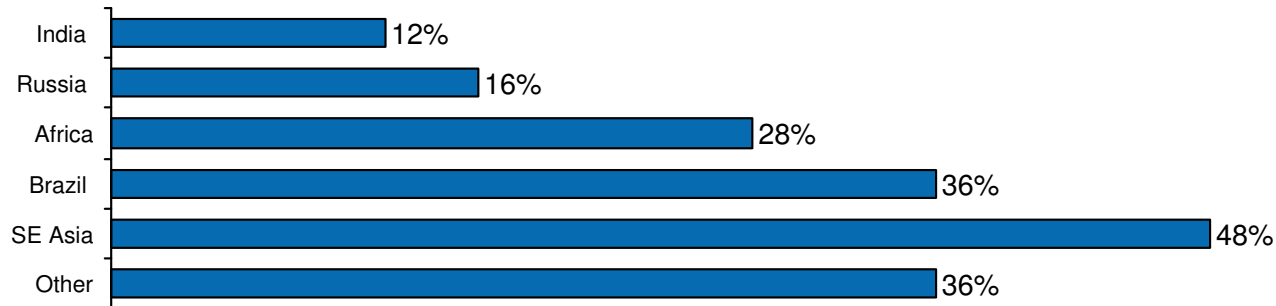


Countries of Global Operations²⁾

Developed



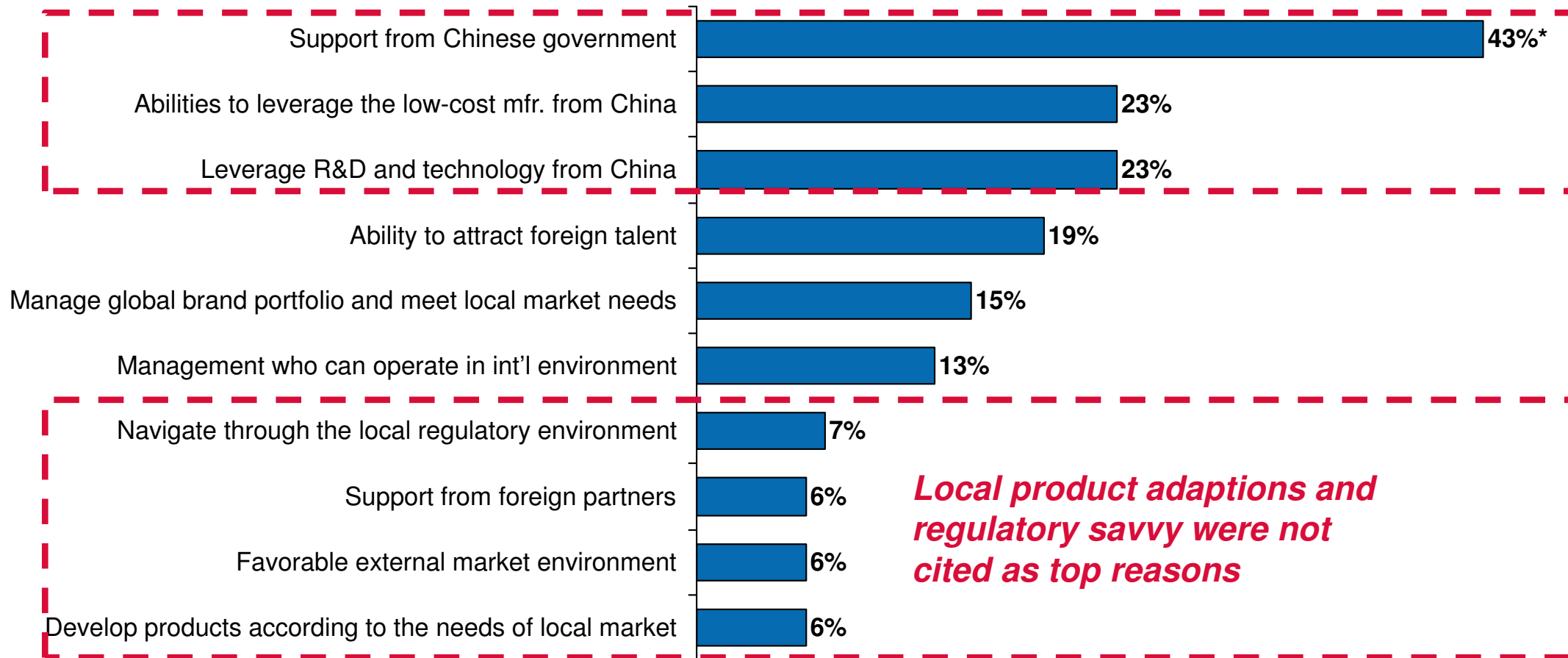
Developing



1) Based on survey of 100+ MNC companies
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 Source: Survey data; Booz & Company analysis

Strong government support and the ability to leverage low-cost manufacturing and R&D capabilities are key success factors

Key Success Factors for Chinese Companies' Overseas Ventures²⁾



* % of respondents rank it as top factor

1) Based on survey of 100+ MNC companies

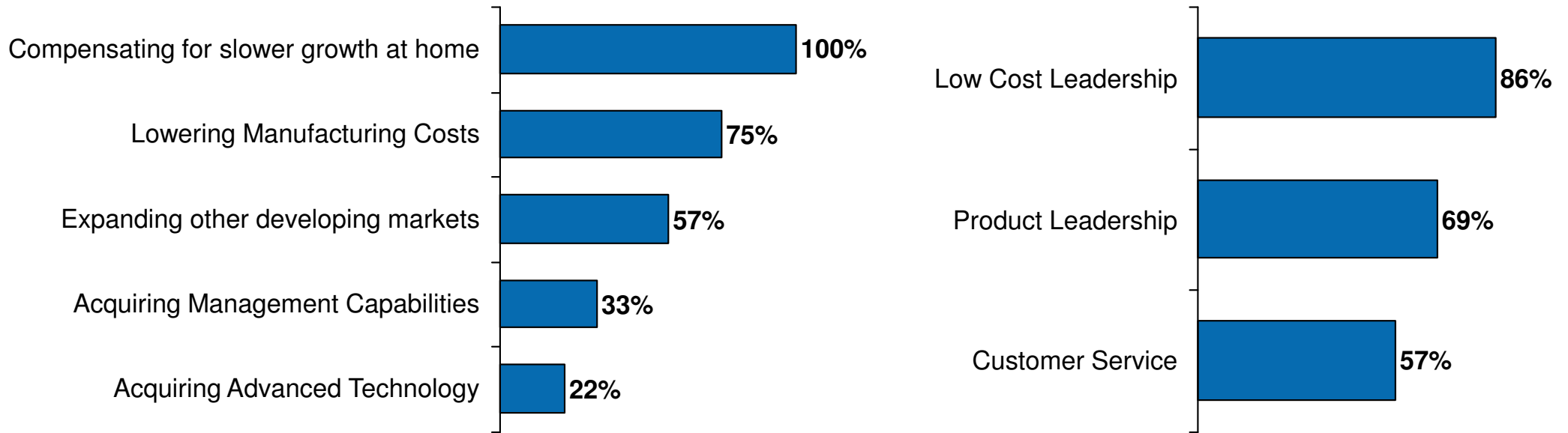
2) Based on survey of 85 Chinese companies

Source: Survey data; Booz & Company analysis

Chinese companies enter developing countries primarily to capture market share by leveraging their cost leadership positions

Primary Reasons for Entering Developing Countries²⁾

Intended Right To Win

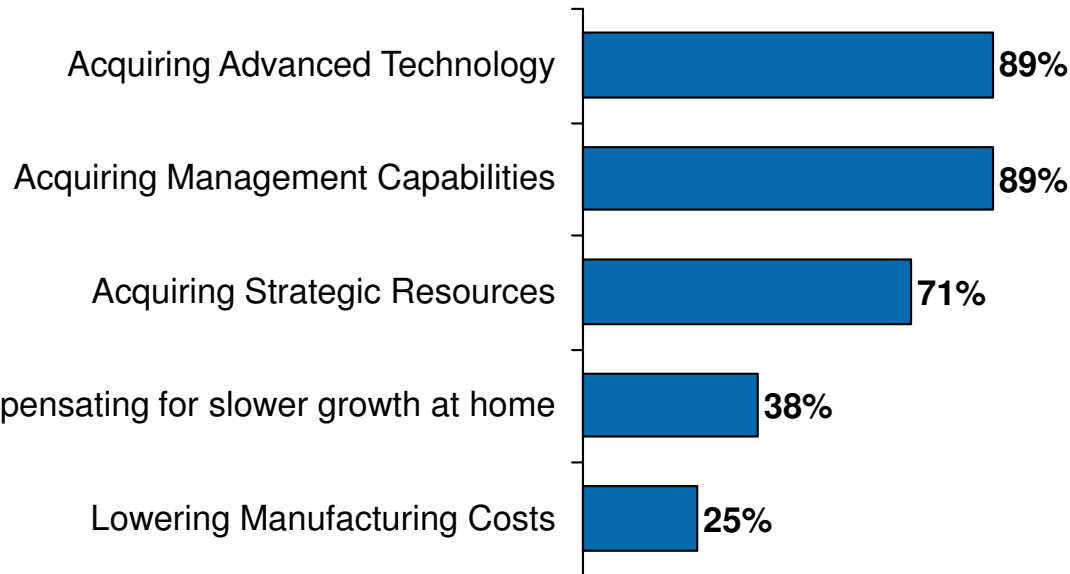


Market access is primary theme

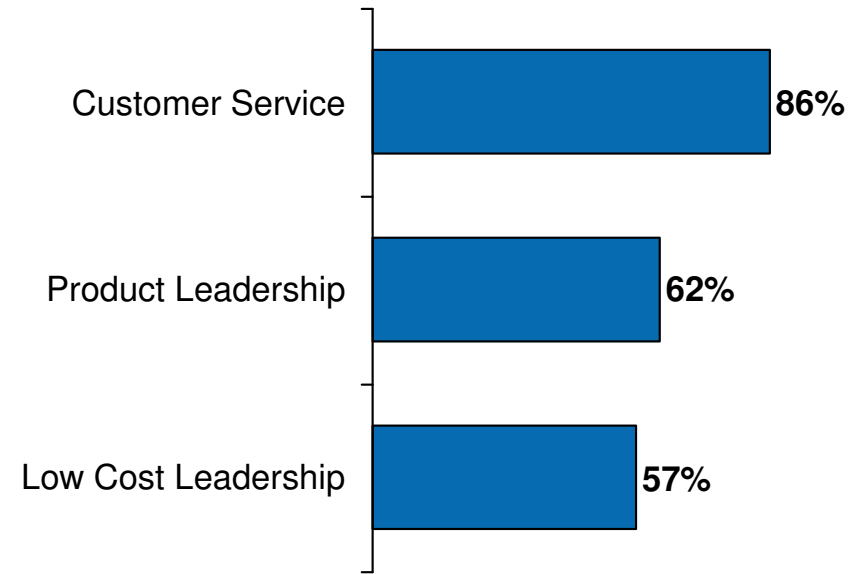
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On the other hand, Chinese firms focus on acquiring technology and management capabilities in developed markets

Primary Reasons for Entering Developed Countries²⁾



Intended Right To Win

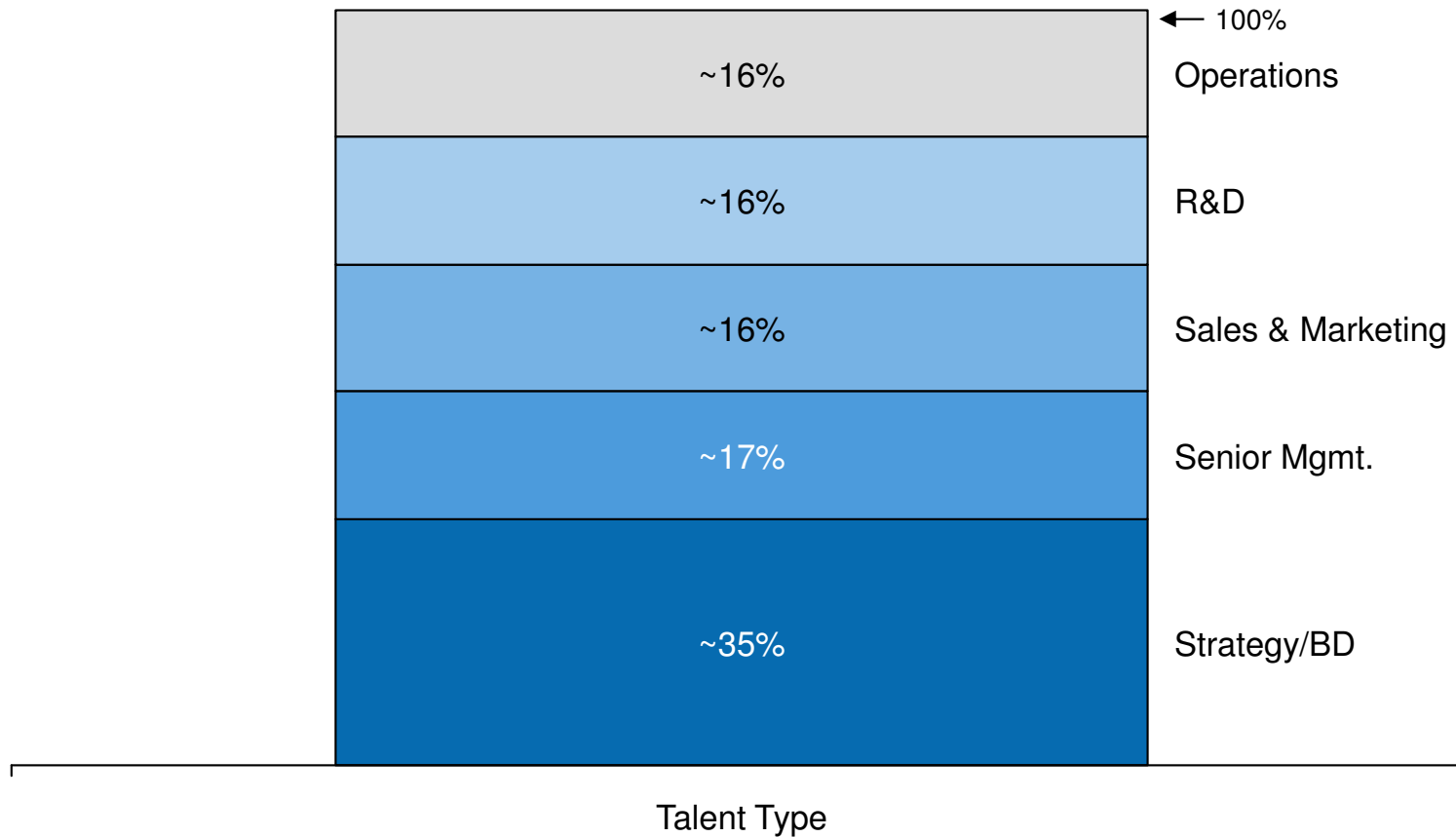


Capabilities acquisition is primary theme

1) Based on survey of 100+ MNC companies
2) Based on survey of 85 Chinese companies
Source: Survey data; Booz & Company analysis

Chinese companies believe they lacking senior management and strategy expertise - entirely consistent with MNCs' perspective

Talent Gap in Overseas Ventures²⁾



1) Based on survey of 100+ MNC companies
2) Based on survey of 85 Chinese companies
Source: Survey data; Booz & Company analysis

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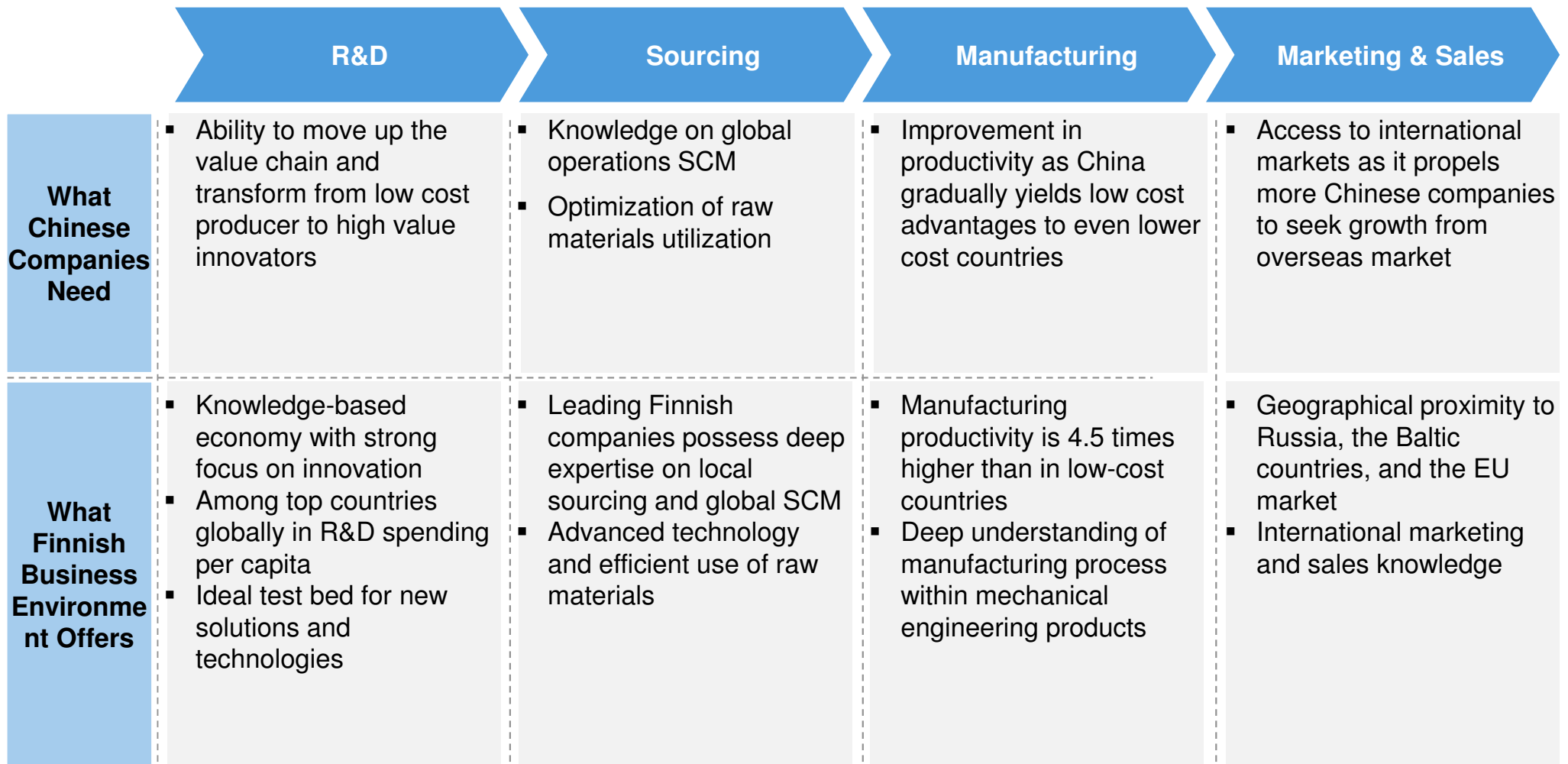
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We believe Finnish companies can offer tangible benefits along the entire value chain to help Chinese companies internationalize



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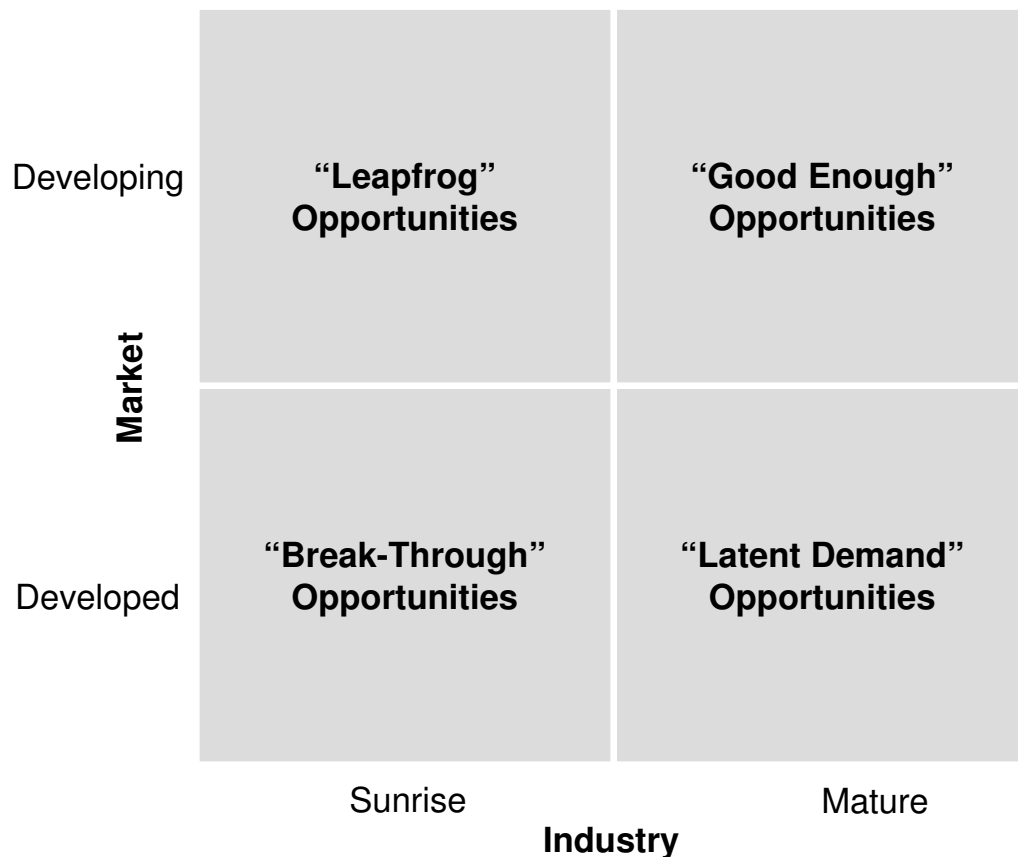
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Our findings suggest that there are significant Sino-Finnish partnership opportunities

Sino-Foreign Partnership Opportunity Matrix



- **“Good Enough” Opportunities**
 - Jointly develop low-end / mid-market versions of existing products for emerging markets
- **“Latent Demand” Opportunities**
 - Jointly penetrate developed markets by activating latent demand for low-end / mid-market products
- **“Leapfrog” Opportunities**
 - Capitalize on latecomer advantages to develop new products and technologies in greenfield emerging markets first
- **“Breakthrough” Opportunities**
 - Combine high-end developed market and low-cost emerging market capabilities to create truly breakthrough products

Source: Booz & Company analysis

Each partnership type demands a different collaboration model

Good enough

- SAIC and GM leveraged the partnership to gain access to the automotive market in India
 - GM provided manufacturing facilities, distribution networks, advanced technology, and its world-renowned brand; SAIC provided low-cost engineering expertise
 - In 2012, the joint venture produced the first Indian launch of a Chinese-designed car and 2013 saw the launch of the Chevrolet Enjoy

Latent demand

- Mahindra successfully tapped into the “latent” demand in the US for tractors
 - In the 1990s, the company realized there was an opportunity to provide tractors those who can't afford expensive machines. That catered to industrial—scale agribusiness
 - Under the Mahindra USA name, Mahindra built strong relationships with dealerships and offered highly customized products at attractive prices

Breakthrough
















- LDK Solar acquired a 70% stake in the US-based Solar Power, Inc. (SPI) in 2001 to tap into the U.S. solar market
 - The deal couples SPI's downstream design expertise with LDK's world-class upstream capabilities
 - LDK will open joint manufacturing operations in the U.S. to enhance SPI's competitive advantage in North America

Leapfrog

- BYD partnered with Daimler to produce electric vehicles in China
 - The partnership enables Daimler to bring its technology to China, coupling it with BYD's technology and low-cost capabilities, and supported by government incentives
 - The partnership is scheduled to launch its first vehicles, the Denza in 2014

Source: Booz & Company analysis

Industry cluster and size are two important characteristics in determining partnerships that make sense for Finnish Companies

Company Size	Large	<ul style="list-style-type: none">  Experience in many markets  Strong R&D, Sales / Marketing  "Wait and See" approach for collaboration  Require higher returns 	<ul style="list-style-type: none">  Strong growth or willingness to invest in technology and capabilities  Eager for partnerships  Experience in many markets  Underutilized capacity
	Small	<ul style="list-style-type: none">  Strong R&D, Sales / Marketing  Nimble, flexible  Require higher returns and may be more stringent in evaluation 	<ul style="list-style-type: none">  Strong growth or willingness to invest in technology and capabilities  Eager for partnerships  Nimble, flexible  Not much to offer beyond current core technology
		<p>Strong (Forestry, Base metals, Energy, Telecom, etc.)</p>	<p>Developing (Construction, Clean Tech, Healthcare, etc.)</p>
		Industry Cluster	

Source: "Advantage Finland" – the Research Institute of Finnish Economy; Booz & Company analysis

Similarly, Chinese firms can be classified into four categories to reflect their internationalization profiles and partnership potential

	<u>Profile</u>	<u>Example</u>	<u>JV Cooperation Considerations</u>
	<ul style="list-style-type: none"> Relatively diversified in product offerings and overseas coverage 		<ul style="list-style-type: none"> Have greater freedom to pursue returns, more nimble in dealings with partners
	<ul style="list-style-type: none"> Narrowly focused geographical and product coverage overseas; little govt. funding 		<ul style="list-style-type: none"> More downside risk to protect, shorter / more sensitive collaboration “horizon”
	<ul style="list-style-type: none"> Invested extensively abroad for their business expansion while still being subject to govt. influence 		<ul style="list-style-type: none"> Less discretionary power in international circumstances, thus not at liberty to pursue certain opportunities
	<ul style="list-style-type: none"> Focused on only a few foreign markets while at times fulfilling governmentally mandated initiatives 		<ul style="list-style-type: none"> Receive more support from government, but more red tape

Source: Journal of International Business Study, Booz & Company analysis

Finnish firms should ask some basic questions to get an early read on the critical success factors of a potential Chinese partnership

1

Partner Objectives

Are potential partners primarily seeking to gain market access or to acquire technology?

2

Market and Industry Maturity

What capabilities can potential partners contribute, and what markets and industries should companies target as a result?

3

Partner Size and Role of the State

What company size is appropriate and what role should governments play?

Summary

- Both China and Finland face challenges that will be difficult to solve without expanding their international reach
 - Many Chinese companies must improve their capabilities and acquire technology through international partnerships
 - Most Finnish companies don't have enough capabilities to succeed in emerging markets where the potential for growth is most promising
- Opportunities for Sino-Finnish partnerships abound precisely because Chinese and Finnish companies so often possess complementary capabilities
- They can achieve their own objectives by addressing one another's challenges – and in the process, they can develop the competitive advantages to secure a strong economic foundation for their countries

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