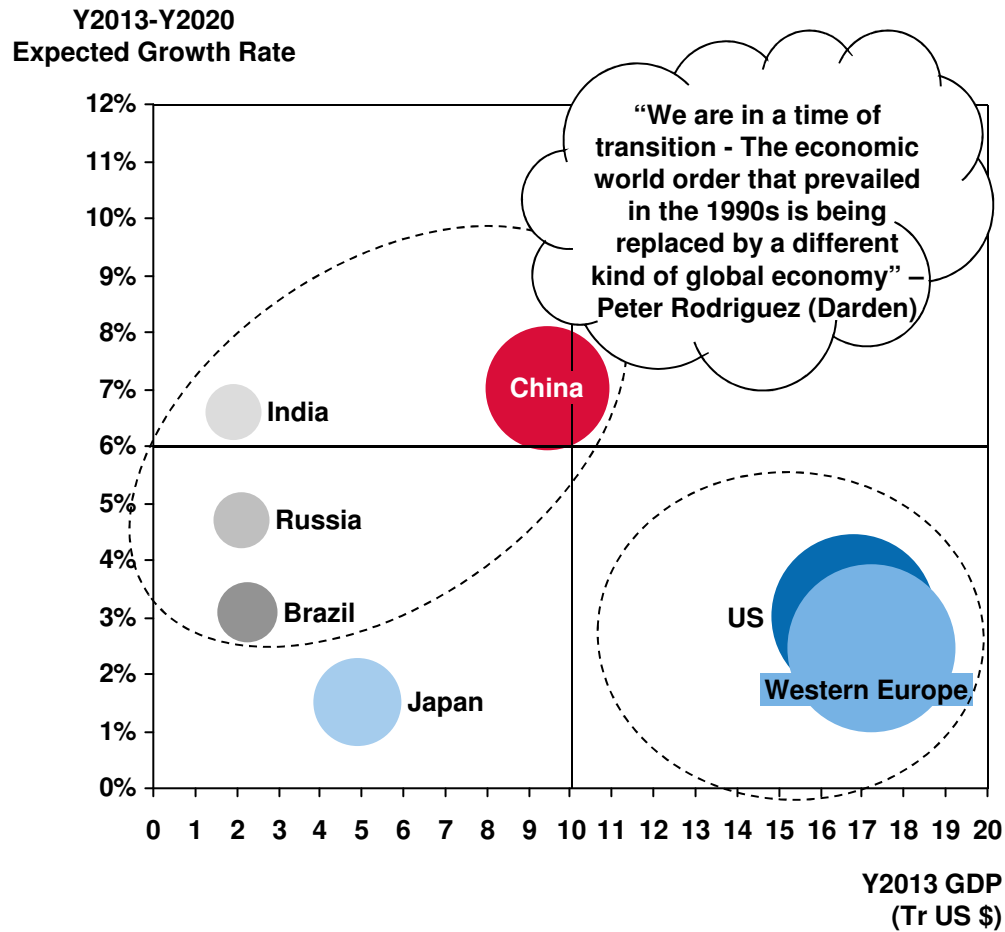


EFFICIENTLY ENGINEERING FOR GLOBAL MARKETS – MEETING THE EMERGING MARKET PRODUCT CHALLENGES

John Jullens, Partner, Strategy&



A New World Order

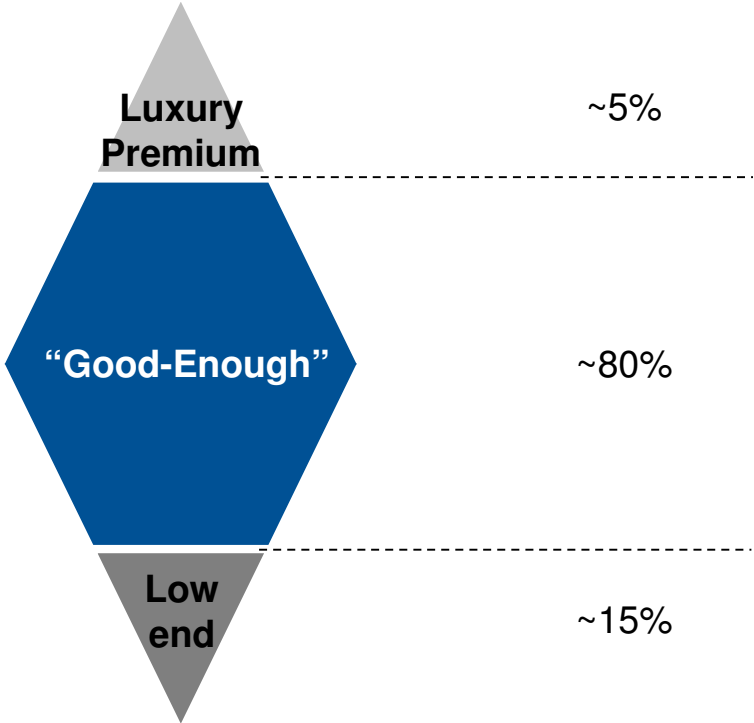


- Emerging markets in general by far the largest source of future growth
- China already the largest market for cars and many industrial goods
- “Emerging Giants” beginning to change the global competitive landscape

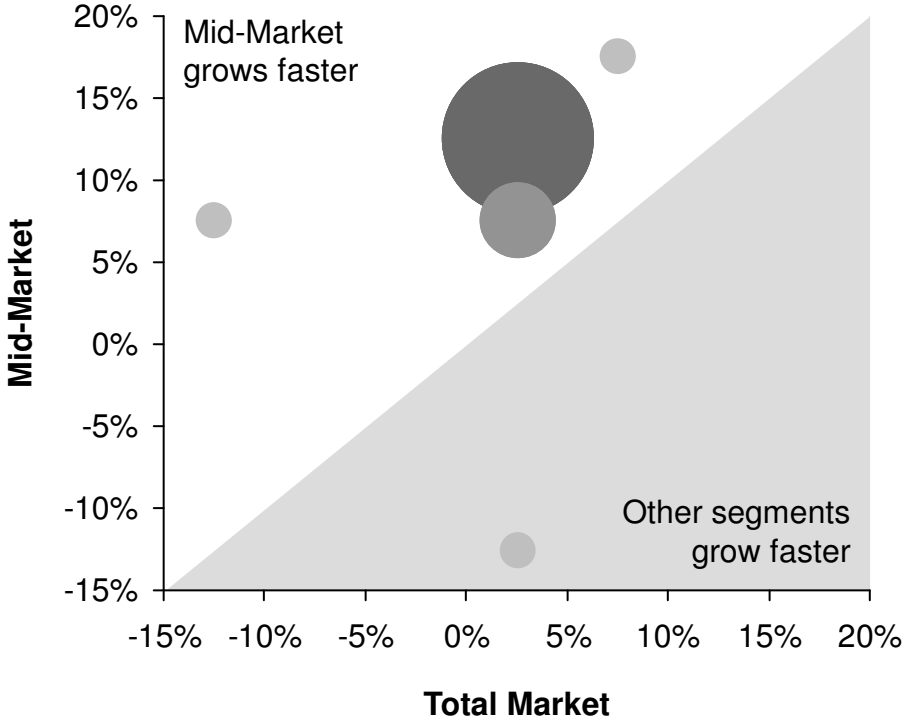
Source: Global Insight, World Bank, Literature research, Strategy& analysis

The Battlefield

Battlefield = Mid-Market
 (Example: Construction Equipment sector in China)



Expected 5-Yr CAGR
 (Total market and Mid-Market)



Note: Total no. of households is estimated under the premise that average no. of people per household is 3.1 (according to National Bureau of Statistics of China)
 Source: Strategy& Mid-Market Study 2012/2013; National Bureau of Statistics of China; Morgan Stanley report; Strategy& analysis

Good-Enough” Just Isn’t

| | Premium Business Model | Mid-Market Business Model |
|---------------------|---|---|
| Product Development | <ul style="list-style-type: none"> World-class product with advanced technology Proprietary parts | <ul style="list-style-type: none"> “good enough” product with entry-level technology Standard parts |
| Sourcing | <ul style="list-style-type: none"> Global sourcing with reasonable localization rate to guarantee product quality | <ul style="list-style-type: none"> Localized sourcing with domestic suppliers to achieve price competitiveness |
| Manufacturing | <ul style="list-style-type: none"> Rigorous manufacturing standards to ensure highest possible product quality at premium prices | <ul style="list-style-type: none"> Flexible manufacturing standards and relentless focus on process costs to guarantee acceptable product quality at ultra-low prices |
| Marketing | <ul style="list-style-type: none"> Target few large fleet owners (key accounts) Emphasize brand image, superior performance, and total lifetime value | <ul style="list-style-type: none"> Target many individual owner-operators Emphasize low initial purchase price and fit-for-purpose design |
| Sales | <ul style="list-style-type: none"> Formal tender process / high initial purchase price Commercial credit Few well-capitalized stores | <ul style="list-style-type: none"> Single Machines / low initial purchase price Personal credit / creative financing options Many low-capitalized stores |
| After-market | <ul style="list-style-type: none"> Complex to maintain and repair | <ul style="list-style-type: none"> Easy to maintain and repair |

Source: “China’s Mid-Market: Where “Good Enough” Just Isn’t”-- Strategy + Business, Jullens, July 2013

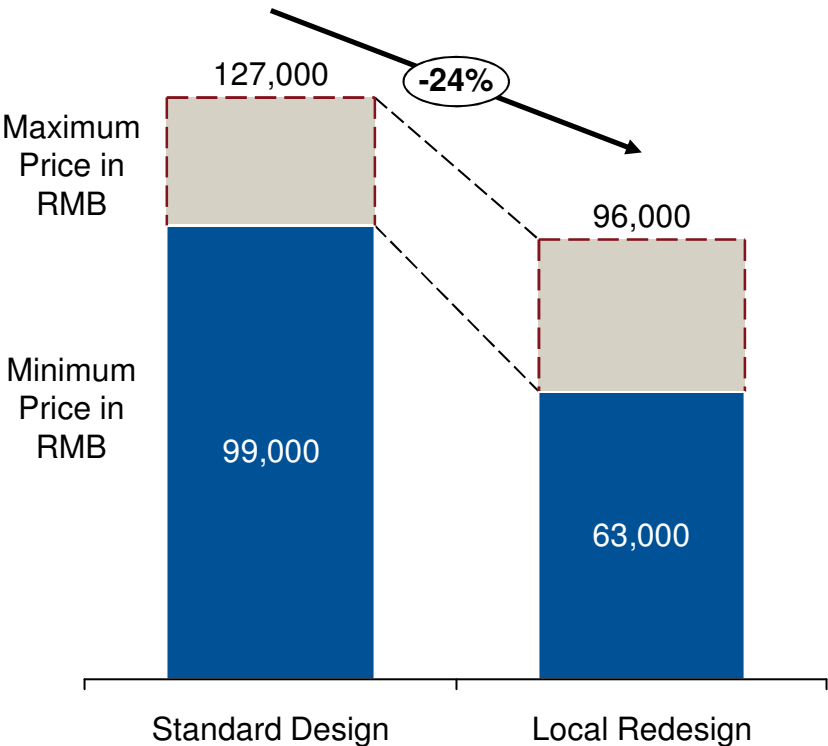
Key Success Factors (MNCs)

- 1 Entry-Level Business Model** – Rethink business model to support unique entry-level market requirements, including product, price, branding, marketing, distribution, and operations
- 2 Low-price Products** – Develop “low-priced” products specifically designed for mid-market customers, as opposed to merely introducing “low-cost” versions of existing world-class product
- 3 Value chain migration** – Transfer core activities to narrow cost gaps with domestic entry-level market competitors through local product development, sourcing, and manufacturing
- 4 Selective Partnerships** – Consider entering into partnerships with local suppliers to fill gaps in entry-level market product portfolio, develop optimal distribution footprint, and navigate institutional voids
- 5 Multi-Brand Strategy** – Consider developing a multi-brand strategy to successfully operate across premium and entry-level market price points as well as multiple product categories
- 6 Multi-format Sales Channel** – Develop cost-effective ways of sale by employing multi-format dealerships including vehicle supermarkets, 2S stores, and brokers to penetrate entry-level regions
- 7 Strong Local Organization** – Ensure that management is capable and sufficiently empowered to enable fast decision-making and sensitivity to local market requirements. Clarify decision rights and put in place a strong governance structure
- 8 Global Mind-set** – A firm’s success in emerging markets is tied to the mind-set of its top managers. At a minimum, ensure that headquarters has at least a basic understanding of each emerging market’s unique business and regulatory context

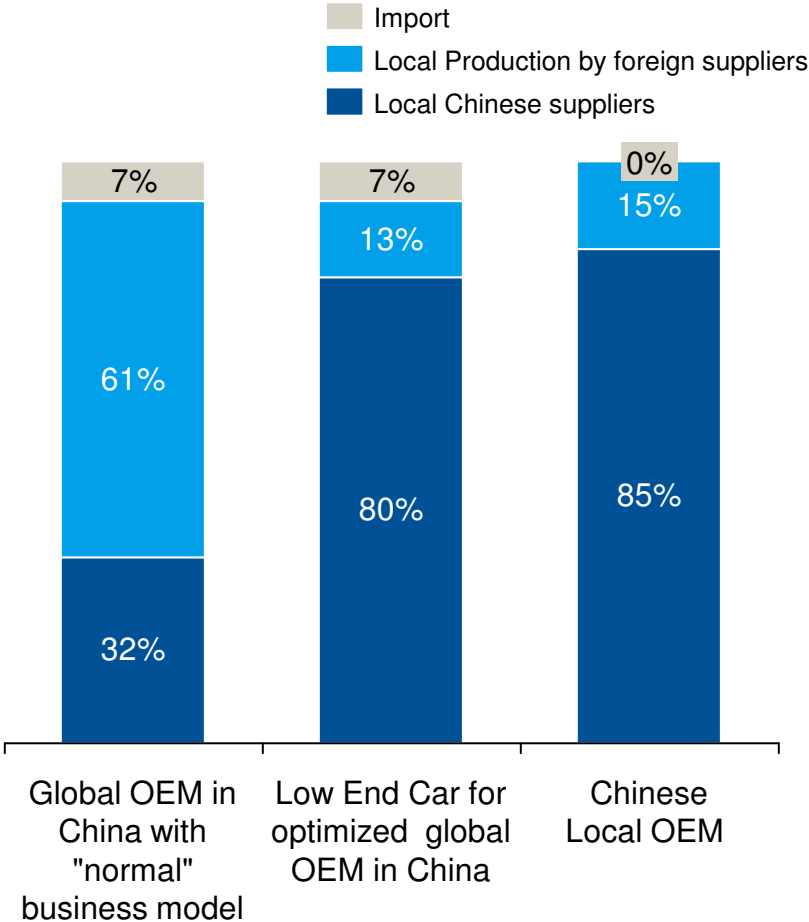
Source: “China’s Mid-Market: Where “Good Enough” Just Isn’t”-- *Strategy + Business*, Jullens, July 2013

Cost Reduction Requirements and Supply Base Impact

Cost Reduction Potential / Requirements
(passenger car, China)

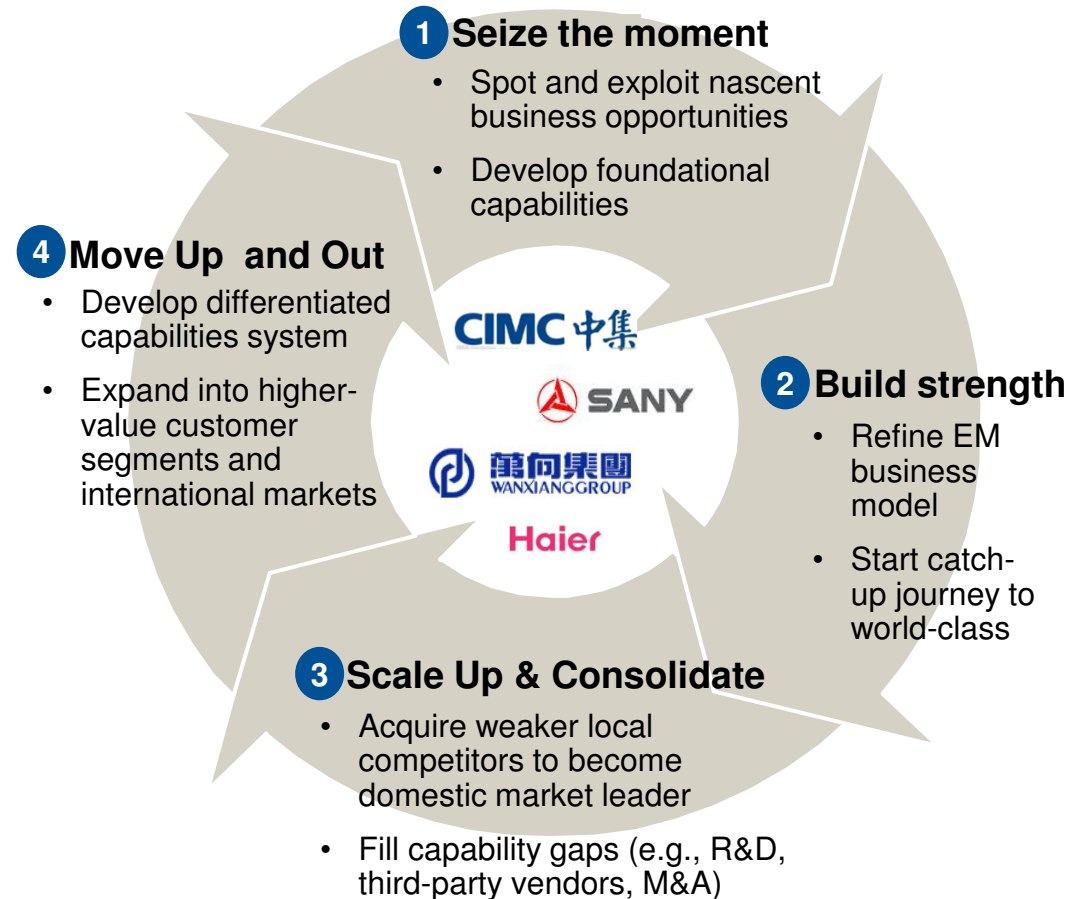
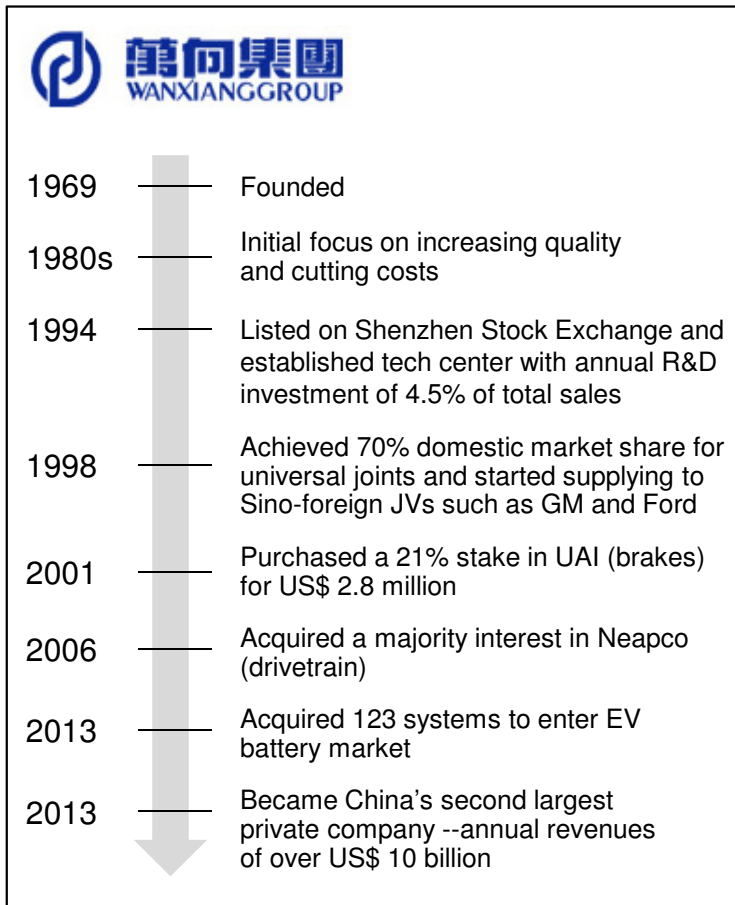


Importance of Truly Local Supply Base



Source: Strategy & analysis

Emerging Giants (eMNCs)



Source: "How Emerging Giants Can Take on the World"-- Harvard Business Review , Jullens, Dec 2013

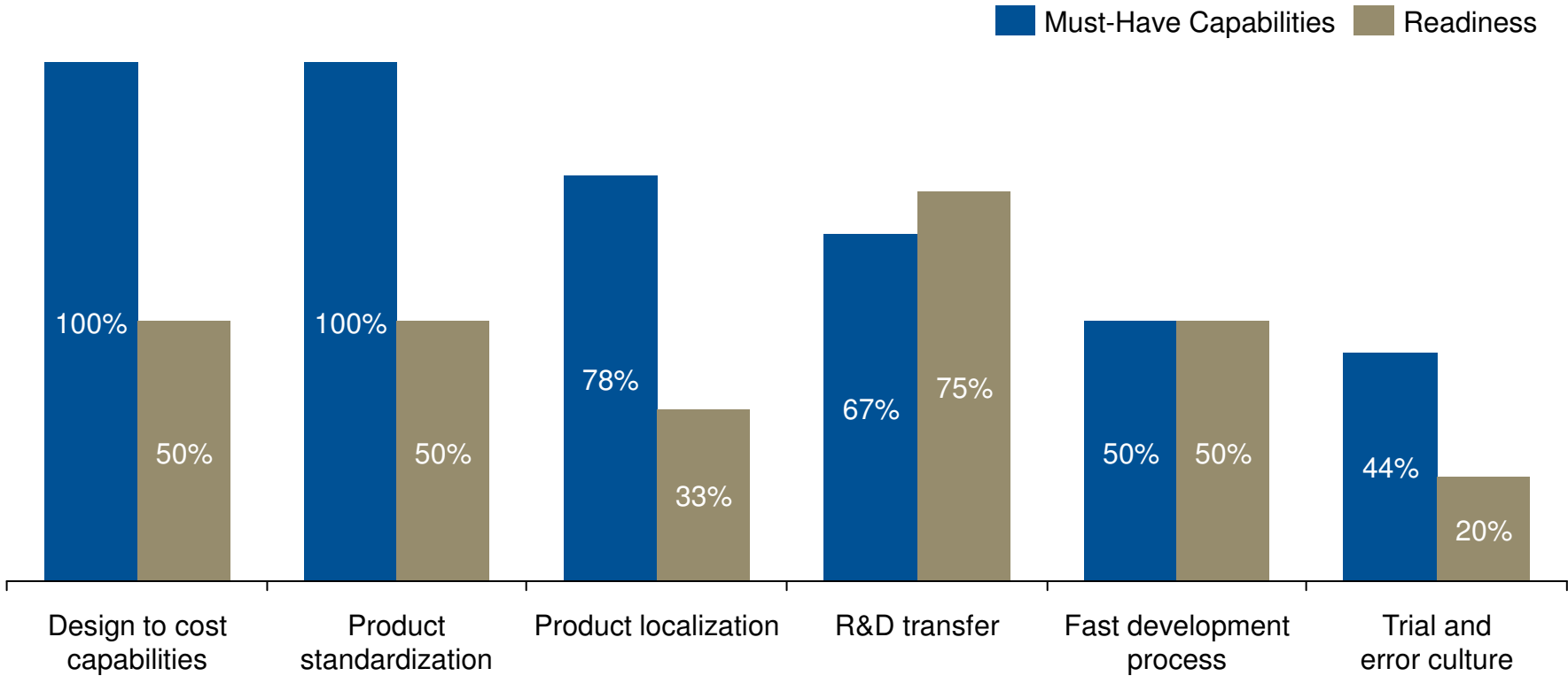
Strategic Options (MNCs)

Four strategic options for MNCs

- 1** “Stay at home” Remain focused on upper tier and leave mid/low-market to other competitors
- 2** “Wait it out” Wait for mid/low-market demand to catch up to premium demand
- 3** “Play to Win” Develop required products, capabilities, and other resources to compete proactively in the mid-market
- 4** “If you can’t beat’ em ...” Partner with one or more emerging market competitors and develop the (global) mid-market together

MNC Mid-market Readiness

Key Mid-Market Capabilities (Ranked by Importance)



Source: Strategy& Mid-Market Study 2012/2013

Summary

- The traditional MNC strategy of merely introducing low-cost versions of world-class products will often not be sufficient to compete in emerging markets
- A new category of competitors – Emerging Giants – is beginning to change the competitive landscape around the world
- MNC, will have to choose among four - not mutually exclusive - strategies to respond effectively to the challenge from Emerging Giants
 - “Stay at Home”
 - “Wait it Out”
 - “Play to Win”
 - “If You Can’t Beat’em ...”
- While every firm has to develop its own mid-market strategy, there are a few universal principles that apply to most MNCs
 - Low-Priced Products
 - Mid-Market Business Model
 - Value Chain Migration
 - Selective Partnerships
 - Multi-Brand Strategy
 - Strong Local Organization
 - Global Mindset

Mid-Market Readiness Assessment

| Step 1. Market understanding | Y | N | Step 2. Market entry strategy | Y | N | Step 3. Implementation readiness | Y | N |
|---|--------------------------|--------------------------|---|--------------------------|--------------------------|--|--------------------------|--------------------------|
| 1. You know your product's current market share across China low/mid/high-end market segments | <input type="checkbox"/> | <input type="checkbox"/> | 1. You have a clear definition of which segments to enter, and with what positioning, target price and customers | <input type="checkbox"/> | <input type="checkbox"/> | 1. You have target costing of your low/mid end product close to local competitor levels, and know how to reach these targets | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. You understand the market trends for the next 5-10 years across segments | <input type="checkbox"/> | <input type="checkbox"/> | 2. You have a clear product strategy for the defined market positioning | <input type="checkbox"/> | <input type="checkbox"/> | 2. You have conducted product tear down study, value engineering etc., and have a clear action plan of how to reach targets | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. You have modeled low/mid end growth scenarios for the next 5-10 years and understand implications | <input type="checkbox"/> | <input type="checkbox"/> | 3. You have conducted a customer need analysis for target customers and understand the implications on the product design/ boundaries | <input type="checkbox"/> | <input type="checkbox"/> | 3. You have available and released Chinese low-cost suppliers (not foreign JVs) to supply your product to >80% | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. You understand customer needs, and differences in needs between regions and tier cities within China | <input type="checkbox"/> | <input type="checkbox"/> | 4. You understand the required business model to fulfill the target price and reach low/mid end customers, in: | <input type="checkbox"/> | <input type="checkbox"/> | 4. You have released truly local raw materials (e.g. steel, resins) | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. You understand demand/ sales distribution between regions and cities | <input type="checkbox"/> | <input type="checkbox"/> | a) Low Cost Product development | <input type="checkbox"/> | <input type="checkbox"/> | 5. You have production set up with local equipment and automation sufficient for low/mid end product requirements | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. You know the competitor landscape, their strategies, cost base and quality level vs. your own | <input type="checkbox"/> | <input type="checkbox"/> | b) Sourcing | <input type="checkbox"/> | <input type="checkbox"/> | 6. You have multi-format distribution channels capable of penetrating even entry-level regions, including a network of possible agents and brokers | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. You understand current and future regulatory requirements and their implications | <input type="checkbox"/> | <input type="checkbox"/> | c) Manufacturing | <input type="checkbox"/> | <input type="checkbox"/> | 7. You have a globally agreed brand image for your low/mid end product | <input type="checkbox"/> | <input type="checkbox"/> |
| 8. You have a clear view of your company's overall potential and barriers in low/mid end market based on regulatory, market and competitive drivers | <input type="checkbox"/> | <input type="checkbox"/> | d) Marketing | <input type="checkbox"/> | <input type="checkbox"/> | 8. You have a strong local organization capable of domestically managing all points above | <input type="checkbox"/> | <input type="checkbox"/> |
| | | | e) Sales Channel | <input type="checkbox"/> | <input type="checkbox"/> | 9. Your global management understands the unique requirements in China and supports the required business model changes | <input type="checkbox"/> | <input type="checkbox"/> |
| | | | f) After market services | <input type="checkbox"/> | <input type="checkbox"/> | | | |
| | | | 5. You have conducted a branding study and considered multi-brand options | <input type="checkbox"/> | <input type="checkbox"/> | | | |
| | | | 6. You have analyzed various organic and inorganic growth options– and decided | <input type="checkbox"/> | <input type="checkbox"/> | | | |
| | | | 7. You have a solid business model confirming the viability of your strategy | <input type="checkbox"/> | <input type="checkbox"/> | | | |

| | | | | |
|---|---|---|--|----------------------------------|
| If any of the questions are answered "no" | If 4 or more of the questions are answered "no" | If less than 4 of the questions are answered no | If 3 or more questions are answered no | If max 2 question is answered no |
| Market Explorer | Undecided | Getting Ready | Fit For Growth | |

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Relevant Publications

Harvard Business Review

- “How Emerging Giants Can Take on the World”-- Harvard Business Review, Dec 2013
- “Is China the World’s Next Rust Belt?” -- Harvard Business Review China, Apr 2013

CEIBS Business Review

- “Choose Your Capability Path” -- CEIBS Business Review, Mar 2014
- “Modern Zorro is Out” CEIBS Business Review, Feb 2014

Strategy + Business

- “It’s a Race to the Bottom in China’s Auto Market” – Strategy + Business, Sep 2014
- “How Firms in Emerging Markets Can Play Catch-Up”-- Strategy + Business, Jan 2014
- “Why Strategy Matters in Emerging Markets After All”-- Strategy + Business, Dec 2013
- “China’s Mid-Market: Where “Good Enough” Just Isn’t”-- Strategy + Business, July 2013

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