

strategy&

Formerly Booz & Company

22 November 2014

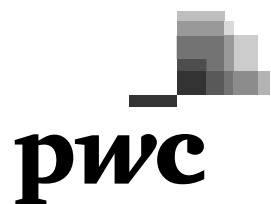
Sanya, Hainan Island

The China Outbound Forum

Going after the high end of the value chain

&

Session Presentation



Most emerging market multinationals (EMNCs) embody a contradiction – they are both first movers and latecomers

EMNCs = First Movers

- Among the first to have made cars, appliances, and other manufactured products in their home countries ...
- **Strategic Focus**
 - Adapt industry's existing global business model to local market conditions
 - Pre-empt competitors to capture and leverage early mover advantages



EMNCs = Latecomers

- ... but way behind MNCs that have been honing their capabilities, technologies and brands for decades
- **Strategic Focus**
 - Overcome lack of experience, scale/scope, and other time-based disadvantages
 - If possible, leverage potential latecomer advantages (e.g., new technology)



Getting Ahead of the Pack



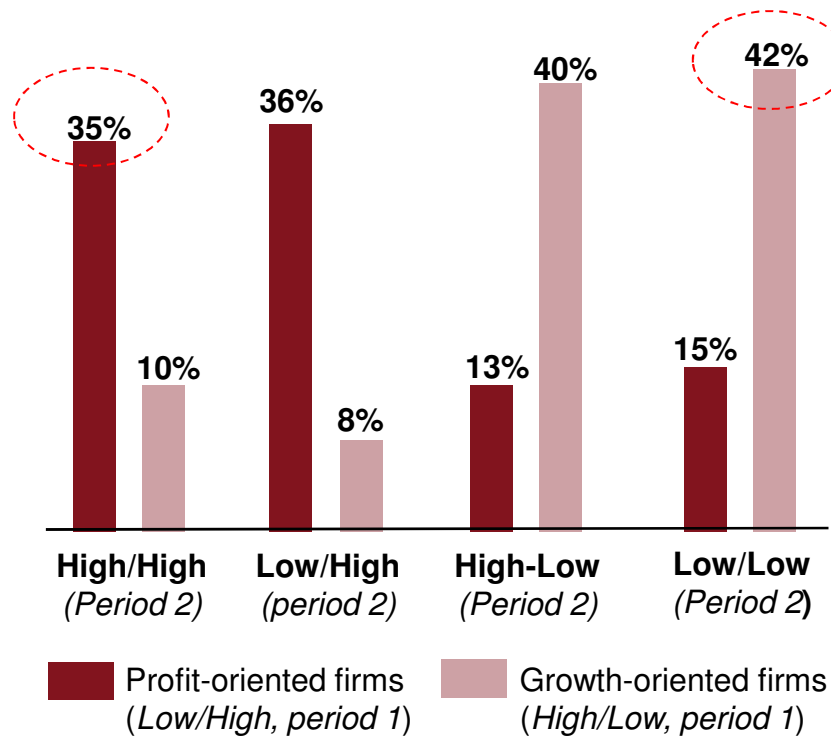
Playing Catch-up

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

Many EMNCs find it difficult to manage this contradiction

Profit- versus growth- oriented firms

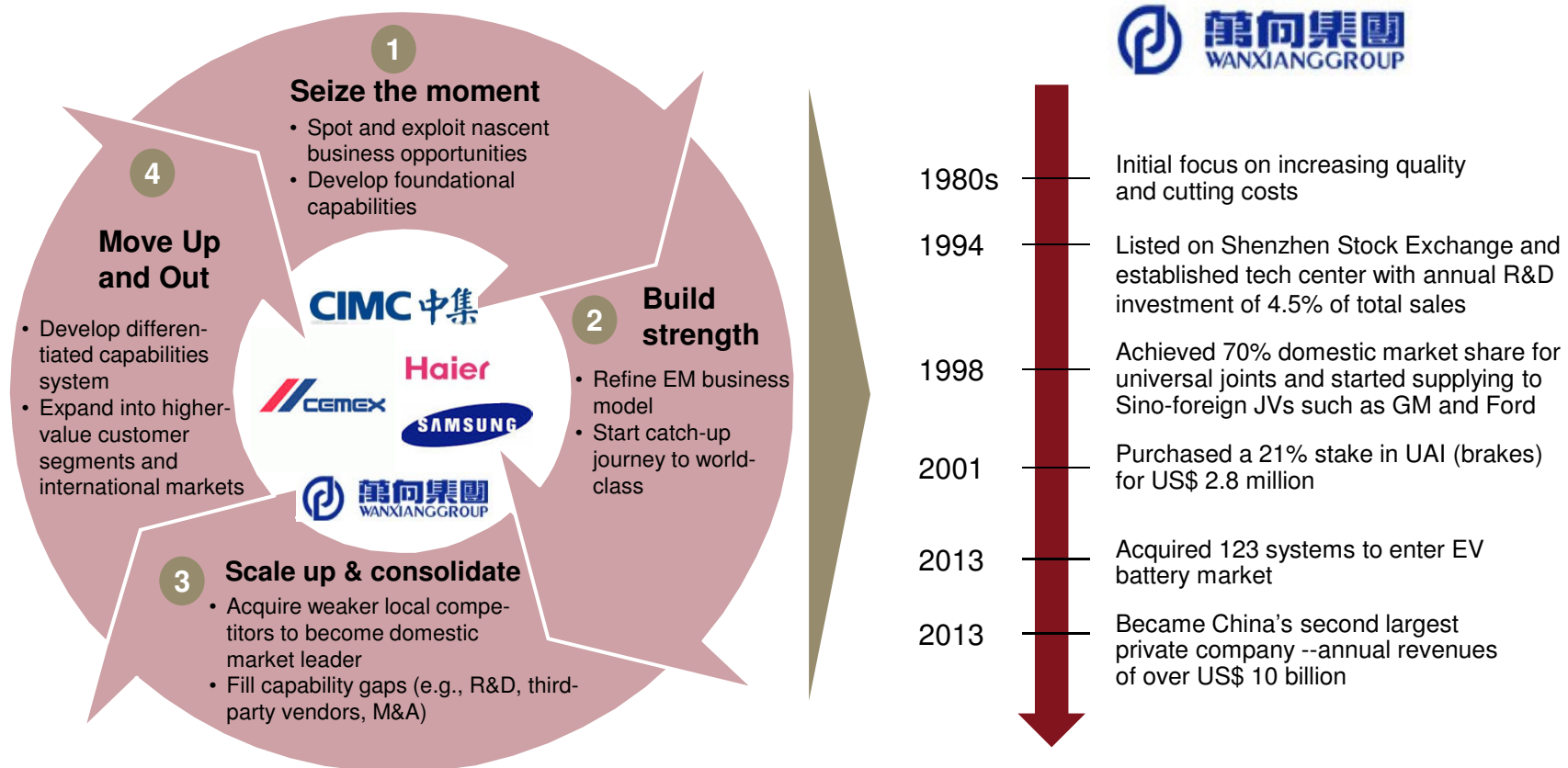
Sales and profits growth trajectories over consecutive five-year periods ($N = \sim 105,000$ firms in Brazil, Russia, India, and China)



- In their eagerness to get ahead, many EMNCs focus primarily on top-line growth and neglect to lay the foundation for profitability in any environment other than a rapidly expanding market
- In reality, profit-oriented firms are significantly more successful over the long-term than growth-oriented firms

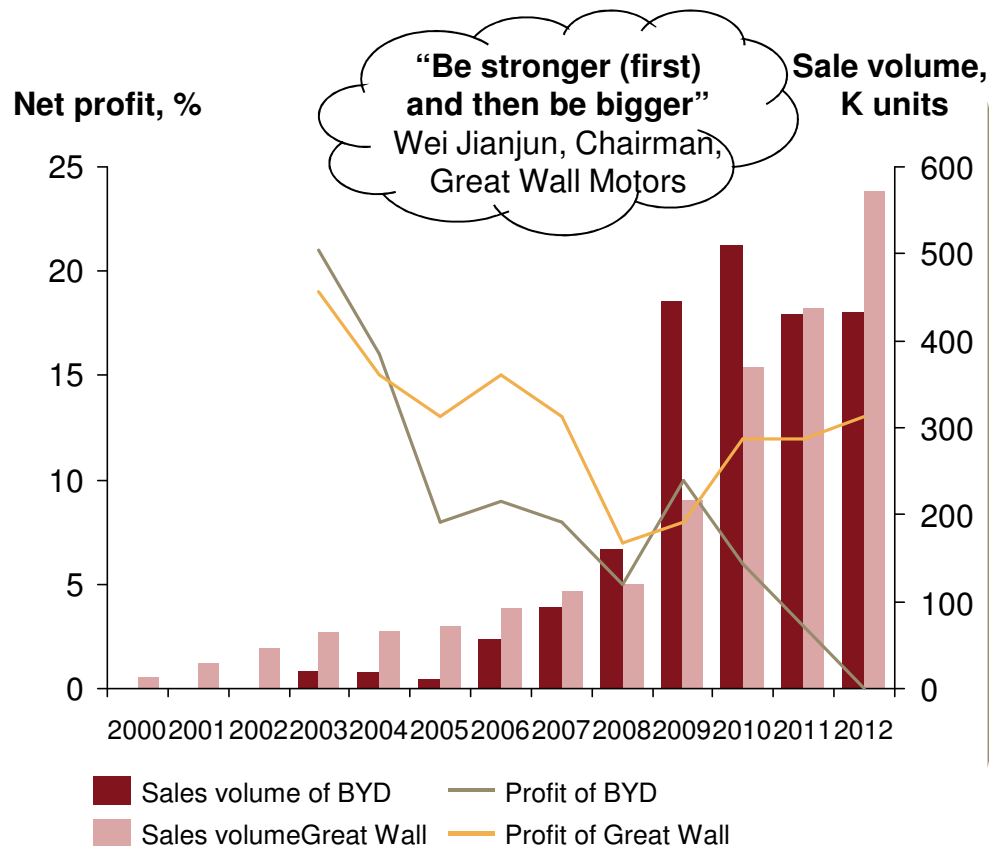
Sources: "Rough Diamonds", Park, Zhou, Ungson (2013) / "How Emerging Giants Can Take on the World", Jullens, Harvard Business Review, Dec 2013

Successful EMNCs typically follow a deliberate four-step process of developing advanced capabilities over time



Source: "How Firms in Emerging Markets Can Play Catch-Up", Jullens, Strategy+Business, Jan 2014

For example, Great Wall's capabilities-driven strategy was more successful than BYD's growth-at-all-costs approach



BYD

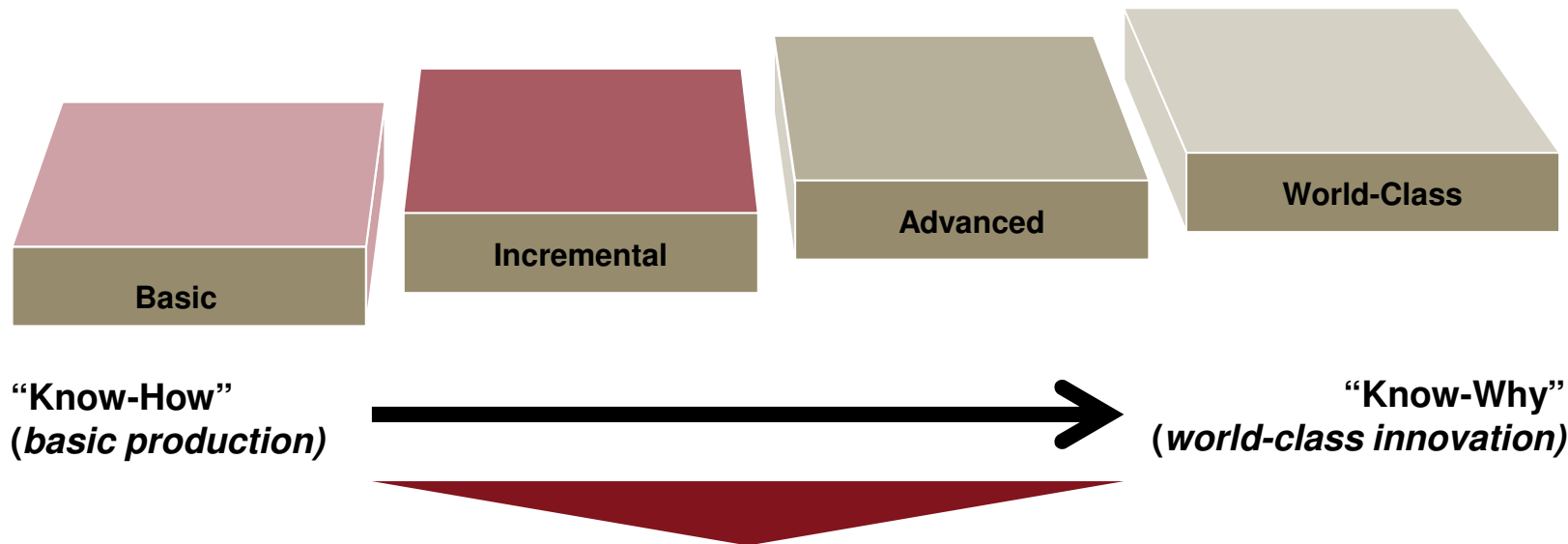
- Growth-oriented
- Focus on increasing sales
- Bold vision of global industry leadership position by 2025
- Aggressive product line and dealer network expansion
- ...

Great Wall

- Profit-oriented
- Focus on improving capabilities
- Conservative vision of becoming a strong Chinese automaker first
- Cautious product line and dealer network expansion
- ...

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

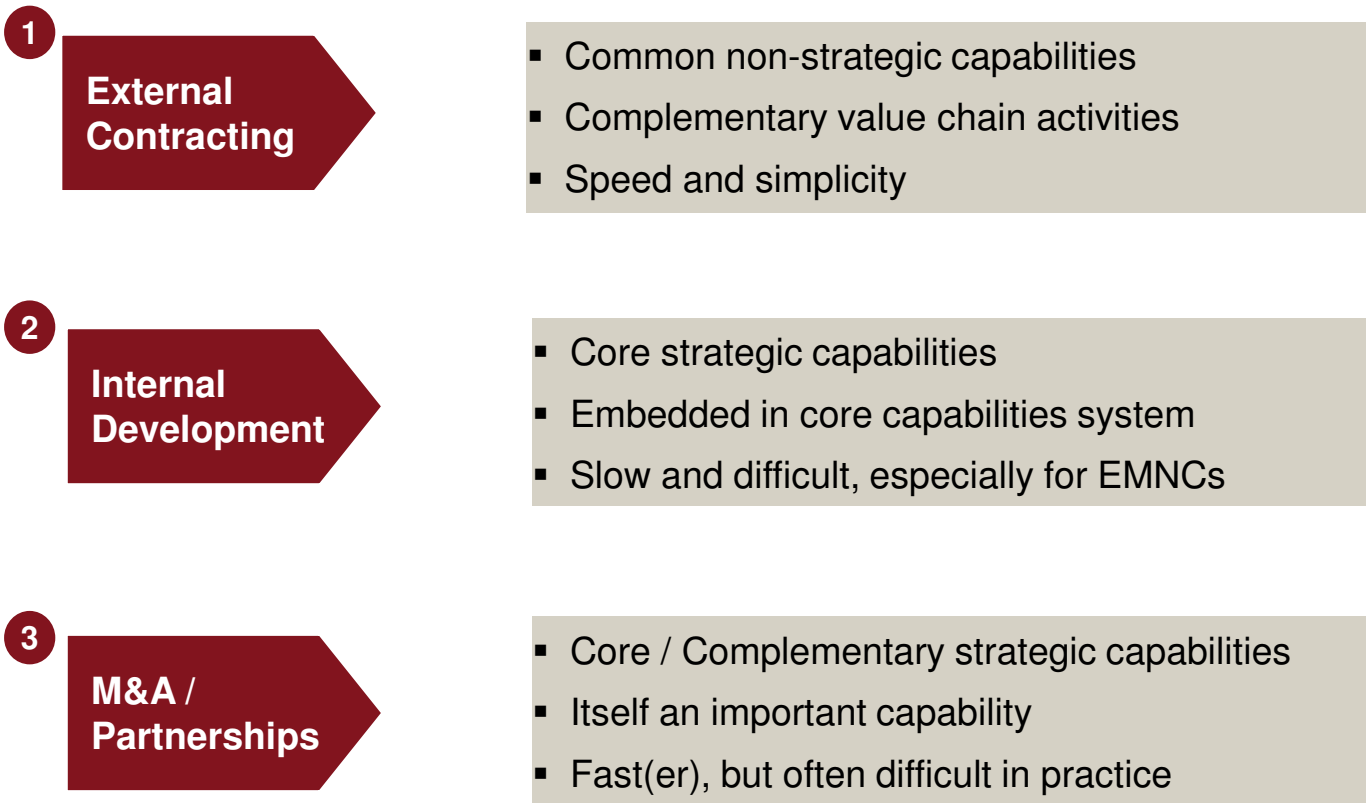
In practice, the EMNC's journey from basic production to world-class innovative capabilities takes a long time



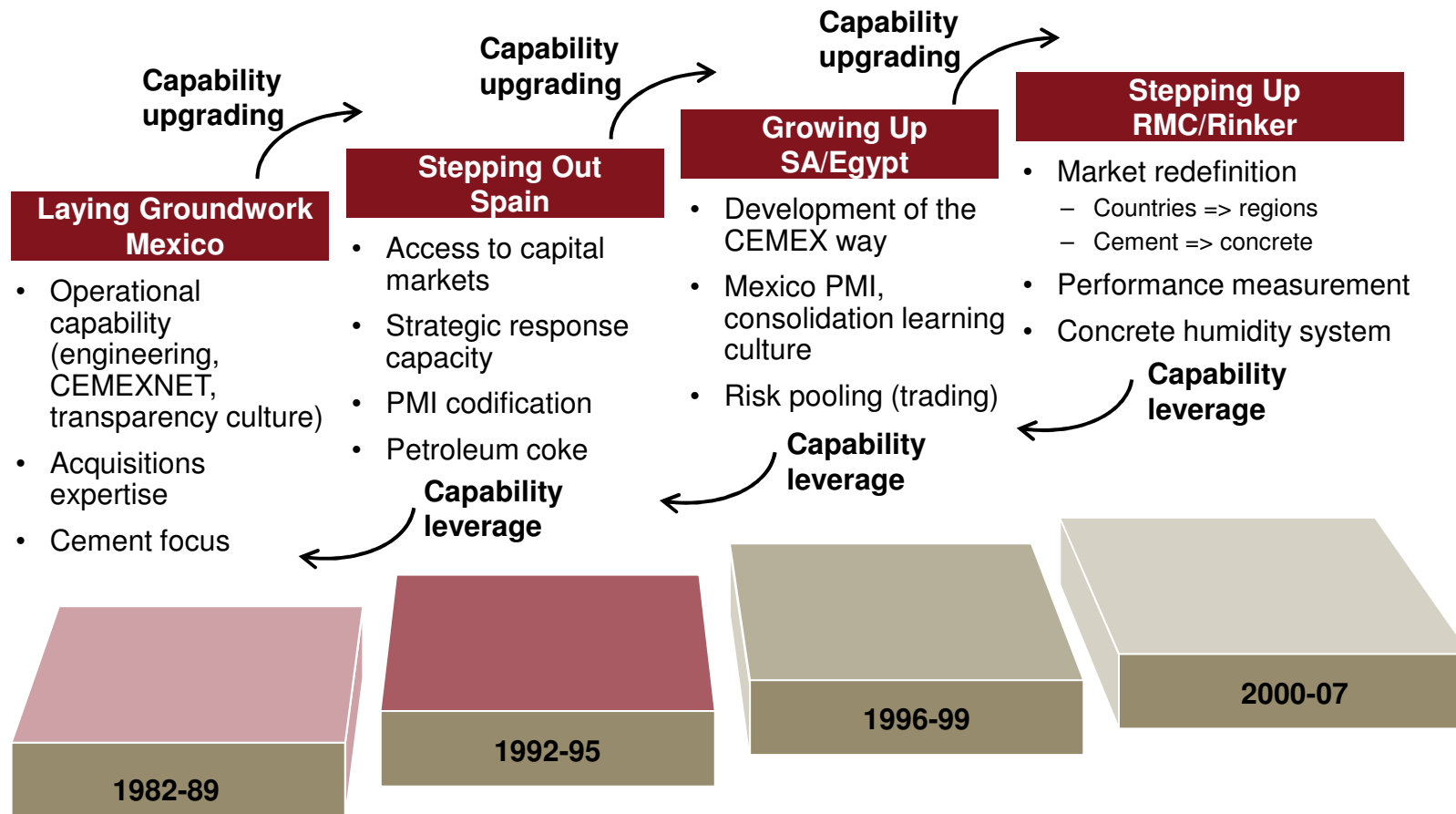
- EMNCs must evolve from acquiring basic production expertise to mastering world-class innovation through a process of “chaining” increasingly advanced capabilities
- Capability chaining is a deliberate and cumulative process with significant path dependency which requires a top-down and bottom-up approach and needs to be embedded in a complex ecosystem to enable co-evolution with other stakeholders

Source: Adapted from Bell and Figueiredo (“Building Innovative Capabilities in Latecomer Emerging Markets Firms: Some Key Issues”, Oxford University Press, 2012)

Firms must decide how to develop their future required capabilities at each step along the way



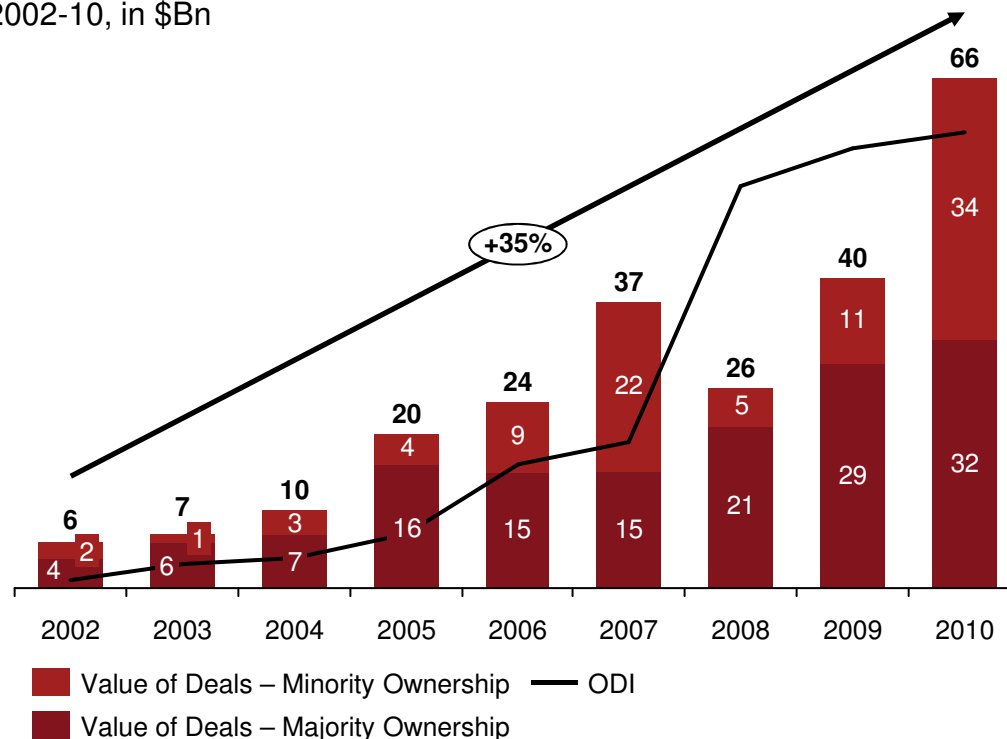
CEMEX has been especially effective at leveraging acquisitions to enhance its own organizational capabilities



Source: "Mexican Multinationals: Insights from CEMEX", Lessard and Lucea, Cambridge University Press, 2009

Chinese EMNCs have also focused heavily on acquisitions to upgrade their capabilities - especially since the '08 GFC

China ODI and Outbound M&A
2002-10, in \$Bn



Primary Drivers

- Domestic upgrading efforts not consistently successful (e.g., JVs)
 - *High-speed rail (+)*
 - *Automotive assembly (-)*
- Increase in ODI and M&A to improve competitiveness at home
 - *Sany => Putzmeister*
 - *Geely => Volvo*

Source: Global Insight, Strategy& analysis

However, results have been mixed, due to overly aggressive strategies and limited organizational capabilities

Aggressive Acquisition Strategies

- Capability upgrading often focused on outright acquisitions anywhere instead of gradual geographic expansion nearby
 - **Time pressure** to catch up quickly
 - Need to develop **multiple capabilities** at once
 - **Cheap financing** and **government pressure**
 - Numerous acquisition targets following **'08 financial crisis**
 - **Hubris**



Limited Organizational Capabilities

- **Turnaround Management**
 - Industry leaders not for sale
 - Acquisition target typically financially distressed
- **Integration Management**
 - Limited PMI experience
 - Little understanding of know-how to be transferred
- **International Experience**
 - Lack of fungible talent
 - Language and cultural issues
 - Poor governance, managerial competence, and systems

Source: "Sino-Finnish Paths to International Competitive Advantage", Jullens/Suonio/Tang, TEKES, 2013

Strategic partnerships with leading foreign players often represent a viable alternative to outright acquisitions

- 1** Partnerships may sometimes be more suitable than outright acquisitions
 - Knowledge transfer requires side-by-side collaboration
 - No need for managing and/or integrating the foreign partner's business
 - Potential to collaborate on project-by-project basis, at least initially
 - Opportunity for collaborating with industry leaders instead of acquiring laggards

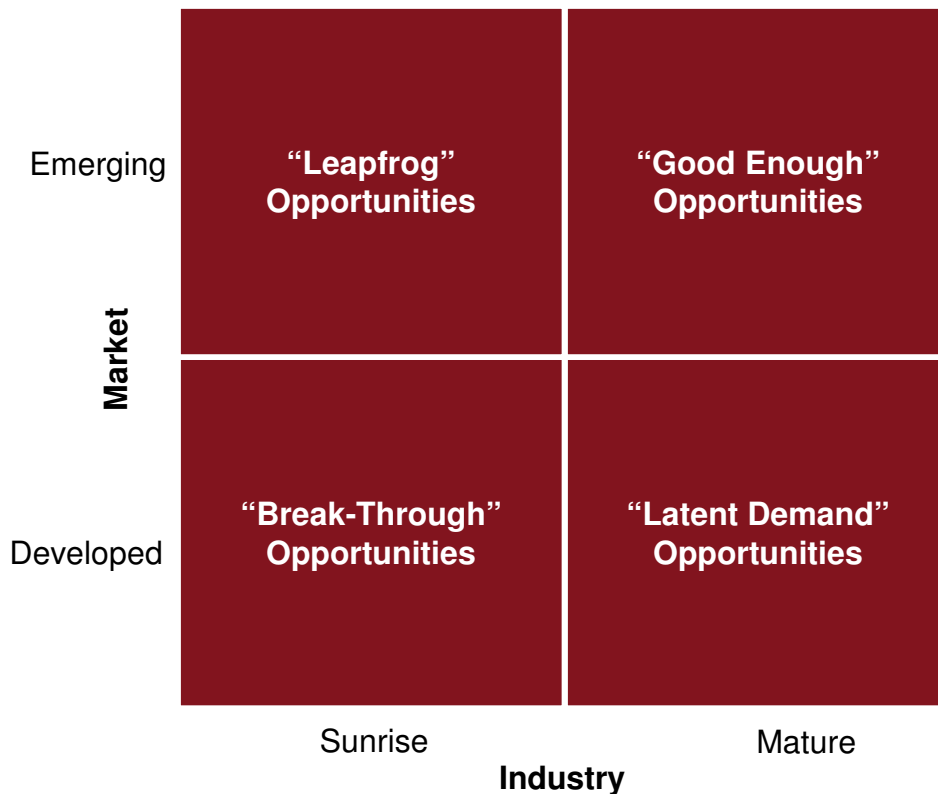
- 2** At the same time, many foreign companies need to capture new growth opportunities in emerging markets, but lack the critical capabilities to do so themselves
 - Limited mid-market products and know-how
 - Little experience in emerging markets, especially in SE Asia
 - Large number of SMEs with limited financial and managerial resources

- 3** Potential “Win-Win” collaboration opportunities lie at the intersection of complementary firm capabilities, country-specific advantages, common target industries, and geographic proximity

Source: “Sino-Finnish Paths to International Competitive Advantage”, Jullens/Suonio/Tang, TEKES, 2013

Such Sino-foreign partnerships can be classified into four groups as a function of industry and market maturity

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: “Sino-Finnish Paths to International Competitive Advantage”, Jullens/Suonio/Tang, TEKES, 2013

Summary

- Chinese firms will continue to look for acquisitions to accumulate assets and develop their organizational capabilities and resources
- Ongoing economic difficulties elsewhere will likely continue to create an environment where attractive acquisition targets will be available
- However, many Chinese firms will have to significantly “up their game” and become much better at managing and integrating these acquisitions
- This implies placing much more importance on improving management and other organizational skills as opposed to simply focusing on technology acquisition itself

Contact information

John Jullens

Partner, Strategy&

Formerly Booz & Company

Suite 2511, One Corporate Avenue
No. 222 Hu Bin Road
Shanghai 200021, P.R. China

Telephone: +86 21 2327 9800

Fax: +86 21 2327 9833

john.jullens@strategyand.pwc.com

www.johnjullens.com

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