Case Studies on

MNCs in China – Vol.I

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OVERVIEW

"Study the past if you would divine the future."

— Confucius

It may not be an exaggeration to say that global companies are spending half their strategic planning time on exploring growth opportunities in emerging markets. And in that, not a single strategic planning session goes by without making a conscious reference to China. China is a key market for all the multinational companies. The success in China defines the bottom line success. The Boardrooms are filled with consultants, market researchers, and go-getters. But, success in China is not to come by easily. China decision is wrought with potential as well as peril. Navigating through the perils would spell the success for the companies. This book primarily seeks to answer two intriguing questions: why it makes sense to put China on the growth agenda, and what it takes to be successful in China?

China is one of the most discussed topics in the multinational business community. Because of the country's vast size and huge development potential, many multinational consumer product companies believe they must compete there. Yet the special characteristics of the Chinese market have made a presence challenging at best and often frustrating. China's size, diversity and rapid change, not to mention its culture and the broad influence of its government, all contribute to a difficult operating environment. On top of these factors, competition in many consumer product sectors is intense. Local players, leading multinationals and overseas Chinese companies are all vying for business from the country's huge pool of consumers.

In a recent McKinsey Survey[1], just over a third of the survey's respondents report that their companies have operations in China, and almost 30 percent trade there (Exhibit I). Just over half say their companies can earn some revenue from China. Two-thirds of large companies – those with annual revenues of $1 billion or more – currently operate in China, and 81 percent generate revenues from there. Perhaps most interestingly, at a time when many companies are assessing whether they have concentrated too much of their operations in China, only 14 percent of all survey respondents say their companies own one or more manufacturing plants, service facilities, or retail stores there. Even among companies in the production sectors (as opposed to service firms), the figure is only 21 percent.

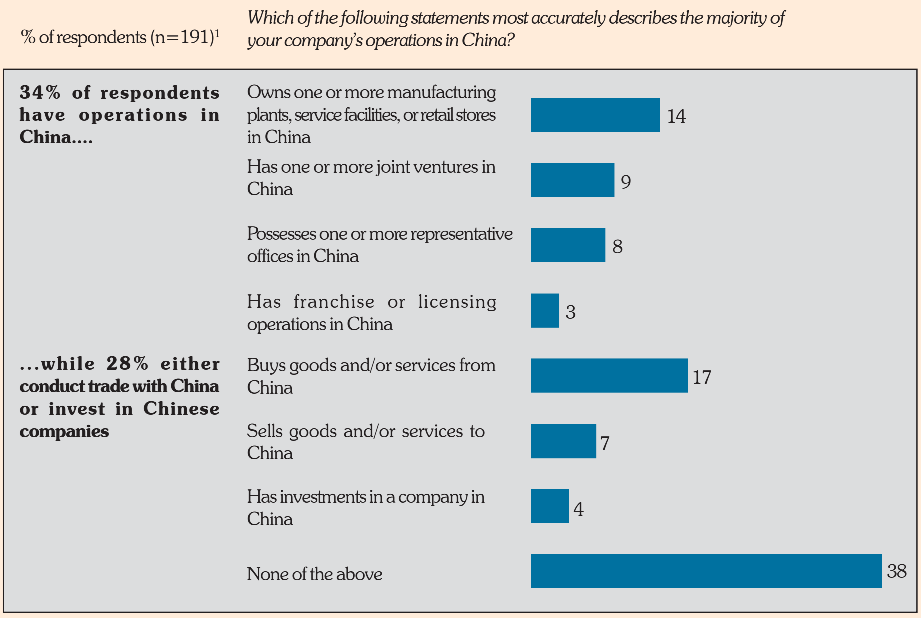
China is at a turning point and practices once good enough to support a market entry strategy no longer assure success[2]. Whether a company views China as a manufacturing base, an attractive market, or both, world-class execution will be necessary to succeed, and success in China will be needed to survive not only there but also around the globe. As China solidifies its roles as a market, a global manufacturer and a talent pool,

[1] "Doing Business in China: A McKinsey Survey of Executives in Asia", *The McKinsey Quarterly*, January 2007

[2] "Bringing Best Practices to China", *The McKinsey Quarterly*

executives will find that they must lead in China to lead in the rest of the world. Unique practices developed to enter the market will no longer suffice in China's increasingly competitive environment, particularly if Chinese operations are held to lower performance standards. Instead, multinationals must lead with their strength: world-class processes honed over many years in established markets and adapted to Chinese realities.

Exhibit I
Doing Business in China



[1] Includes respondents whose office locations are in Asia but not in China

Source: "Doing Business in China: A McKinsey Survey of Executives in Asia", *The McKinsey Quarterly*, January 2007

Multinational companies are shifting gears in China, turning away from entry strategies and focusing instead on execution[3]. Innovative approaches to recruiting and retaining managers are needed to counter expected staff shortages. Along with distribution and marketing, recruitment will also pose a challenge for global companies as they reach beyond China's large cities. China has targeted innovation as a national priority, and there are early signs that some domestic companies are becoming more creative. Foreign companies should encourage this trend and find ways to benefit from it. As the importance of personal contacts begins to fade, a systematic approach to government relations is

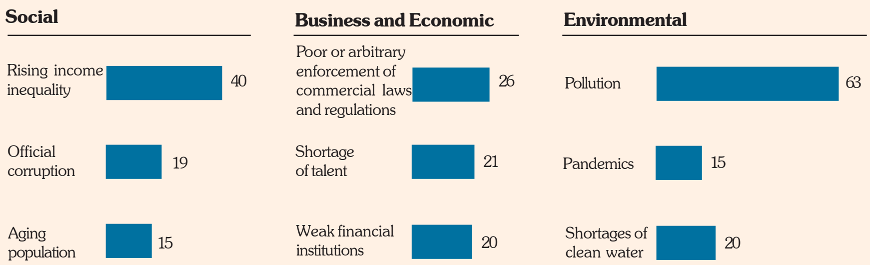
[3] "What Executives Are Asking About China: From Entry To Execution", *The McKinsey Quarterly* (2006 Special Edition)

becoming a necessity. Many companies still face local corruption, although the situation is improving. Executives see a variety of social, economic and environmental threats to China's continued growth and development (Exhibit II). They indicate that economic and social issues are far more important than environment ones. About 63 percent of respondents cite pollution as a threat to growth. But when asked to weigh it against economic and social issues, 80 percent choose a threat other than pollution as the most significant. Across all issues, pollution is the only health or environmental issue among the top five. The others are rising income inequality, poor enforcement of commercial laws and regulations, a shortage of qualified talent and weak financial institutions. Some issues that are significant concerns in other regions – such as renminbi's exchange rate against the US dollar and rising energy prices – are, surprisingly, of very little concern to the executives.

Exhibit II
Potential Threats

Top three threats, % of respondents (n=253)

Which of the following issues poses the greatest threat to China's continued growth and development?



Source: "Doing Business in China: A McKinsey Survey of Executives in Asia", *The McKinsey Quarterly*, January 2007