How Chinese companies can succeed abroad

Meagan C. Dietz, Gordon Orr, and Jane Xing

Chinese companies are seeking opportunities abroad. They will have to acclimate to new surroundings—just as the foreign companies that entered China did.

The wheel has turned: Chinese companies, like the multinationals that have come to China over the past two decades, are reaching for opportunities in new markets abroad. Searching for raw materials, talented employees, technologies, brands, and customers, these companies—many virtually unknown outside China—are themselves becoming multinationals.

As more Chinese businesses succeed internationally, others will probably follow. In interviews with executives at 39 Chinese companies, nearly 80 percent said that globalization is a strategic priority, and of these almost half said that they want their companies to become true multinationals within ten years. Chinese industries that have a relatively large global reach include automotive, pharmaceuticals, high technology, energy, and basic materials; those remaining primarily local are real estate, consumer goods, and retailing. Nearly half of China's outbound corporate investment focuses on securing natural resources, mostly through acquisitions. Other companies have gone abroad to tap new markets as domestic growth slowed. Still others seek to gain either intellectual property (usually technology, but also product designs, brands, or business processes) or a strategic advantage (such as the scale required to compete with foreign competitors).1

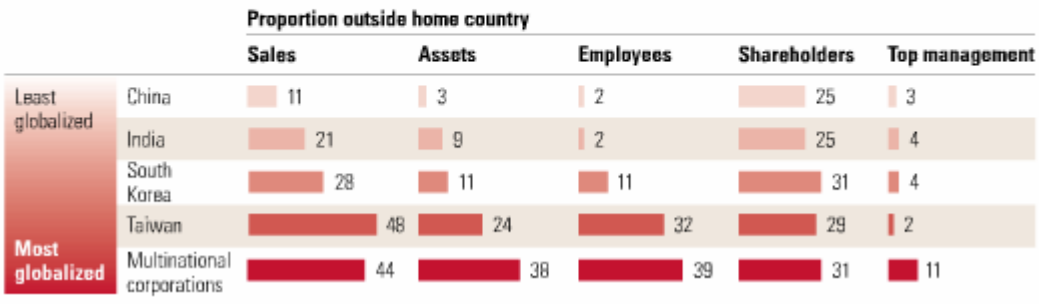
Chinese companies have found acquisitions the fastest way to establish a global presence: in recent years, for example, Lenovo acquired IBM's personal-computer unit for $1.35 billion, and the China National Offshore Oil Corporation (CNOOC) unsuccessfully bid $18.5 billion for the US oil company Unocal. Earlier this year, Huaneng Power International's $3 billion purchase of Singapore's Tuas Power and Sinosteel's hostile $1.1 billion bid for the Australian mining concern Midwest further demonstrated the Chinese appetite for foreign acquisitions.

Behind these headlines, however, the true story of Chinese globalization is unfolding more slowly—a reality that comes into particularly high relief when you compare the globalization efforts of Chinese companies with those of their Indian, South Korean, and Taiwanese counterparts (see sidebar, "Measuring a global company"). Our analysis, focusing on the 100 top companies in each country by market capitalization, shows that Taiwanese, South Korean, and Indian ones generate, respectively, four, three, and two times as much revenue from foreign sales as the Chinese do. Foreign asset ownership and the number of foreign workers employed paint a similar picture (Exhibit 1).

EXHIBIT 1

A slower pace toward globalization

Top 100 companies by market capitalization, 2006, %



What has restrained the expansion of Chinese companies abroad? Some of the hesitation comes down to inexperience in this challenging arena, as well as a disinclination to adopt business practices widely applied in the developed world. Other impediments include those that multinationals from developed countries confronted when they first expanded across borders, such as the need to reorganize and to find talent that can play international roles. Nonetheless, Chinese companies can certainly overcome the sizable obstacles to global expansion if senior managers have the commitment and determination to build the appropriate capabilities and adopt the right organizational structures.

Globalization can take various paths, but 55 percent of the Chinese executives we talked with said that M&A and alliances are the heart of their longer-term global strategies. In the near term, though, most companies are focused on exporting, with only a minimal presence outside China. Given the risks, the costs, and the difficulty of managing a global organization, takeovers by Chinese companies have generally been friendly; Sinosteel's hostile bid for Midwest was an exception.

A close look at outbound mergers and acquisitions by Chinese companies from 1995 to 2007 confirms these observations. Of the top 100 Chinese companies, only 17 completed any outbound transactions during this period, and only 6 concluded more than three. By contrast, 31 of the top 100 Indian companies have completed cross-border transactions since 1995, and 18 have done more than three deals.

This inexperience puts most Chinese companies on the back foot as they consider their international opportunities, whether regional or further afield. To succeed globally, these companies must not only recognize and overcome their shortfalls but also change the way they are managed. Traditional approaches that served them well when they focused on Chinese consumers, Chinese managers, and Chinese employees will no longer suffice as they grow into multinational, multicultural institutions.

Improving assessments of risk

Chinese companies regularly seem to misjudge the political, labor, and environmental risks that foreign business environments present. Many have missed investment opportunities by being too cautious. Others have unnecessarily suffered drastic consequences from their efforts to make overseas acquisitions. To avoid such problems, these companies must build a better assessment of risk into their investment decisions. In particular, they should develop a fuller understanding of how it might affect the future value of their targets.

CNOOC's effort to acquire Unocal, which failed after politicians in the United States began attacking the takeover as a threat to US national interests, is one example of misunderstood risk. This was not the only such case. In 2001, a Chinese utility considered an investment in Southeast Asia but decided that the political risks were too high and declined to move ahead. (Three years later, it returned to the market. Leading an international consortium that helped it to assess local risks and offering a significantly higher price for the target, it won the acquisition.) And in recent years, the Chinese consumer electronics group TCL Multimedia Technology was surprised to find that labor union restrictions made it expensive and time consuming to close newly acquired loss-making operations in Europe.

Training in-house experts and recruiting overseas employees who can assess risks will be necessary mid- and long-term steps in building better internal capabilities. But Chinese companies can do something right now: engage third-party experts (such as law firms and public-relations agencies) that have a deep knowledge of the target's local environment early in the evaluation process. Working with knowledgeable advisers will also accelerate a company's efforts to understand how risk should be managed.

Business partners and Chinese government officials, too, are valuable resources for companies weighing and addressing risk. So are private-equity partners, which can provide not only funding, marketing expertise, and managerial insights but also access to foreign talent pools and networks. Chinese embassies, as well as non-Chinese entities such as law firms specializing in government relations and local development groups charged with attracting

foreign investment, may be able to help Chinese companies manage government and business relationships in foreign countries.

Preparing for acquisitions

Chinese companies should be ready to seize international opportunities, which can arise unexpectedly, especially in mergers and acquisitions. To expand effectively through M&A, companies must have access to the right conversations about businesses that may be on the block and clear processes for making speedy—but not hasty—decisions.

A company lacking experience in acquisitions should start with the basic steps that today's multinationals have already taken. One necessary move is building a comprehensive database of acquisition targets reflecting a company's strategic objectives. Companies should also carefully consider possible markets to enter, their policy makers and other stakeholders, and their business and economic environments. A factual catalog with this kind of information will make it easier to manage risk once active targets for acquisition have been identified. To catch wind of suitable opportunities, companies should create friendly networks within their industries, the investment community, and the home and host governments.

Companies that can act quickly on interesting opportunities use rigorous screening criteria to identify potential acquisitions worthy of serious consideration. For less experienced companies, the criteria could cover basic value drivers, such as market prospects, potential synergies, and operational and financial strengths. Companies have also developed in-house M&A handbooks compiled from their own experience, that of other companies, and global best practice. M&A guidelines typically cover governance and decision making, valuation and pricing, the management of transaction processes, the capabilities required to complete deals, and merger integration approaches, including ways to address differing legal systems, cultural norms, and values—generally, the most difficult areas for executives. Preparing this kind of handbook in advance could allow Chinese companies to break through the endless consensus building that now slows them down.

Developing global talent

One of the greatest barriers to the globalization efforts of Chinese companies is a dearth of employees with the right know-how. As an executive at a high-tech company told us, "We have a shortage of global talent in every department—especially those who can negotiate with partners and those who have a profound understanding of European and American markets." In our interviews, 88 percent of the Chinese executives said that their globalization efforts were hindered by the scarcity of people with real cross-cultural knowledge or experience managing foreign talent. Ninety-three percent said that Chinese companies would not achieve their global aspirations unless they developed suitable leaders more aggressively.

These limitations reach into the executive suite. Of the Chinese executives we spoke with, 56 percent said that they had no cross-cultural training and half that they wouldn't accept a foreign assignment. By contrast, multinationals based in developed countries often make such postings a prerequisite to career advancement.

Many Chinese companies have started to deal with this lack of global experience by sending their best managers to intensive management-training programs—for instance, those of corporate universities sponsored by multinationals and business schools. Others appoint human-resources leaders with experience hiring international talent. The telecommunications-equipment maker Huawei is among the companies that have undertaken pilot programs combining global recruitment, competitive compensation, job rotation within an individual location, and mobility. These programs include instruction in giving presentations, communicating with people (particularly foreigners), and resolving conflicts. Along with these skills, Chinese managers must learn to delegate, to coach, and to have difficult conversations with colleagues. These soft skills, increasingly important as an organization expands across the globe, are generally underused and underappreciated in China's business culture.

Some Chinese companies have filled the capability gap by looking for employees outside China. TCL recruited a Singaporean, Leong Yue Wing, a 28-year Philips veteran, as vice

president, for example. Lenovo lured an American from Dell, Bill Amelio, to lead the company, banking on his broad experience in both emerging and developed markets and in many senior operational roles. Indeed, more than 70 percent of the members of Lenovo's top team are not Chinese nationals.

In recruiting and retaining foreign managers, Chinese companies face a challenge rooted in their global inexperience. Unlike local employees, who regard company loyalty as a given, foreign recruits require more attention from senior management to feel a similar level of commitment: if their local supervisors and peers don't allow them to complete assignments with minimal supervision, for example, they will never be fully integrated into the organization. Foreign employees also want greater clarity than local ones about issues such as career paths, corporate governance, and the expectations of management.

Creating a global brand

For Chinese companies in the high-tech and consumer goods industries, the push to globalize largely reflects the need to find new markets for their products. Brand building is one of the most important considerations for such companies. Whether they buy established global brands or launch their own, they must build marketing capabilities that were less important in the captive domestic market.

To reap value by investing in and acquiring brands, Chinese companies, broadly speaking, must work on changing the way the world market views their products—from low cost and quality to a level of quality equal to or better than that of their global competitors. No company has so far perfected a formula for turning a Chinese brand into a well-perceived global one, but some have made strides. For many companies, part of the answer is better marketing, backed up by a product-development strategy that stresses value through quality as well as low costs.

As Huawei, for example, expanded beyond China, it adopted a business model that emphasized new technology, focused more sharply on the customer's needs, and carefully built a brand image. The company also made a strategic choice to enter developing markets first. "It takes time to build a brand," one Huawei executive offered. "To tackle that, we started with emerging markets, such as Eastern Europe, with lower brand loyalty, which reduced our entry cost, before moving to developed markets." Lenovo's high-profile marketing efforts have included major sports sponsorships—the Beijing Olympics, the US National Basketball Association, and Formula One racing, for instance—as well as prominent exposure in global mass-market business magazines.

Redesigning the organization

Many Chinese companies are organized from the top down: headquarters is the nominal profit center where cross-functional decisions are made. This structure worked so long as these companies offered one kind of product to one market. But global organizations clearly require different structures and processes.

In the last decade, Huawei, for example, has grown from a company with 800 employees and a single kind of product (telephone switching equipment) sold only in China into a corporation with 61,000 employees and six product lines sold to customers in more than 100 countries. Along the way, it created an organization in which product unit and geographic heads have profit-and-loss responsibility and make decisions independently. Each product unit develops its own product and sales strategies, which geographic subsidiaries implement. Both make their own human-resources decisions.

As one executive told us, "Managing by people instead of by process is deeply rooted in Chinese culture." Changing gears will be difficult. Many Chinese companies struggle to frame, update, and execute new organizational designs. Creating strong regional organizations with transparent financial-performance standards is a good first step. This kind of organization could be useful because it is relatively straightforward to design, minimizes disruption, and creates a clear picture of profit and loss. Simplicity is important: many executives in the leadership teams of Chinese companies lack international experience and, as a result, are not

well prepared to assume responsibility for global operations. Standardized systems throughout a global organization—to evaluate performance, for example—help ensure that employees work under the same quality yardstick and encourage many of them to overcome their experience gaps. As companies become more familiar with global operations, they can adopt increasingly sophisticated organizational models.

Finding a balance of cultures

As Chinese companies globalize, they will face the challenge of combining Chinese and Western forms of communication and cultural norms. For many, this will be one of the greatest obstacles to global integration and, by extension, to performance in global settings. What's more, many Chinese managers have limited fluency in English, which is increasingly the language of global business. This problem undermines their confidence when they speak outside China. Coupled with a cultural distaste for direct confrontation, it prevents them from speaking directly and concisely to global audiences, the norm in Western business discourse.

In addition, Chinese culture typically places few boundaries between work and personal life, while most Westerners consciously try to separate the two. Chinese corporate culture tends to emphasize seniority and relationships more than responsibility and accountability—another stark contrast with the Western emphasis on personal accountability and demonstrated merit and ability.

The right mix of Chinese and Western norms will vary from company to company and is likely to evolve. To accelerate the process of global acculturation, the top teams of Chinese companies should hold meetings with open agendas at offsite locations around the world so that managers from different backgrounds can break the ice in a variety of settings. Training in communications and external programs for senior executives also help to bridge cultural differences.

A message of common values and visions must be central to this new approach to communications, particularly when dissimilar companies integrate. Managers should work to establish a common strategy and mission for the new organization and to articulate a new culture, including a clear delineation of roles and responsibilities. Communications and cultural workshops ought to build an understanding of the different core values and beliefs of people from different countries. They should be designed to encourage a shift in attitudes about decision making and execution—a shift from risk averse and nonconfrontational to proactive and inclusive.

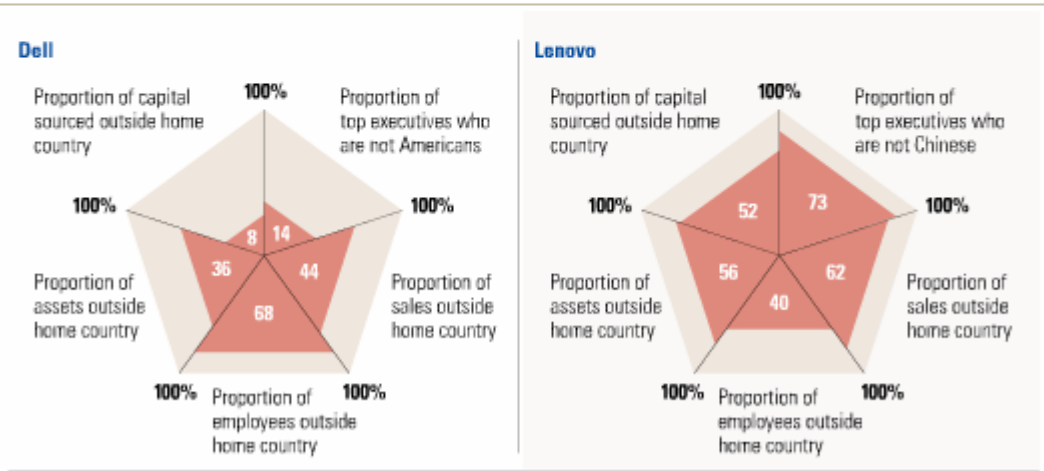
China's companies are on the cusp of a major period of foreign expansion. They have a great potential to reach beyond their home market, but to succeed they must overcome their inexperience and change themselves boldly.

Measuring a global company

To gauge the extent to which Chinese companies have become global players, we examined their sales and assets outside the country as a proportion of corporate assets (a proportion that increases as companies grow abroad, organically or through acquisitions). We also looked at these companies' sources of capital and of human resources—in particular, the proportion of people who are not Chinese nationals in top management and the overall workforce. By looking across these metrics and contrasting Chinese enterprises with their leading global competitors in Europe, Japan, and the United States, we developed a better sense of how globalized Chinese enterprises are. In fact, some of them seem to be more global than their better-known international counterparts; Lenovo, for example, leads Dell in most of the metrics we examined (Exhibit A).

EXHIBIT A

Globalization—Dell and Lenovo



Source: 2006 annual reports; Thomson

Disponível em: <http://www.mckinseyquarterly.com>. Acesso em 13/5/2008.