The Consequences of China's Rising Global Heavyweights

Competing in China is the only option for multinationals that want to build or preserve their global position.

Orit Gadiesh and Till Vestring

Since Huawei Technologies Co. Ltd., the Chinese network equipment maker, bid for a minority stake in Massachusetts-based networking equipment producer 3Com Corp. in September 2007, the deal has encountered resistance from U.S. regulators concerned about foreign access to intrusion protection technology supplied by 3Com to the Pentagon and other organizations. Huawei recently withdrew its merger application, and both companies say they are reviewing their options. Meanwhile, it's worth stepping back and asking a broader business question: How did Huawei get here? The trajectory of one of China's leading technology companies is a story in its own right — and one that points to the emergence of China's middle market as the staging ground for a new set of global competitors.

Historically, multinationals zeroed in on China's premium market, where global competitors could earn decent margins. But the playing field over the last few years has changed rapidly. Multinationals sticking with a premium-only strategy are increasingly under attack from emerging Chinese champions with compelling "good-enough" offerings — good-enough products at prices low enough to attract China's fast growing enterprise customers and midlevel consumers.

Indeed, China's middle market today is growing faster than the premium and low-end segments combined. A full 80% of all televisions and washing machines sold in China, for instance, are good-enough brands.

Huawei has used this trend to its advantage, rising from the low end of the market for telecom network equipment to become one of the top global players. Established in 1988, Huawei has consistently invested 10% of its sales in research and development. It developed its own products to penetrate new segments in China and forged technical alliances to further broaden its product mix. With government support, Huawei helped consolidate the domestic market, gaining massive scale in the process.

The company now controls 14% of the local market for telecom networks. Firmly established at home, Huawei has built its brand and reputation with global customers by pursuing top tier customer contracts, establishing 12 R&D centers around the world, developing next-generation technologies and partnering with global brands including 3Com. It consistently has taken advantage of its low-cost China-based R&D and engineering resources by leveraging its ability to outsource some of its manufacturing processes to other players in China.

A little more than a decade ago, Huawei was simply a regional company in a local market that few multinationals had considered important. Today, it counts 31 of the world's top 50 telecommunications companies among its clients.

A number of multinationals have begun to counter such threats with their own good-enough strategies. For example, the Gillette Co. had this in mind in its 2003 acquisition of Fujian Nanping Nanfu Battery Co. Ltd., China's leading battery manufacturer. Although already in China, Gillette's Duracell division had been losing market share to lower-priced competitors throughout the 1990s. By 2002, Duracell's share was just 6.5%. By contrast, Nanfu controlled

more than half the market. Facing such odds, Gillette decided to buy a majority stake in Nanfu.

Gillette took care to protect both Duracell's and Nanfu's brands in their segments — a crucial part of the strategy, as Gillette continued to sell premium batteries under the Duracell brand while maintaining Nanfu as the leading national brand for the mass market. Dual branding, cost synergies, a broadened product portfolio, economies of scale and distribution to more than 3 million retail outlets in China have paid off for Gillette, which has seen significant increases in its operating margins in China.

Colgate-Palmolive Co. went a step further and used China to create low-cost products it now ships around the world. In the early 1990s, it entered into a joint venture with one of China's largest toothpaste producers, and it acquired China's market leader for toothbrushes a decade later. As a result, Colgate more than doubled its oral hygiene revenues in China between 1998 and 2005, and it now exports its China products to 70 countries.

China is such a big market now that playing to win in China is really the only option for multinational companies that want to build or preserve their global position. As Colgate-Palmolive has learned, the skills and experience that companies build by competing in China enable them to target emerging markets in other developing countries — one of the fastest growing segments of the global economy. Indeed, with the emergence of new Chinese champions like Huawei with massive scale and cost benefits they can deploy globally, it's becoming clear that succeeding in China's good-enough market is becoming essential to success everywhere else.

Orit Gadiesh *is chairman of Bain & Co. Inc. and is based in the management consulting company's Paris office.* ***Till Vestring,*** *based in Singapore, heads the company's Asia-Pacific Industrial Practice. Comment on this article or contact the authors through Paul Judge at paul.judge@bain.com.*

Reprint 49305. *For ordering information, see page 1.*

Fonte: Mit Sloan Management Review, vol 49, n. 3, p. 10-11, Spring. 2008.