



Overview

China is *en route* to becoming the world's second largest economy. In the last five years, it has undergone drastic economic change, including: transforming to a service economy, building capabilities to support innovation and improving sustainable economic development. As China changes, the opportunities for multinational corporations (MNCs) require a re-examination of strategy and business models. It is critical that MNCs understand the new business environment in order to compete. Those seeking success in China will need to assess their core capabilities in five key focus areas: product, positioning, place, process and people.

IBM Institute for Business Value

Succeeding in a changing China

How multinational corporations can be more competitive

How China is changing

The rise of China's consumer class makes China one of the most important consumer markets in the world. From 2006 to 2011, consumer consumption capacity increased significantly in first- and lower-tier cities, as well as rural areas.¹ Through the twelfth Five-Year Plan, China's government is currently working to develop seven strategic emerging industries as part of its National Development Agenda:

- Energy saving and environment protection
- Next-generation information technology
- Biotechnology
- High-end equipment manufacturing
- New energy
- New materials
- Alternative energy vehicles.

Rapid change is not without its challenges, however, China is experiencing rising labor costs that have resulted in jobs moving to Asian countries with lower labor costs.² Factories in developed coastal areas face a shortage of workers as the next generation of workers increasingly relocates to work closer to its hometown areas. In addition, China's economic incentive plan has led to inflation, which has increased the uncertainty of sustainable economic growth.³



Multinational companies (MNCs) have facilities and other assets in at least one country other than the home country. With offices and/or factories in different countries, MNCs usually have a centralized head office to coordinate global management.

Three trends associated with MNCs in China

In this evolving business environment, MNCs are part of three major trends:

- **China is one of the most important markets for business growth.** Global economic recession left most developed markets with weakened growth and slow recovery, but China was able to sustain high economic growth. MNCs are increasing investments in market insights to better understand consumer needs and develop products to cater exclusively to the China market.
- **MNCs are extending operations in China to serve the global market.** China is transforming to a service economy by playing a more important role in MNCs' global value chains. MNCs are extending their operations in China – including global delivery centers – not just to support the Chinese market, but also to serve the global market.
- **MNCs in China operate in a more complex and less favorable business environment.** As the Chinese government encourages innovation and supports direct investment in the seven strategic emerging industries, MNCs face greater competition from local companies. Favorable policies toward MNCs are phasing out and MNCs will have to compete on equal footing with local companies.

Important challenges facing MNCs in China

Given these trends and the ongoing changes in China, MNCs will need to address challenges in five major functional areas: Research and innovation; Marketing and branding; Operations management; Sales and channels; and Resource management.

Research and development/product innovation: Translating consumer insights into products and services using new approaches and tools

Chinese consumers are becoming increasingly diversified and empowered, but most MNCs have an insufficient understanding of consumer needs and market changes. As a result, new products sometimes do not cater to the needs of specific customer segments. There is also an “innovation dilemma” for MNCs as innovative products are frequently imitated by those with similar functions at lower prices. MNCs in China find it difficult to balance creating new products with protecting intellectual property.

Marketing and branding: Justifying brand premiums versus local brands and handling negative publicity

As local brands compete more with premium brands, MNCs must continue to deliver unique value propositions. And when they include lower-priced brands in their own portfolio, it becomes harder for MNCs to avoid cannibalization. Moreover, as safety and environmental concerns increase, issues related to product safety and quality can damage the brand.

As China becomes one of the most important markets for business growth, MNCs are:

- Considering China's booming domestic market as a crucial part of global revenue
 - Launching more advanced products in China to satisfy increasing consumer demands
 - Expanding their customer base from targeting single market segments and high-end, first-tier cities to targeting multiple market segments and lower tier cities
 - Changing their global business strategy to better manage China's changing domestic consumer market.
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Operations management: Managing scale, gaining full value chain visibility, and broadening external collaboration

The Chinese market is becoming more complex and consumers are becoming more diversified with very different value drivers. When companies expand businesses – for example, to capture different customer segments, lower-tier cities and rural markets – operational complexities grow. As business scale increases, three logistical challenges are most apparent: 1) insufficient external collaboration with new business partners and new customers, 2) higher operating costs for local companies to maintain global operational standards, and 3) lack of visibility and control over decision-making.

Sales and channels: Building diversified channel structures and leveraging emerging channels

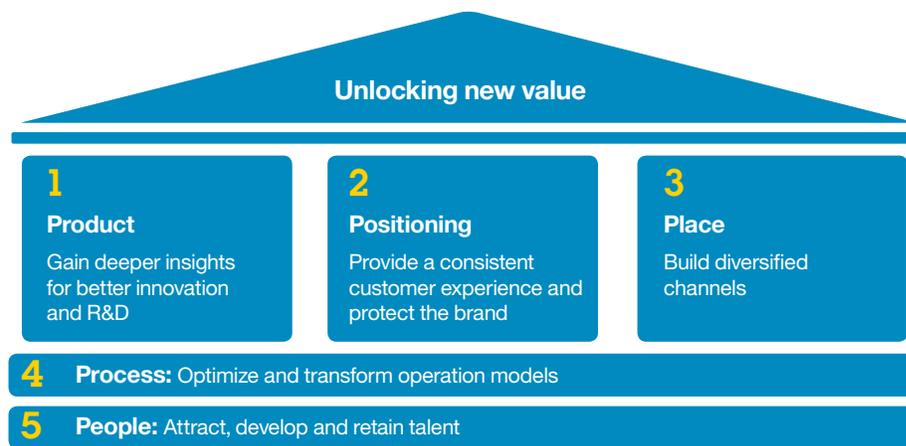
When MNCs expand businesses to lower-tier cities and rural areas, finding qualified local distributors is not easy. However, it can be expensive and risky to build direct channels there. Other common difficulties include: managing multiple channels and avoiding conflicts between traditional and new channels; a lack of control and collaboration with channel partners; and verifying sales compliance in a fast-changing and immature market.

Human resources: Attracting, retaining and developing talent to build a stable workforce

Over the last few years, MNCs have become less attractive in the eyes of many potential employees, ranking fifth of six possible employers. In 2011, the order of career choice ranking of Chinese college graduates was reportedly: civil service, followed by government institutions, central government-owned enterprises, state-owned enterprises, MNCs and then privately-owned enterprises.⁴ What's more, the turnover rate of employees at MNCs remains high due to competition from local companies. Employees who stay will need more training in new technologies and social media to develop their skills to meet new business opportunities.

Using a “5P model” to boost MNCs’ competitiveness

We believe that in order to sustain and/or regain leading positions in China, MNCs need to focus on core capabilities illustrated by a 5P model (see Figure 1). The five P’s are: **Product**, **Positioning** (brand and price), **Place** (sales and channel), **Process** (operation and management) and **People**.



Source: IBM Institute for Business Value.

Figure 1: The 5P model depicts focus areas for MNCs as they seek to become more competitive in China.

1. Product – Gain deeper insights for better innovation and R&D

- Reinvent innovation by transforming internally-focused innovation within the enterprise domain to externally-focused collaborative innovation
- Leverage social media and new channels in consumer understanding, and collaborate with business partners to secure customer insights.

2. Positioning – Provide a consistent customer experience and protect the brand

- Optimize customer engagement at every touch point and deliver integrated cross channel marketing campaigns
- Find new opportunities to proactively manage crises to limit negative impacts on brand
- Engage customers in brand communication through social media and digital technologies.

As new channels (especially online channels) emerge in China, MNCs need to build a diversified multi-channel structure to cover different city tiers and consumer segments. Ideally, this would happen concurrently with expansion into lower-tier cities and new segments to help reduce channel conflicts and increase economies of scale.

3. Place – Build diversified channels

- Make the most of effective channel coverage by diversifying and optimizing the channel mix and creating direct channels
- Apply innovative technology and tools to build new channels and improve transparency and efficiency
- Transform traditional, one-way electronic channels to social, two-way online channels.

4. Process – Optimize and transform operation models

- Focus on core capabilities and streamline operations by outsourcing non-core capabilities to business partners
- Integrate global and Chinese management systems to implement effective global decision-making, operational support, risk management and control.

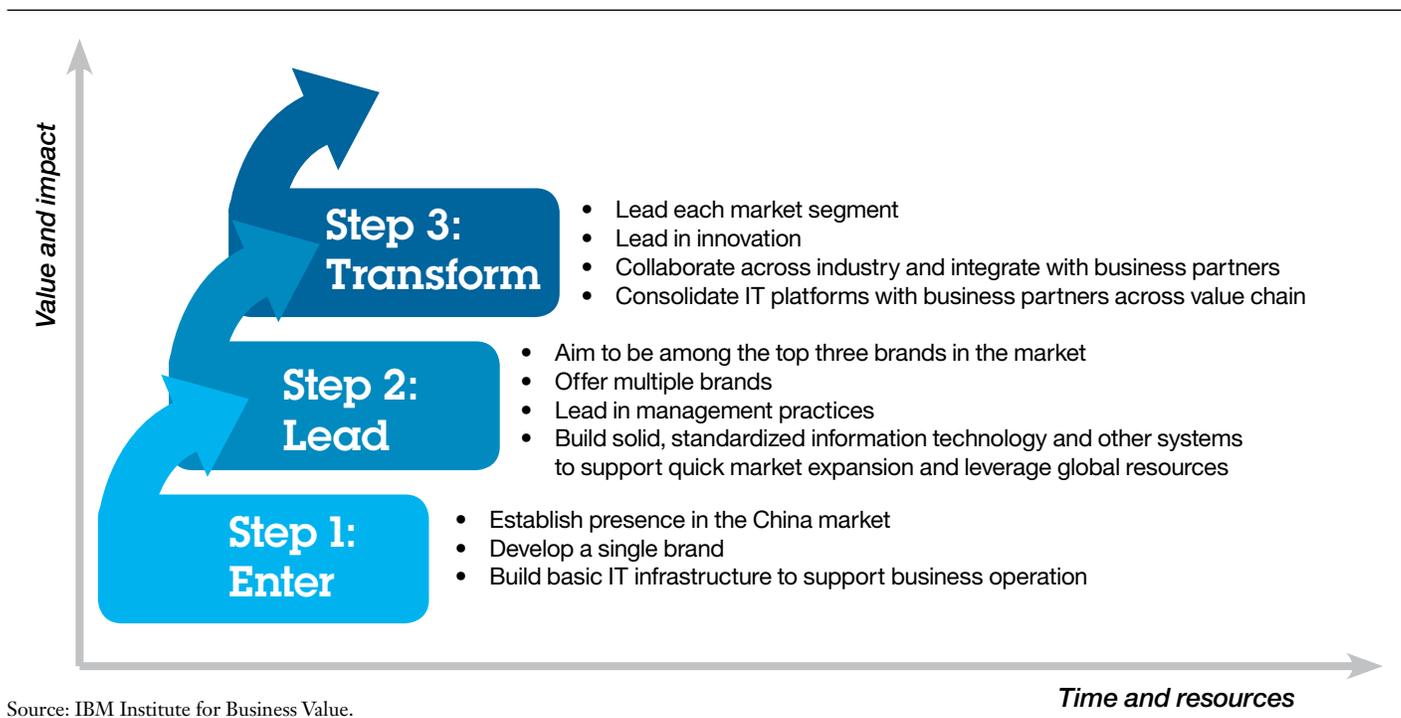
5. People – Attract, develop and retain talent

- Launch innovative programs for career development, enhance a balanced, respected and diversified culture, and offer attractive packages. Improve HR efficiency by outsourcing non-core functions.
- Culture, career and compensation are three key elements that can help companies in China attract and retain talent. In addition to an attractive salary and benefits, MNCs will need to be innovative with both career development and workplace culture. Employees who feel committed to the company's core values are more likely to stay. Furthermore, companies with a balanced, respected and diversified culture and a localized team are important motivators for Chinese employees.

Stages of progress for MNCs in China

To move forward in China, MNCs will need to take systematic steps to build leadership: Enter, Lead, then Transform (see Figure 2). Capturing opportunities and translating them into sustainable business growth is essential to succeed in China, and the 5P model addresses MNCs' five major challenges.

MNCs that are taking leading positions in different industries in China are those best able to leverage industry-wide resources, and create an open, collaborative environment with both business partners and consumers. To succeed in China's changing market environment, MNCs will need to re-examine their strategies to focus on the unique value and innovation they can deliver to Chinese customers.



Source: IBM Institute for Business Value.

Figure 2: Moving forward: The journey for MNCs in China

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