All-in for China

Four keys to success for SME’s in China

Observations from the Suitable for Growth Project

April 2013
The most significant and perhaps surprising observation from the SfG project has been the importance of internal barriers in the companies. An SME setting out to enter the Chinese mid-market will typically be concerned with bringing down costs, finding local partners, protecting against copycats and other such external hurdles. But, in fact, the first keys to success are to overcome internal barriers and align the company around a whole-hearted China strategy.

The extreme nature of the Chinese mid-market doesn’t leave room for a half-hearted initiative that doesn’t go all the way for China – it’s all-in for China to succeed. There is enormous potential in the Chinese market – but it is not a free ride. Unless companies realize and accept the extent of the commitment that is needed, they will not succeed in lifting this potential.

The SfG project has identified 4 main preconditions for success, which any Western company should ensure are fulfilled before starting the journey.

The four A’s of success are:

1) **Ambitions at the Danish headquarters** – top management sponsoring the initiative must truly aspire for success in the Chinese mid-market.
   - **High priority** on growth markets. Emerging markets with fast growth must have higher priority than developed markets without growth – despite the obvious difference in size and importance for the current business.
   - **Right China mindset** – top management must reset their historical misconception\(^1\) of China and seek new, first-hand impressions of China.
   - **Autonomous mandate** to the Chinese subsidiary – the employees closest to the market must have freedom to operate and their voice must be heard.

2) **Agility of organization** – the organization must be flexible and adaptive to the challenge.
   - **Readiness to (re)structure** China organization – the company may have an existing, but inadequate organization in China, hindering future growth in the mid-market.

3) **Access to market insights** – the needs of the customers in the Chinese mid-market differ radically from those found in other markets, so availability of market insight is crucial to avoid traveling blindfolded through new uncharted territories.
   - **Courage to distrust existing market knowledge** – established assumptions in the organization must be challenged with fact-based analysis of the market.
   - **Opportunities to get close to the customer** – it’s necessary to be in direct contact with customers to understand their specific needs.

4) **Availability of resources** – top management at HQ and the project team in the local subsidiary must align expectations of the resources that are required. The strategy must be carried out by the best possible business development team.
   - **Encourage entrepreneurial spirit** – the project team needs to act as entrepreneurs and draw attention from top management to attract resources.
   - **Allocate sufficient resources** – top management should not fool itself into thinking that it is cheap and simple to succeed in China. They need to invest the necessary resources to a dedicated project team.

\(^1\) Misconception may be Chinese make poor quality, our brand is well-known, China is one big market, we can sell our phased out products in China, you can’t do anything about IP violation in China, we are better than the Chinese.
China facts:

**Fendou – Struggle, hard work**

There's a strong belief that hard work and plain living is the way to build up a person – and a country, as well. Fendou is the drive that allows China to catch up.
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China is extreme. And doing business in China is extreme. At first glance, the market looks very attractive, as it is large and growing very fast, particularly in the mid-market. However, when taking a closer look, entering China becomes scary with daunting barriers and fierce competition to overcome. In other words, the Chinese mid-market has an extreme duality of opportunities and challenges.

Future economic growth in China will lift hundreds of millions of consumers into the middle class and this in turn will drive the demand of industrial products in the B2B market.

However, many companies find it very difficult to move downward to this market segment, with lower prices and margins, but also much higher volume. Almost by default, Danish products and services tend to target the more niche-like premium and high-end segments of the market.

Over the past decade, several larger Danish companies have shown how it’s possible to achieve a profitable and sustainable position in the Chinese mid-market. However, Danish SME’s still have difficulties truly exploiting the unique and historical business opportunities that the Chinese market presents. Instead, SME’s tend to invest their resources in the more familiar Western markets – missing out on the opportunity to grow in emerging markets, even though developed markets are stagnating or in decline. This is worrisome for the individual companies, but it is also critical to the Danish society because

| Conditions are quite different in the high, mid and low segments of the Chinese market. The figures above describe the segments of one particular industry in China as seen from a Danish B2B company. Danish companies from several different B2B industries confirm that the figures are typical. |
| Clearly, the potential in the mid-market is huge – this is where the main growth is happening now and in the near future. |
China will become our second home market. Our goal there is to grow by 50% annually.

the large number of SME’s in Denmark constitute the backbone of the national economy.

Therefore, the Danish Industry Foundation and the Universe Foundation have joined forces in the Suitable for Growth (SfG) project and set forward to support six Danish SME’s in their endeavor to enter the Chinese mid-market. The aim of the SfG project is to learn from the specific experiences of the participating companies with the purpose of devising a general approach to success for Danish SME’s on the Chinese mid-market which could increase the competitiveness of Danish industry and create more jobs in Denmark.

This report documents the findings after approximately 15 months of work – half way into the project. The findings are not conclusive, but made public at this point in order to increase interest in the project and to encourage more companies to follow the project during its remaining period.

The primary target group for the report is top managers in Danish SME’s that are present in China today and who are considering growing their business in this market. The findings from the SfG project are structured into four general preconditions or keys for success – the 4 A’s – which can be used to initiate a discussion and align expectations between the top management sponsoring the new business initiative and the team executing the development project in China.

Companies who are already deeply engaged in the endeavor of entering the Chinese mid-market and now find themselves in a fog of barriers and unforeseen challenges may benefit from reopening a discussion on these keys for success. Also, companies with a more general outlook towards emerging markets may consider this a report of relevance, as can researchers, consultants, teachers, etc. within the fields of emerging markets and business development.

All readers must bear in mind that the results presented in this report are preliminary and should not yet be seen as complete or proven to lead to a successful business. The SfG project hosts a Ph.D. research project, so the final report will of course be based upon scientifically proven results.

The report emphasizes practical application and makes wide use of case stories to exemplify various situations. All cases originate from either the six participating companies in the SfG project or from some of the other companies, who have been invited to share their experiences from the Chinese mid-market. All cases in the report are anonymous, as the SfG project works under high confidentiality.

The SfG project team at Universe Foundation wishes you an insightful experience:

- Peter Skat-Rørdam – President of Universe Foundation
- Peter Jyde Andreassen – SfG Program Director
- Thomas Aakjær Jensen – Senior Innovation Specialist
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² The Chinese B2B mid-market can be characterized by: 1) intense competition from mainly local companies, 2) price levels at index 40-60 compared to the premium market, 3) low margins, 4) high growth rates of 30-50% per year and 5) customers focused on value-products, with optimal price/quality relation.
The Suitable for Growth (SfG) Project

*By suitable* we refer to products and solutions that fit the needs and demands of the local customers including suitable price. Suitable solutions are based upon deep customer insights and not just on defeating Western products.

The SfG project is a joint effort by the Danish Industry Foundation and the Universe Foundation. The project seeks to strengthen the competitiveness of Danish SME’s by demonstrating a new approach to business development aimed at the rapidly growing mid-market in China. Suitable for Growth is a learning-by-doing project in which six Danish companies are supported and studied as they each develop a new offering, “suitable” for targeting mid-market customers in China. In this way, the SfG project is both a case of real business development and a powerful learning experience for the participating companies. During the business development process, the teams are supported through educational sessions with regional business schools, consultations with leading innovation experts and through frequent exchanges of experiences among the participants. During the process, researchers from the Universe Foundation are studying the progress of the participants’ business projects. The research seeks to identify the key factors determining the success – or failure – of each individual project, as well as the commonalities and differences between the projects.

While the short-term objective of the SfG project is to make the participating companies innovate and develop new business models and real solutions that are suited for the Chinese mid-market customers, the more general, long-term objective is to spread the knowledge and experiences to the Danish industry in order to strengthen Danish competitiveness and create more jobs in Denmark.
The project consists of a 3.5-year research and development phase, which is followed by 2.5 years of rollout and follow-up to secure the widespread adoption and full industrial and societal benefits from the project (see figure).

During the first 2-year development phase, the SfG project will intensively follow and support the six Danish companies as they develop their business to target the Chinese mid-market.

**Progress barries and preconditions for success**

The Chinese market is currently one of the fastest growing markets in the world. The Chinese mid-market is particularly promising, because future economic growth in China will lift hundreds of millions of consumers into the middle class which will drive a huge demand for affordable consumer products and the resulting industrial products. Many Danish companies are already well established in China in the high-end segment of the market, so taking a step downward to a mid-market position may be easier for them than entering a completely different emerging market in a new geographical region. However, many companies find it very difficult to move downward to market segments with lower prices and margins, but also much higher volume. Almost by default, Danish products and services tend to target the more niche-like premium and high-end segments of the market.

Whereas the larger Danish companies seem to be successful in addressing the Chinese mid-market, so far only few Danish SME's have managed to build profitable and sustainable positions in the mid-market segment.

As this report is written, the six companies participating in the SfG project have spent approximately 15 months on their path towards success on the Chinese mid-market. The companies have not yet completed their business development projects and established a profitable and sustainable position on the market. However, they have all struggled with a set of barriers and in some cases, have found creative ways to progress forward that may be valuable to other companies in similar situations.

The SfG project has followed the six companies through interviews with top management at the Danish headquarters and with the project teams at the subsidiaries, during educational sessions in China, and through progress reports and meetings with the project teams. All the business development projects have been analyzed for process barriers i.e. conditions that prevent the projects from progressing as expected. Simultaneously, we have analyzed many other case stories from Danish and Western companies operating in china. A common pattern of barriers has been identified and structured into four general preconditions or keys for success, i.e. conditions within a company that must be in place before setting out to conquer the Chinese mid-market or otherwise, the initiative will most likely not succeed.

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### THE FOUR PRECONDITIONS

**The four A’s – for success of SME’s on the Chinese mid-market are:**

**Ambitions** at the Danish headquarters – the opportunities in the Chinese mid-market are great, but so are the challenges. Top management at headquarter sponsoring the initiative must truly aspire for success in the Chinese mid-market and allocate the necessary resources for it.

**Agility** of organization – the mid-market is very different and very dynamic, so the organization must be quick in adapting to new and ever changing conditions.

**Access** to market insights – the needs of the customers in the Chinese mid-market differ radically from other markets, so availability of market insight is crucial to avoid traveling blindfolded through uncharted territories.

**Availability** of resources – Both top management and the project team must be flexible to move from an idea to a stage of knowledge and planning which can support an investment in developing a new mid-market business.
Key to success #1: Ambitions at Danish headquarters

The most important conclusion from the SFG project is that companies cannot succeed in China with a half-hearted effort. Competition is so fierce and conditions are so different and difficult that companies must be prepared to go all-in if they really wish to expand to the Chinese mid-market.

Arguably, the upcoming urban Chinese middle class of consumers is the most dynamic and important market segment in the world. It is currently the main locomotive for industrial growth, not just in China, but generally for countless companies globally that otherwise suffer from stagnant growth and declining sales in their traditionally developed markets.

There are enormous business opportunities, but the Chinese mid-market is crowded and tough. It takes dedication and determination to make it there.
"It’s necessary to make a decision about China: Do you want to do it? Either you’re “pregnant” or you’re “not pregnant”.\"
Trusting China and Chinese partners
Most companies, who have been doing business in China for a long time, have had unfortunate and challenging experiences with the Chinese style of business. They all have stories about local Chinese companies copying their products and violating their intellectual property rights; stories of not being able to take legal actions against these copycats or of local governments trying to protect and support Chinese companies through subsidies and other regulations. In many cases, this has left Danish companies with a rather negative view and a very low trust in China and Chinese companies.

CASE
Cheated by joint venture partner
One Danish company had operated in China for 15 years through a joint venture (JV) partnership with a local Chinese manufacturer. The JV was mainly set up as a local sourcing platform, focusing on manufacturing some specific products for the global and local market. 4 years ago, the company discovered that their JV partner cheated them as he illegally sold their products to local customers in his own name without informing the company. After a 4-year struggle, the company finally got out of the JV partnership and took control of the local manufacturing setup in China – but leaving the former JV partner as a direct competitor. During the process of getting out of the JV partnership, the company also discovered that the sourcing network around the JV was, to a large extent, built around close friendships and family relations, meaning that sub-suppliers to the manufacturing site in China were actually close family members of their JV partner.

As a consequence, some companies are very cautious and suspicious when they enter into a new potential cooperation with a Chinese partner. This lack of trust inhibits an open dialogue and free flow of information, which slows down the local business development process, as HQ wants to control and monitor what is going on. The most common solution to cope with this issue is to find a person that HQ trusts 100% and place this person at the local partner. The main objective and task of this person is to build a strong and equal relationship with the local partner so that they are acting according to mutual agreements.

A tendency to focus on existing developed markets
Even though management at the Danish headquarters declares that China is the company’s future market for growth, their actual actions often indicate that they are still much more focused on maintaining their existing developed markets, where they currently make the main part of their profits and revenue. Consequently, most of their
resources and attention are invested in the developed markets, where future growth opportunities are low. Only a small share of resources is invested in China, where the future growth opportunities are high. Obviously, this is the opposite of what would be expected if the company were truly dedicated to creating new growth. However, the reason for this prioritization is obvious: For most of the companies, the Chinese market currently contributes only 5-10% of their global revenue and profits. If a company is struggling on the larger, developed markets, it will most likely focus its energy and resources there, despite the long-term opportunities in the emerging market.

In the short-term perspective of daily operations, succeeding in China is not seen as a burning platform for the company. In other words, the mindset at HQ is that “China is the future, but not tomorrow”.

The decision described in the case above is understandable. Nevertheless, the case illustrates a main challenge for many SME’s trying to target China and other growth markets: Even though the Chinese market has been declared to be strategically important for the future growth and has been given specific resources, it will always come second for the management back at HQ. This is a fact and precondition that the local business development project teams must be able to adapt and manage.
Channeling resources from HQ to the subsidiary
It is a main challenge for the headquarters in Denmark that they typically lack a deep understanding of the Chinese market. They are, therefore, likely to be “maneuvering in the dark” when it comes to managing the business development processes at the local Chinese subsidiary.

The findings from this project suggest that to ensure the performance of the local business development process, it is crucial to give the subsidiary a strong mandate and a high degree of autonomy.

CASE

Upgrading the Chinese subsidiary
In 2003, one company established its subsidiary in China in order to continue serving its large global customers as they moved their business activities to China. From the beginning, the mandate of the Chinese subsidiary was to sell premium products to its global customers in Asia, and to set up a value chain enabling them to purchase raw materials for production in Denmark. Due to the high growth in the local market in China, the subsidiary gradually received more attention from HQ.

In 2011, headquarters in Denmark upgraded the mandate of the China branch. They designed a new business model at their subsidiary in which the portfolio of products of their China branch should cover the existing customers in the high-end market and add a new segment of customers in the mid-market.

The motivation for this strategic decision was 1) the mid-market seemed to grow very fast, 2) the high-end products were quickly copied by other competitors and sold at lower prices and 3) in a long-term perspective, headquarters expected to benefit from having good relations with strong local mid-market Chinese customers, who had the potential of moving into Western markets in the future.

CASE

Downgrading the Chinese subsidiary
When one company joined the SfG program in 2011, they had a local manufacturing and sourcing setup in China, producing products for their global market and a distributor mainly focusing on sales in the local region. Although the management at headquarters saw a great potential for growth in the Chinese market, they decided to close down manufacturing in China in 2012. The reason was that the benefit of producing their global products in China had diminished, due to higher product standardization, automation and shorter lead-time requirements, so the Chinese sales could not justify the cost of a local manufacturing site. Furthermore, the management at headquarters made it clear that the strategic focus was on the existing developed countries.

This strategic decision weakened the mandate of the subsidiary as their local resources and local presence were removed from the business development project. The effect of these actions was a significant slowdown in the process of their business development project for the Chinese mid-market.

“When you experience how local companies are copying products, you cannot be a cry baby and think it’s unfair. You need to be faster, better, quicker – and always in front of those who copy.
As these cases illustrate, the strength of the Danish headquarters aspiration influences the priorities and mandates of the subsidiary in China. To maintain progress and high performance in the local business development project, HQ must confirm the China strategy by giving it sufficient priority, allocating the resources needed for its execution as well as securing the right mandate for the subsidiary to act on.

Shanzhai
Literally: The bandit’s nest
Refers to pirated copies and low quality semi-legal products. Shanzhai companies are used to working fast, delivering what customers want, really cheap and with whatever means it takes.
Agility of organization

A key insight from the SfG project is that although China is a difficult and different market to operate in, the main challenge is not external in the market, but internal in the organization. The hardest part for companies is to adapt their organization, routines, assumptions and culture in order to function in the Chinese context.

"It’s step dancing in China and a very slow walk in Denmark. But sometimes the Chinese steps are too fast."
A Danish SME rarely moves directly into the Chinese mid-market. Typically, the company was initially established in Denmark to serve the domestic market. It then grew by moving in to the developed markets in the West. Then it started exporting to China, usually by exporting its existing product to the high-end of the market. Of course, some SME’s were “born global”, but this is still the rare case and none of the companies in the SfG project belong to this category. This explains why Danish SME’s – like the SfG participants – are moving to the Chinese mid-market from an established position in the high-end market. Their high-end position in China may be seen as a strength that can be leveraged to extend the business into the mid-market. However, as described in this section, starting from a high-end position may also hinder the company in being sufficiently agile and fast in adapting to the new market in China.

**One company – two ways of working**

A mature company has often evolved certain ways of operating that are explicitly described in strict procedures and implicitly rooted in the company culture. Procedures are developed and optimized over time and shaped by experiences from entering established markets in the West. However, China differs radically from established markets, so a Danish company’s conventional and deep-rooted ways of operating may be difficult to adapt to meet the new working conditions of the mid-market.

In established markets, high quality and low risk normally have high priority and therefore, companies have adopted procedures such as the stage gate process. Whereas the stage gate process can ensure quality and help to find a better fit with market needs, there is no emphasis on shortening the time to market. Speed is not so critical in mature markets, but in the rapidly changing emerging markets, there may not be time for a thorough stage gate process. Therefore, the well-established procedures in a Danish company may need to be complimented by other, faster processes better suited to the emerging market – and this, in turn, imposes different ways of operating within the same company. However, top management may not encourage other ways of working, as exemplified by the following case.
**CASE**

**Losing face in front of top management**

A general manager of a subsidiary in China was advised by a professor to make a project plan that focused on verifying the most critical assumptions first. As soon as new knowledge was acquired, the project plan should be revised and adapted accordingly. The general manager liked this way of working since he was Chinese and knew from experience how fast the market is developing in China and how risky it can be to base new business development on wrong and dated assumptions. Nonetheless, the general manager rejected working in this entrepreneurial manner, since he knew he might lose face in front of the top management at headquarters in Denmark. The Danish management would not take him seriously, if he first showed one project plan and soon after showed them another plan. In this company, a well-documented business case and plan was an important decision basis for initiating new projects and investments. To the Danes, changing an approved plan was considered bad project management regardless of the unpredictable market dynamics.

As companies continuously strive to optimize their operating procedures, they have a tendency to develop “one size fits all” processes, since it takes more resources and increases complexity to develop, implement and maintain several processes. However, as the case illustrates, standardized business processes and principles used at the company HQ are often not suited for the very different and rapidly changing conditions that exist in the local Chinese market.

Having several styles of operating within the same company obviously require greater managerial agility at HQ.

> “Sometimes customers don’t understand what we are trying to sell them – they’ve simply never seen it before. Obviously, they won’t order anything, unless we explain what they are getting and what they can use it for.”

**Changing the brand to fit local taste is not an easy choice**

Usually, a company will have very specific definitions of their brand and the company will adhere quite strictly to its brand value and corporate identity in order to build and maintain a strong relationship with customers. Naturally, the company will try to protect the brand from devaluation.
This is one of the reasons why companies with high-end brands are often afraid of entering the mid-market with offerings that have lower specifications and prices than their regular line of products — what's known as a “vertical downscaled brand extension”. Companies are typically concerned that this will lead customers to lower their overall perception of the brand. On the other hand, companies also want to leverage their established brand equity when introducing a lower level brand to the market. All told, branding for the mid-market is a dilemma with pros and cons.

In general, there are three brand strategies for positioning a company in both the high-end market and mid-market:

- Distinct brands – two distinct brands with no relation seen from the market perspective, i.e. customers will not realize there is a connection between the two brands.
- Related brands – the new mid-market brand is related to the established high-end brand with names like “x by y” (x is sub-brand and y is mother brand). Public announcements may also be used to create awareness of the underlying ownership relation.
- Same brand – only one brand, but the brands are clearly differentiated in specifications, marketing, service, etc.

Different circumstances in China call for a more nuanced understanding of what “quality” means to different customers. Quality is about fulfilling the needs and expectations of the specific customers and therefore, the definition of quality can differ from one segment of customers to another. The challenges described above are illustrated by the case example below.

CASE

Perceived customer quality
One Danish B2B company uses extensive test procedures, which enables them to secure a high and well-defined quality for their products. In this way, they can guarantee their customers a product lifetime of 20 years! This durability is highly valued by their Western customers, who use the product as a component in some of their own high-end consumer products. However, in China, such a long guarantee is not appreciated by Chinese customers, since their customers (the end users) use their products for only 5-6 years before they exchange or scrap them. So the Chinese customers are not willing to pay a premium for a 20-year lifetime guarantee that they do not need.

The company decided to adapt their product offerings to the needs of the local customers in China, reducing the lifetime guarantee (among other things) and thereby costs. As a consequence, the company had to adapt their brand architecture and clearly differentiate their market offerings, so customers understand the value propositions of each product.

Cannibalization – threat or opportunity?
A company with an established brand position in the high-end market must consider how to avoid cannibalization if they want an additional position in the mid-market. Customers, who would normally buy a high-end offering, may downgrade if they become aware of the alternative mid-range offering. However, in some cases, a lower priced offering may actually increase sales of the premium products as the next case exemplifies.

If cannibalization occurs, it may be an indication that there is a misfit between the high-end offering and what the market needs and/or is willing to pay for. Such a misfit
is rarely sustainable, since customers eventually will find alternative solutions with a better fit between benefits and cost. As Steve Jobs put it, “if you don’t cannibalize yourself, someone else will”. Within the field of branding, this is termed “preemptive cannibalization”. If cannibalization occurs, it may initially be considered a threat, but long-term, it may also be seen as valuable market feedback indicating an opportunity to introduce a new lower priced offering which is better aligned with the market’s demands.

**CASE**

**Attracting high-end customers with a mid-market product range**

A large B2B company had been on the Chinese market for several years selling standard high-end product offerings to their global customers in China. Some years ago, they experienced that their growth in the high-end segment did not follow the general market growth. The mid-market segment was growing much faster and they realized that they needed to be present in that segment to compete with the local Chinese competitors, who were growing and gaining market share.

After long discussions, they decided to develop and introduce a new product range for the Chinese mid-market priced 20-40% below their established high-end range. To reduce the risk, the new mid-market product range was clearly differentiated and positioned.

The result of the new mid-market product range was positive. Normally, mid-market customers wouldn’t invite bids from this high-end company due to their high prices. However, the lower priced product range now gave the company access to biddings and more importantly, provided opportunities to start a dialogue with potentially new customers. In some cases, these new customers actually decided to upgrade from a mid-range product to a high-end product when they considered total cost of ownership. All in all, this extension of their product program increased the growth in both the mid-market and high-end market, and cannibalization didn’t occur.

**Making the mid-market attractive to sales people**

A company which is already established in China can obviously draw on its existing organization to extend the business into the mid-market. However, extending a business downward to lower priced levels imposes some organizational challenges. In particular, the sales organization must be flexible to serve both a high-end and a mid-market segment as exemplified with the case below.

**CASE**

**Low prestige in selling second brand**

A company introduced a product range under a second brand on the Chinese mid-market priced at 50% of their established high-end product range. The products were based on dated technology that was being phased out from the high-end brand. However, the low cost products didn’t sell, primarily due to poor performance of the sales organization. The sales people felt there was more prestige in selling high-end products with the latest technology, so the sales people started leaving the company, resulting in an average employee turnover rate of 3 months in this part of the sales organization.
Sales people, who consider the high-end market more prestigious to work in, are not specific to emerging markets. However, loyalty among sales staff is a major challenge in China, where employees in general have a higher turnover rate than other markets. This is a particular challenge for SME’s that typically are seen as less attractive than larger multinational companies among talented Chinese people who, in a rapidly growing market, continuously seek better opportunities.

Another issue of flexibility can arise when a high-end company reassigns sales staff to scale up the business by reaching out to new customers in the mid-market. The sales people may not be willing to leave their current safe position in the high-end market and take on the risk of establishing a new market with new offerings and new customers. There are several reasons for this:

- Chinese sales people are more focused on products that can generate the highest revenue with the lowest effort (=in the fastest and easiest way).
- The new customers may ask questions they cannot answer, which can be a problem for the respect and reputation of the sales person (keeping face).

Therefore, it is important to make new mid-market products very attractive for the sales organization to handle. One means is to introduce internal training of the sales people and preparing sales tools, so they understand the new product and feel confident that they can go out and sell it with the right arguments.

Sales people can, like any other employee, be motivated by the right incentives. However, if the established high-end position is not a burning platform, it takes more to convince sales people to take a risk.
China facts:

Renao – Lively, hot, noisy
Whereas Danes typically prefer a quiet, orderly setting, Chinese often like to go where everyone else is mingling, talking, eating.
Key to success #3: Access to market

The Chinese mid-market is unlike any other market in the world and compared to Western markets, there are substantial barriers for a Danish SME to find market insights, e.g.:

Culture – The cultural differences between China and developed markets in the West are substantial and even basic assumptions need to be checked.

Characteristics – The mid-market in China differs radically from the high-end market with respect to price, quality, service, etc.

Market information – Market information is not readily available in the formats known from Western markets.

Size – The Chinese market is too big to be considered as one market. The various regions in China differ and often need to be further segmented.

Geography – The geographical distance between China and Denmark means that most meetings are held by phone or videoconferencing, and this often makes it more difficult to understand one another fully.

Language – Language barriers prevent a Danish project team from getting in direct contact with non-English speaking Chinese customers.

Together, these barriers may result in an SME traveling blindfolded through new uncharted territories.
There is no such thing as the Chinese market. There are so many differences that it is like countries within a country. People think they understand this, but they still go back and say “yes, we need to sell more in China”.
Unlearn and relearn what you know about markets

It is obvious for a company, which has already established a subsidiary in China for sales, to draw on its own sales peoples’ understanding of the market. It’s reasonable to assume that they have overcome most of the barriers mentioned above regarding cultural differences, language translation, geographical distance, etc. However, if the company previously has only had a high-end position in China, it will still be crucial to do further investigations in order to understand the specific conditions of the mid-market, since the needs of the mid-market customers can be very different from those of high-end customers.

CASE

Make up your own mind

A company with a high-end position in China was losing market shares and sales were slowing down. Yet, the overall market of the industry was growing fast, so a product manager located in China decided to investigate the market situation. He initially asked the sales organization, which responded: “Yes, we have some local competitors, but they are not very big”. However, a thorough competitor analysis found that there were in fact 70 competitors in China – of which the sales organization only knew 5%. Three of the competitors had 40% of the market. At that point, the product manager decided not to trust the sales organization and instead made up his own mind, since “sales people don’t see the part of the market where they don’t have access”.

For a company, which is already established in the high-end of the Chinese market, the first step towards learning about the mid-market is to “unlearn”. One needs to be very critical of existing “knowledge” and assumptions floating around in the organization. Preferably, knowledge should originate from fact-based investigations of the mid-market and not be based on opinions and guesses. Worst case, it may be necessary to challenge and correct the sales organization – which can be rather controversial in China. It’s important to maneuver with political elegance when overruling the sales organization.

One must respect that sales is not marketing. The primary role of sales is to sell existing offerings to the market, and not to conduct market intelligence as input for developing a new business in a new market. Sales organizations are often driven by short-term sales targets, so they naturally focus on the immediate opportunities in the market, where the current portfolio matches the customers’ needs. Due to the organizational setup, the sales organization is only motivated to investigate the mid-market if they have products that match this segment. In fact, sales cannot be blamed for not having market insight beyond their focus.

This highlights another main barrier that many SME’s are facing when trying to target the mid-market in China. None of the case companies in the SfG program have local product management or marketing resources in China. Instead, these functions are located at HQ and service all the company’s markets. This may work well in established well-known markets, but in China, this is problematic because the marketing people at HQ are likely to lack a deep understanding of the particular Chinese mid-market situation.

Getting close to customers

Getting closer to customers in order to observe and understand their needs can be very difficult for B2B companies with long value chains. Long value chains are not unique for China; they exist in all markets. However, value chains are sometimes longer for international companies in China because they may use distributors as intermediaries to the market or have local partners responsible for sales.
A Danish B2C company selling outdoor clothing for children, e.g. overalls, observed children in China and quickly realized an important cultural difference. Most Chinese toddlers don’t wear diapers, but instead wear split pants that can be opened in the back, so they can quickly go to the toilet in the open. Danish overalls normally only have one zipper in the front and need to be taken completely off before going to the toilet. A Danish pair of overalls will never sell in China, but a Dane wouldn’t realize this before going to China.

Western B2B companies may have overcome the barriers of the long reach to the end customer in their mature markets. However, these insights into customers needs and demands in a Western high-end market can most likely not be transferred to the Chinese mid-market. Worst case, the company is not even aware of the assumptions they are implicitly making when they approach Chinese customers.

Don’t take anything, not even a zipper, for granted
A Danish B2C company selling outdoor clothing for children, e.g. overalls, observed children in China and quickly realized an important cultural difference. Most Chinese toddlers don’t wear diapers, but instead wear split pants that can be opened in the back, so they can quickly go to the toilet in the open. Danish overalls normally only have one zipper in the front and need to be taken completely off before going to the toilet. A Danish pair of overalls will never sell in China, but a Dane wouldn’t realize this before going to China.

When implicit assumptions cross cultural borders, they may turn out to be critical factors to the business. Thus, long value chains in new markets with a different culture need to be followed all the way to the end customer.

Sending expats to China from HQ is one way to shorten the value chain. Installing a sales director in China can remove the need for a wholesaler, thereby drawing the company closer to the real sales and distribution activities in China. However, this will also highlight potentially unethical situations as they will become more visible to the company.
**Lack of trust in employees**

The cultural barriers can be overcome by having Chinese employees in the subsidiary, since their cultural values and beliefs are more similar to the Chinese customers’. However, Chinese employees introduce a new barrier on the matter of getting close to the customers as exemplified with the case below.

**CASE**

**Chinese employees are not trusted to have direct customer contact**

A company has had a subsidiary in China for almost ten years primarily focusing on sourcing, but also with some sales to local Chinese companies. Initially, the Danish General Manager for the Chinese subsidiary didn’t allow the Chinese employees to have direct contact to Chinese customers as the manager was afraid that the employees would take over the customers and start their own business.

Once a company has realized that getting close to the customer is valuable for business, the employees closest to the customer in the value chain, e.g. the sales people, will quickly realize their position of power, and they may not be willing to give away this power to others in the company. This is obviously not optimal for the organization as a whole; nevertheless, it happens in companies all the time.

**CASE**

**Customers are considered the property of the sales organization**

A company wanted to develop a lower cost product for the Chinese mid-market, and the project team considered presenting the initial ideas to some of their existing customers as well as asking the customers to test some prototypes. However, in this company, the customers were “owned” by the sales organization and the project team was not allowed access to the customers. The reason given by the sales organization was that the company had only a few, but very large customers in China and sales feared that such experimentation could damage these precious relations. The sales company argued that they already had sufficient market insights and no further investigation was needed. The project team had to blindly trust sales and they never got documented market insight.

**It’s not necessary to speak Chinese to understand the Chinese**

A simple approach to getting a better understanding of the needs of a potential customer is to do an interview. However, Chinese people, in particular the older generations, rarely speak English, so the language barrier prevents a Danish project team from having direct verbal contact to Chinese customers. An obvious solution is to use a translator or to turn over the complete interviewing task to a Chinese speaking person. Another solution is to use non-verbal approaches like questionnaires, where a translator can support in the creation and analysis of the questionnaire. However, all these solutions suffer from creating a distance to customers, where essential information may be lost.
CASE

You’ll never know if you don’t take a look

A company introduced a piece of machinery on the Chinese market that was 1 meter tall and weighed 25 kg. A Chinese customer filed a claim that the product didn’t work and was “junk and all bad”. The product manager had never had any complaints about this product from other markets, so he decided to visit the customer site, where the product was installed.

At the customer site, he observed how a technician had to lift the product ½ meter in order to service it. This is a big challenge for Asians, who tend to be smaller than Caucasians. Therefore, the product was often accidentally dropped on the floor and damaged. The engineering department at HQ in Denmark had been blind to this situation at the market, since they didn’t have an Asian customer in mind when designing the product.

The product manager took the specific case to the Danish headquarters, who responded that the customer just needed to use the right tools for lifting and servicing the product. Once again, HQ was blind to the market. The product manager knew from his visit at the customer sites that Chinese repair shops are not as well equipped with tools as Western sites.

The cultural barrier of “never say no”

Even if the language barrier is overcome, the cultural barriers between Danes and Chinese remain. One important difference is that Danes are used to being quite outspoken, even if this means criticizing others. A Danish customer being interviewed will typically tell his or her honest opinion, while the Chinese in general “never say no”. The Chinese will not confront a superior, in this case the interviewer, directly and initiate disharmony. This needs to be taken into account in the technique used for the interview. Questions prepared for Danish customers and simply translated to interview Chinese customers will not likely result in reliable answers. Worst case, the interview session may seem to be a success with answers to all questions, but the answers may have been given just to please the interviewer.

China facts:

Mianzi – Face

Showing a big face, protecting face is very important. Nice clothes, a big car, an impressive façade on the house, paying the bills at restaurants – even if you can’t really afford it.
Key to success #4: Availability of resources

The past decade has seen a lot of hype about the growing business opportunities in China. Without first-hand impressions from China, it is easy to understand why top management at the Danish headquarters can have the initial impression that “it must be easy to sell something in China with so many potential customers” – in particular, if they already are present in China in the high-end segment and now want to expand further down to the mid-market. In reality, however, establishing a position on the Chinese mid-market is not a quick win and it takes substantial resources to overcome all the barriers to enter the market. Consequently, there is often a misalignment between HQ and the Chinese subsidiary about the resources required to start a new business initiative in China and scale it up.

“The HQ is very concerned about hiring too many heads in China. This limits our local growth initiatives because in China, you can easily hire and fire people, and they are still relatively cheap.”
HQ tends to underestimate and underinvest in China

Organizations continuously strive to become more efficient, so resources for new activities tend to be scarce, particularly in SME’s, where employees often need to be generalists spanning several tasks and working in several areas at the same time. Furthermore, the daily operation in the subsidiary of an SME is often focused on urgent, short-term issues rather than long-term business development tasks. Ideally, a new Chinese venture should start because the management at HQ identifies and believes in a new business opportunity in China, therefore allocating sufficient resources for the subsidiary in China to execute the business development project. However, this situation rarely occurs as:

HQ may not be close enough to the market to understand the new opportunities, and HQ will most likely have other promising projects competing for the same resources. Odds are bad for a risky project in the Chinese mid-market compared to investments in lower risk projects in more familiar and mature markets.

An HQ with insufficient knowledge about the challenges of entering the Chinese mid-market will simply add a new business development project on top of all the other pressing tasks in the subsidiary and naively hope that the employees can also solve this task within their existing budget. However, it is a clear finding of the SfG project that a business development project for the Chinese mid-market requires dedicated and committed resources in order to succeed.

Breaking the deadlock of resources

Consider a project, originating from the Danish company’s subsidiary in China. The local employees are close to the market and may easily be inspired during their regular contacts with customers. However, the first glimpse of an idea rarely stands up to the scrutinizing examination of any investor, not even within a company, where headquarters may be considered an internal investor. Therefore, in most situations, the subsidiary must mature the new business idea before presenting it to HQ and requesting more resources.

The challenge for the subsidiary in China becomes the use of very limited resources to build up sufficient arguments to attract the attention of headquarters in Denmark in order to get the resources to develop a proper project proposal and business plan. This can be a deadlock, where the subsidiary “needs resources to get resources” to move beyond the focus on daily operations and investigate the new possible business.

CASE

Looking beyond the obvious

An expatriate for a global company in China positioned in the high-end market noticed a business opportunity in the lower mid-market. Part of his daily product management job was to visit customers with quality complaints and scout for competitors at trade fairs. These visits gave him an excellent opportunity to discuss his new business idea with existing customers and to look for lower level competitors at fairs. When he had gathered substantial evidence on the business opportunity, he confronted top management at headquarters and asked directly: What does it take to convince you about the business opportunity in the Chinese mid-market?

He got a 3-point wish list from top management as well as the extra resources to further investigate the opportunity, which eventually led to a full investment in the business opportunity. In this case, lack of resources was overcome by the local product manager, who had the drive and the courage to go beyond his daily duties and widen, the lens with which he viewed the market.
In rare cases, the subsidiary is completely autonomous and can invest their own resources – or maybe the subsidiary has a few non-allocated resources in reserve to prevent such stalemate situations. But if not, the subsidiary must mature the idea in a skunk works project, where the employees invest their personal spare time or by cleverly tapping into existing resources as exemplified by the previous and following case.

Building the trust of HQ
Once the deadlock of resources has been unlocked, the developers at the subsidiary face another barrier. They need to build sufficient trust at HQ – both in the business opportunities of the project and in the local teams’ ability to carry out the plan.

CASE

Involve respected employees from HQ
A subsidiary made a business plan on new opportunities in the Chinese market in the beginning of 2011, but it never caught the attention of the Danish headquarters. Later in 2011, the company signed up for the SIG project with a team of two Danish employees from HQ. The two Danish participants went to boot camps in China and later teamed up with a Chinese participant from the subsidiary to get insights into the Chinese market.

The Danish project manager now recognizes that the initial business plan for China was ignored by HQ because of a low level of trust towards the subsidiary. It remains to be seen if top management will listen more now that the two respected Danes from headquarters that were sent to China are involved.

Making do with what you’ve got
As mentioned, SME’s are almost always pressed for resources, so a major challenge when setting up a team for a new business development project is whether to reprioritize employees’ time and tasks, wait until existing employees become available to join the project or to hire new resources into the company.

Forming the team is a particular challenge for SME’s, since their existing pool of resources is smaller than larger companies. Furthermore, hiring new resources is proportionally a bigger task for SME’s than larger companies, since SME’s may not have dedicated human resource departments, training programs, job rotation procedures, etc.

An alternative approach to hiring new resources is to rely on external resources and consultants for well-defined tasks that don’t require extensive company knowledge, e.g. an analysis of the Chinese mid-market. SME’s rarely have the budget to hire consultants, so most often, they have to “make do with what they’ve got”. However, there are a limited number of tasks any employee can solve efficiently, so management cannot make-believe with resources and naively add new business development projects on top of existing projects without reprioritizing.

Even if there are resources available to hire new employees for the business development project, the subsidiary of a Danish SME may have difficulties attracting talented Chinese people. If working for a foreign company, Chinese prefer to work for large multinational companies, since a well-known company looks good on a resume and can lead to more career opportunities than a smaller company. Another issue, although general and not particularly related to SME’s, is the loyalty of Chinese employees, who tend to change jobs more often than Danes and are driven by opportunities. In spite of this, several Danish SME’s have in fact managed to develop good retention rates among their Chinese employees by introducing incentive systems and career opportunities with many small steps including training programs at the HQ in Denmark.
Next steps in the SfG Project

The findings in this report focus on the barriers encountered by the participating companies as well as on case stories from other companies that already have succeeded on the Chinese mid-market. The main challenges for new businesses have been generalized into four critical preconditions for success.

Our ongoing work in the SfG project to understand how companies can overcome the challenges and fulfill the preconditions is still not conclusive and consequently, this report offers only limited recommendations and advice. Future work in the SfG project will focus on developing a complete handbook with processes, tools and methods for Danish SME’s entering the Chinese mid-market.

Along the way, new findings will be published in reports and newsletters. Please stay up to date by visiting the project website http://www.suitableforgrowth.dk/, where it’s also possible to sign up for a newsletter.

The boot camps in China with invited experts are reserved for the six participating companies, but the SfG project is open to suggestions, if a company would like to relate to the SfG project.

Please contact the SfG Program Director, Peter Jyde Andreassen, at pja@universefonden.dk for further information.
Appendix

The six companies participating in the SfG project have been selected based on the following criteria:

- Mid-sized Danish company with a global turnover of DKK 250 – 1,500 million
- Experience with international business activities
- Local presence and setup in China
- See China as a strategically important market
- Willingness to invest time and resources in a business development project

Apart from the criteria for participating, the participating companies have several characteristics in common as they all:

- belong to the group of Danish mid-sized international companies, where resources are relatively scarce and limited.
- serve a high-end niche market in their existing mature markets, where they are successfully delivering high-value and quality products to their customers.
- operate in the B2B market, which for many, means they have limited access to the end users of their offerings.
- consider costs as one of their main challenges in targeting the Chinese mid-market.
- are experiencing increasing pressure from local Chinese companies that deliver products similar to their own, but at much lower prices.

Being in China is strategically important to all the companies, but for various reasons. For some companies (C1, C3 and C5), their presence in China is driven by the need to be present and able serve their global customers, who are operating in China. For the others (C2, C4 and C6), the main driver has been the growth opportunities and prospects of their industry in China.

Looking at the value chain and the activities that each company has established in the local market, the companies who have moved to China due to the presence and need of their global customers are more mature with more local functions. See figure.

The six companies involved in the project are:

<table>
<thead>
<tr>
<th>Company</th>
<th>Global Revenue 2011 (MDKK)</th>
<th>Employees global (FTE)</th>
<th>Established in China (Year)</th>
<th>China Revenue 2011 (MDKK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>C1</td>
<td>900</td>
<td>573</td>
<td>1994</td>
<td>60</td>
</tr>
<tr>
<td>C2</td>
<td>650</td>
<td>460</td>
<td>1994</td>
<td>48</td>
</tr>
<tr>
<td>C3</td>
<td>260</td>
<td>63</td>
<td>2003</td>
<td>12</td>
</tr>
<tr>
<td>C4</td>
<td>714</td>
<td>655</td>
<td>2003</td>
<td>10</td>
</tr>
<tr>
<td>C5</td>
<td>700</td>
<td>484</td>
<td>2005</td>
<td>240</td>
</tr>
<tr>
<td>C6</td>
<td>752</td>
<td>220</td>
<td>2006</td>
<td>1</td>
</tr>
</tbody>
</table>
The value chain activities implemented locally are linked closely to the way in which the companies have approached China. According to Prof. Vijay Govindarajan, companies targeting emerging markets can be categorized by their position in four distinct phases of maturity on the local market.

<table>
<thead>
<tr>
<th>Company</th>
<th>R&amp;D</th>
<th>Sourcing/procurement</th>
<th>Production</th>
<th>Sales and distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>C1</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>C2</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>C3</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>C4</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>C5</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>C6</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

The figure indicates that the main part of the companies in SfG are still in the early phases and have not yet reached phase 3, where focus is to develop a local business model capable of delivering competitive offerings suited for the local customer needs and situation. Companies C3 and C5 are both close, but still have some steps to go.
Looking at the history of the participating companies, it is evident that they all entered China in a conventional way aiming to minimize risk by following a staged investment plan. Starting with a local sourcing or sales setup (phase 1) and then later expanding the business with local or regional production for the local market (phase 2) and then getting to local development and design (phase 3) as the market matures and the company acquires better knowledge and greater experience with the market.

The companies have quite different project organizations. Generally, there are three different types:

- **All in China**: Team members and project sponsor are located at the subsidiary in China, making daily communication and access to local market data easy. The companies are: C3 and C5.

- **Split between China and DK**: Team members are located at the subsidiary in China while the project sponsor is located at HQ in Denmark, making daily coordination and decision more difficult. The company is: C2.

- **All in DK**: Team members and project sponsor are mainly located at HQ in Denmark, making daily communication easy, but access and understanding of the local market difficult. The companies are: C1, C4 and C6.
China facts:

**Hexie – Harmony**

A very important concept in later years. Chinese leaders have emphasized the wish to develop a harmonious society, with comfortable, stable and fair relationships. Family and teams in companies should also be in harmony.
Suitable for Growth:
A joint research and development project to strengthen Danish industry's position in emerging markets.

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