



# OPERATION CHINA

FROM STRATEGY  
TO EXECUTION

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HARVARD BUSINESS SCHOOL PRESS

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## PREFACE

For those of us living and working in China today, perhaps no comment is heard more often from visiting American, European, and Japanese executives than this: “I’m amazed at how much China has changed since my last visit here five (or ten) years ago.” They marvel at the dramatic growth in consumerism, most obviously seen in the profusion of restaurants and gleaming new stores offering a broad array of global and local brands. They express admiration regarding the boom in construction, the improvements made in infrastructure, and the enormous investments China is making in its future—such as the US\$4.2 billion spent on a high-tech train system to ferry passengers from Beijing to Tibet. They note the increased signs of wealth and the willingness of government officials to relax the rules governing foreign-owned businesses. They are dazzled by the whirl of change, transformation, and novelty found everywhere in the country. Indeed, even those of us who live here are frequently awestruck by the historic events unfolding all around us. China is the story of the twenty-first century: an immense nation changing at an unprecedented pace.

But the pace of change in China poses a significant threat to the businesses these executives lead. Nearly a quarter million foreign (that is, non-Chinese) companies of all sizes operate in China today. Tens of thousands of these companies are multinational organizations (including 460 of the *Fortune* 500 giants) with business operations in China and corporate offices in Western nations, Japan, the Middle East, Latin America, eastern Europe, and elsewhere in Asia. Many multinational companies (MNCs)

are thriving here, with annual double-digit revenue growth rates and plump margins. But these sunny days won't last, and MNC executives who work in China know it. The pace and intensity of competition between (and among) "foreign" and "domestic" rivals is accelerating quickly. Even as markets are becoming bigger and more attractive here—in some categories, already the largest in the world—they are also becoming more treacherous.

This book is primarily for MNC executives in the home office and in the region. Multinational companies urgently need to improve performance in nearly every aspect of their operations in China if they are to continue to be profitable here—indeed, if they are to survive here. Until now, many MNCs did not need to focus as relentlessly on executing to world-class standards in their China operations as they did in other markets. China wasn't like other markets. For years, winning in China (in fact, *being allowed into* China) was intertwined with securing government permission to enter the market, picking the right joint venture partner, and then selling existing brands at premium prices in the right cities to the right customers. It was about developing strategies for creating privileged access, and those who made smarter choices about partners, brands, cities, and distribution networks tended to fare better than rivals. Companies could always stumble in how they executed strategies, and in China, as elsewhere, bad execution of a good strategy has had dire consequences. But superb execution—on the level that MNCs would expect of their operating managers in competitive developed markets—was hard to achieve here, even hard to define. Multinational managers in China encountered a market that seemed to play by rules very different from what they found elsewhere in the world. As a result, they frequently tailored processes and practices to this very different world to get the job done. Also, they did not hold themselves to the same operating standards their organizations de-

manded in developed markets (such as manufacturing and sourcing measures, product development cycle times, marketing return on investment, and so on). For many years, that worked. Good enough was good enough.

That era is over. Today, China is open for business. Strategies based on creating and sustaining privileged access to a local market where global standards and measures do not apply look increasingly outdated. Joint venture partners and acquisition targets are available to the highest (or at least most suitable) bidder. Business licenses are readily available today, which was not true ten to twenty years ago. Rules are changing, and the landscape for business here is beginning to look familiar. Though China is still unique in many aspects—and probably always will be—today, China's fast-moving markets for information, people, and technology do not differ in their essential competitiveness from what managers see elsewhere in the world. Multinational companies, many of which are now expanding from their initial positions here, are fighting each other for Chinese customers and are increasingly competing as well with fast-rising domestic competitors that frequently possess better knowledge of Chinese markets and a dogged ability to operate at lower cost. This transition to a much more competitive and complex business landscape is dramatically ratcheting up the pressure on companies to find ways to operate at a comparatively better level of performance than rivals.

In other words, China is turning the corner from an emerging market, where local context drives most of the strategic and operating decisions managers make, to a maturing one, where top-quality execution is a cornerstone for success. Many of the bespoke systems and processes that MNCs put into place a decade ago now undermine their performance—and anyway, since many of the rules of business have changed in China, many old operating

assumptions are outdated. Good strategy still counts, of course. But in a market where competition is white hot and global, the ability of companies to execute sound strategies extraordinarily well—across every operating function and core process of the company—is key to getting to the front and staying there. Suddenly, good enough is no longer good enough.

Multinational companies are at the very eye of this storm, which is why we've addressed this book primarily to MNC executives. Good execution in China is about adapting—sometimes a little, sometimes a lot—world-class operating standards, management tools, and frameworks to the realities of the Chinese environment. The advantage that MNCs operating in China have over their domestic Chinese rivals is their knowledge of, and experience with, such operating standards. Indeed, top-performing MNCs are frequently the very definition of world-class execution—*outside* China. But MNCs will only realize the benefits of their knowledge and experience if they can learn to select the right standards, tools, and frameworks from their global arsenal to put into place in China, adapted in the right way to optimize them for the local context. To succeed in China's evolving and increasingly more competitive markets, executives in China, and their colleagues and bosses in other countries, will have to change their managerial focus 180 degrees. They will have to put behind them tendencies to view business conditions here as simply unique, requiring in turn unique operating approaches and performance standards, and instead will have to focus on the familiar, seeing opportunities to instill practices and processes that are hallmarks in other competitive markets, tuning them locally as needed, and linking them globally at every opportunity. In the decade ahead, it is inevitable that innovations in management practice will emerge in China's hypercompetitive markets; MNCs that are prepared to spot these and move them quickly into their worldwide operations will be tomorrow's winners, globally.

A number of MNCs in China have begun to transform their organizations, to raise the bar on execution in order to win in China's burgeoning consumer and business-to-business markets. This book is about how these leading companies are succeeding and how other companies can, too. Although we highlight many best practices in marketing, product development, manufacturing, sourcing, distribution, and talent management in China today, this book is largely focused on helping managers learn how to think through the needed shift in emphasis from good enough to world-class execution in China, how to understand the principles of execution in this environment, and how to overcome challenges to adapting world-class operating standards to a Chinese context in order to be successful here.

This book should provide insights for a range of other readers, too. The principles of good execution in China apply to small businesses as well as large. The heads of small foreign (particularly Western) businesses in China face many of the same marketing, sourcing, and distribution challenges that Procter & Gamble (P&G), Yum!, IBM, and Motorola face. Although many of the practices highlighted in this book will not make sense for small businesses—hybrid distribution networks, for instance, or organizational designs for research and development units—understanding the path to success for larger companies may provide small business executives with food for thought as suppliers, partners, or competitors to larger businesses.

Finally, it goes without saying that executives of Chinese businesses also are learning to adopt top-quality standards for execution. Companies such as Baosteel, Huawei, and Ping An are investing significant management attention and cash toward understanding global operating standards and performance management approaches. We do not directly address their very different challenges and advantages in these pages. We would write a very different book for them: the strategic and operational challenges they



## Preface

face are frequently different in kind or degree from what MNCs in China face, and their organizational learning curve is also quite different. But the core message of this book—the way to outstanding execution in a Chinese context—is the same for both audiences. So are the stakes of the game. For that reason, executives in many Chinese companies will want to understand what their foreign rivals are up to. We have no doubt that if we were writing this book ten or twenty years from now—when we expect that a number of Chinese companies will be in the *Fortune* 500, and perhaps a few will even be truly global as well—the differences between these two audiences would be much less pronounced.

The old saying “The more things change, the more they stay the same” certainly does not apply when it comes to doing business in China. Each of the authors has been in China for roughly twenty years; today one of us lives in Shanghai, the other in Beijing. Both of us speak Chinese, allowing us to get inside the market we have sought to understand.

As partners in McKinsey & Company’s Greater China Office—Jonathan has been with the firm twenty-two years and Jimmy fourteen—we have been at the very center of the changes we describe in this book. The insights in these pages reflect lessons learned in our work for over two decades on strategic, operational, and general management issues with MNCs in China, large Chinese companies that are entering the world stage, and parts of the Chinese government. We have been in the factories and boardrooms (in China and globally) of companies that are setting new standards for operating performance in China, and in factories and boardrooms of companies that, sadly, are not.

But this book does not just reflect the two authors’ direct experience with business transformation in China. The firm of

which we are a part has made substantial investments in understanding how to serve clients here, including establishing centers in China to study consumers and consumer behaviors and best practices in operations in China. We and our colleagues in the Greater China Office have conducted a number of research initiatives and developed several proprietary databases that we have drawn on for this book. A partial list includes the following:

- In-depth interviews with six thousand individuals in households in over thirty cities throughout China, from the largest cities to semirural communities. McKinsey's China Consumer Center is compiling and analyzing data from the market to understand what drives Chinese consumers and how they compare with shoppers in other countries. Our survey coverage currently accounts for about 90 percent of China's gross domestic product (GDP), 80 percent of its disposable income, and 60 percent of its population.
- A 2006 McKinsey Global Institute (MGI) study of urban consumers, including analyses of data from an extensive MGI database of consumption variables covering the years 1985 to 2005 in China, and econometric forecasting of future consumption patterns in China.
- A growing database of sourcing and supply management practices of MNCs operating in China, including in-depth case studies on supply operations at more than twenty companies (as of this writing) in a number of industries, and specific-issue surveys conducted with over fifty companies.
- In-depth interviews and surveys (conducted by the authors while writing this book) with the executives responsible for China-based operations at over forty MNCs in a variety

of sectors, including consumer products, energy, industrial products, retail, and high tech.

- Notes of in-depth conversations with the leading business executives in China conducted by ourselves or our colleagues (some of these have been published in abridged and edited forms in the *McKinsey Quarterly*).
- A study of the operations of ten large MNC research and development organizations in China.
- A study of talent management and performance management practices at three hundred global companies, and a comparison study of twenty-four multinational and Chinese companies using the same “performance ethic” benchmarks.

This book is the fruit of these and other research initiatives, of our work on the ground helping companies succeed here, and of our discussions with hundreds of multinational and Chinese company executives and owners or investors in many small foreign and domestic businesses here. It is also the fruit of discussions with—and insights and concepts from—our McKinsey colleagues in China and elsewhere, who are working with companies to help improve their performance in China. Their contributions were significant, and we acknowledge them later in this book.

Part I provides an overview of how the business landscape in China has changed within the last few years, and how it is continuing to evolve. The role of government relations—indeed, even how companies conduct government relations—isn’t the same today as it was just five years ago. Similarly, the emergence of the global consumer has profound implications for execution, as does the war for talent. Chapter 1 shows how this changing landscape requires MNCs operating here to urgently apply more

mergers and acquisitions (M&A) have begun to open up, and what this might mean for companies intent on buying growth in China. The flow of M&A shapes growth aspirations and industry structures everywhere else in the world, and we believe that in the decade ahead this will come to be true in China as well. Indeed, the M&A deal flow has already started to heat up here. Good execution has always determined whether a merger is a success or a failure, anywhere in the world. Companies large and small will need to understand M&A execution in a Chinese context to win at this game.

Multinational companies are bringing global standards and practices to China and adapting them to the tough realities of this market—to the cost constraints, the speed of market growth, the ambiguities and uncertainties, the fierce competition. Chapter 11 looks at how companies might use the adaptations they forge here to succeed in other emerging markets, and then in developed ones. At some point in the not-too-distant future, what is happening in China today will play a role in defining, and then redefining, the winning business model for nearly every industry. Companies that do not understand this and lead this change will be left far behind.

It's time for executives to move execution management from the back burner to the front in China. Too many MNCs have come here with visions of grandeur untethered to China's realities and are about to fail because they are not applying the same rigor to execution in China that they would in their home markets. This book is intended to help them succeed. To quote Deng Xiaoping, we must "seek truth from facts" and not let dogmas about "how things should be done" blind us to market realities.

managerial attention to execution. Chapter 2 demonstrates just what execution means—that is, adapting selected tools and approaches, with an eye on certain key principles of execution that are specific to China.

Part II begins a series of deep dives to look at what top-flight execution means today in the core functions of a multinational company's operations here. Each of these chapters focuses on key activities to get right in China today and tomorrow. They describe the unique context for execution of these activities in China, and describe how companies operating here have boosted their performance in each activity by adapting to a Chinese context tools and approaches the organizations successfully use elsewhere in the world—what we call global standards.

We have largely organized these chapters functionally, beginning with marketing (chapter 3) and moving to product development (chapter 4), manufacturing (chapter 5), sourcing (chapter 6), distribution (chapter 7), and talent management (chapter 8). We've found in our discussions with multinational executives that this is the most straightforward way to organize and highlight what can otherwise seem to be a complex profusion of recommendations for change. This approach does not mean that every chapter will always address the full breadth of multinational readers, across a number of sectors, that we intend this book to serve—retailers don't manufacture, for instance—but most chapters will, and in any case, retail executives in China will want to see what P&G and other manufacturers are up to. Part II closes by providing advice on how companies can get started on making the changes required for them to raise the bar on execution. Chapter 9 introduces a framework for prioritizing and carrying through on change efforts.

Part III concludes the book by looking ahead at how the demands on MNCs' capabilities in China will evolve in two crucial ways in the years ahead. Chapter 10 looks at how the laws governing

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Of course, this book is far more the fruit of the accumulated experience of our firm McKinsey & Company and the people in it than it is the efforts of the two of us. Countless people have helped each of us separately and together over the years to develop the perspectives shared here.

While many of our colleagues made valuable contributions, a few helped us significantly to pull the book together. In particular, Paul Gao and Kevin Lane each contributed distinctive knowledge by leading the authorship of key chapters. Paul, who leads McKinsey's automotive practice in China, has a wealth of experience in distribution in China, both in automotive and in other industries. Chapter 7, "Distribution: Changing Times," is built around his thoughts, research, and insights on this topic. He is the real author of this chapter, which reflects the distinctive experience he has with local and international companies facing and overcoming distribution challenges in China. Similarly, chapter 3, "Learning to Win in China's Many Markets," owes everything to Kevin Lane. Kevin led our marketing practice in China and founded the McKinsey China Consumer Center. A fluent Mandarin speaker, Kevin has deep and unique insights into the realities of marketing to consumers and businesses in China. We are deeply grateful for the time and energy that both Paul and Kevin put into writing initial drafts of these chapters and collaborating with us as we collectively shaped the book.

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