

Market Leaders in China: Will the Strong Become Stronger?



The 2015 CEIBS *Business in China Survey* found that most firms doing business in China made a profit in 2014, with market leaders doing even better than others. A lot of their success came from providing great service, good quality, and having a strong distribution network. Market leaders also did very well in R&D and developing a strong brand, while non-market-leaders relied more heavily on a price/quality ratio to win the market. However, with those who want to grab a larger piece of the market investing more in R&D, adopting more new sales channels, and increasing the digitalisation of their business, they may close the gap with the market leaders. Furthermore, the implementation of new reform policies may bring additional challenges and uncertainties for those now holding the lion's share of the market.

■ By Dongsheng Zhou, Juan Antonio Fernandez, and Bin Xu

After rapid growth for over three decades, China's economic growth rate has slowed down to around 7.5% in recent years. Nevertheless, it is still by far the fastest growing market among all major economies, and more firms are now counting on China for their future business expansion. In 2014 Samsung Group sold over USD\$60 billion of goods in China, larger than the revenue earned by Baosteel, China's largest steelmaker. General Motors sold more vehicles in China than in the U.S., and generated about half of its net profits from the China market. Similarly, a number of Chinese firms, by leveraging their

deep understanding of their home markets, grew very rapidly in recent years. Xiaomi, a Chinese mobile phone manufacturer founded only 4 years ago, has become the No. 1 domestic brand in China with a market valuation of over USD\$45 billion.

While the strong economic growth has offered many opportunities for firms doing business in China, not everyone has performed well. As a matter of fact, due to the increasingly competitive and dynamic business environment, in the past decade, we have seen as many failed examples as successful ones in China. Whirlpool, OBI, Marks & Spencer, eBay and Google have been very successful in



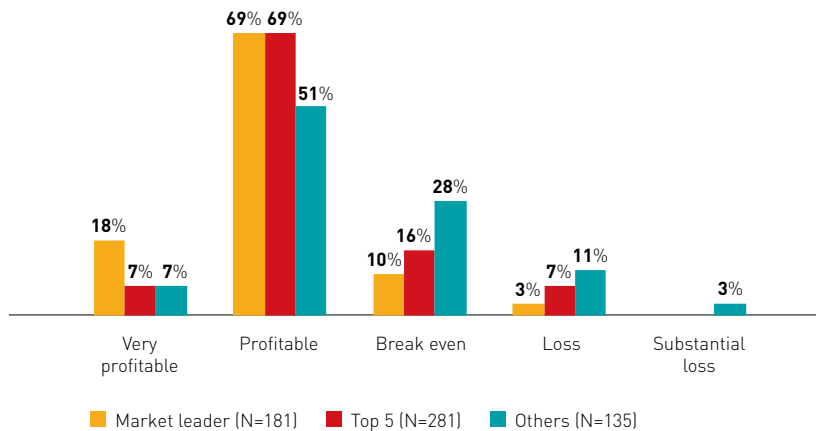
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Chart 1:

How profitable do you consider your China Operation in 2014?



their home and many foreign markets; but they all failed in China. Whirlpool, the largest white goods producer in the U.S. and one of the top players in the world, entered China in late 1994 with a total investment of USD\$300 million, but today its China operation contributes less than 0.5% of its global sales.

What are the key success factors for doing business in China? Do market leaders perform better than non-market-leaders in China? What are the unique strengths of these market leaders? What challenges will firms face in China?

The 2015 CEIBS Business in China Survey aims to answer these and other important questions. The survey is a bilingual poll of senior managers working in China. From November to December 2014, top executives from both Chinese-owned and foreign-owned companies participated in the survey. Firms were grouped into

“ Do market leaders perform better than non-market-leaders in China? ”

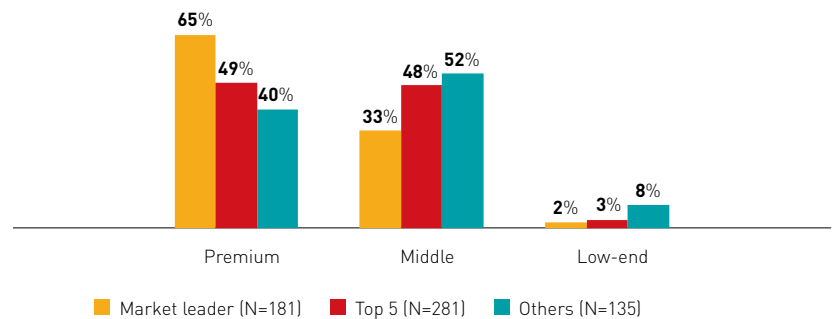
three categories: market leader (the firm that has the largest market share in an industry), the top 5, and the others.

MOST FIRMS DID WELL IN CHINA, AND MARKET LEADERS PERFORMED BEST

Even though the China market has become increasingly competitive, most firms in China did well in 2014. Our findings suggested that more than 70% of all the surveyed firms considered their China operation “profitable” or “very profitable.” Less than 10% of the firms are losing money in China. Furthermore, there seemed to be a positive relationship between market share and firm profitability: 87% of the market leaders considered their China operation “profitable” or “very profitable”, while 76% of the top 5 firms in an industry, and

Chart 2:

What is your main market segment in China?



58% of the others considered their China operation “profitable” or “very profitable”. For the market leaders, 18% of them reported that their China operation was “very profitable”. This was much more than non-market-leaders (7% of the top 5, and 7% of the others said their operations were “very profitable.”)

Chart 3:

Please choose the most important factors on the success of your sales in China. Multiple answers possible.

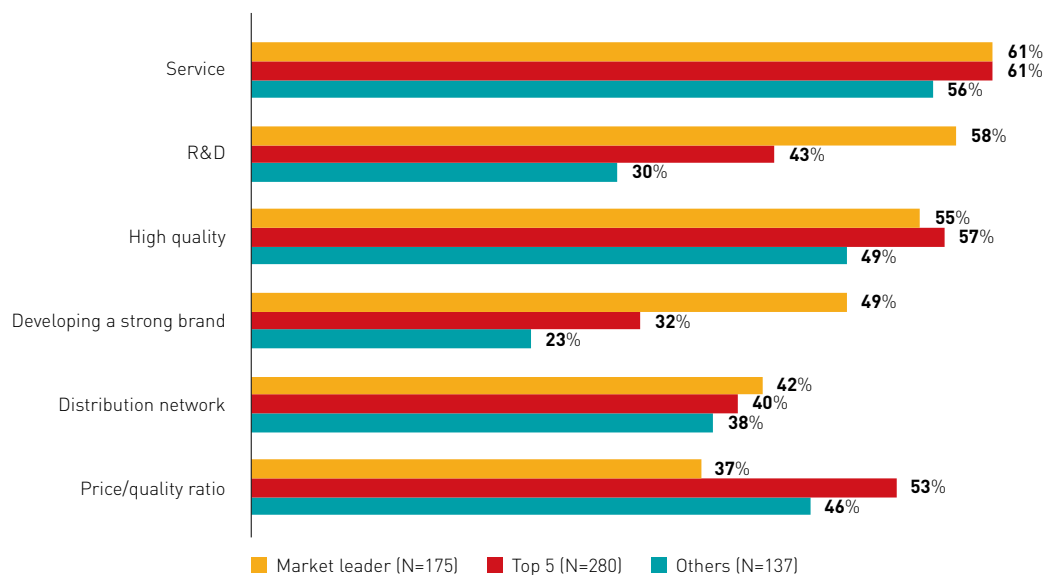


Chart 4:

Does your company have R&D in China?

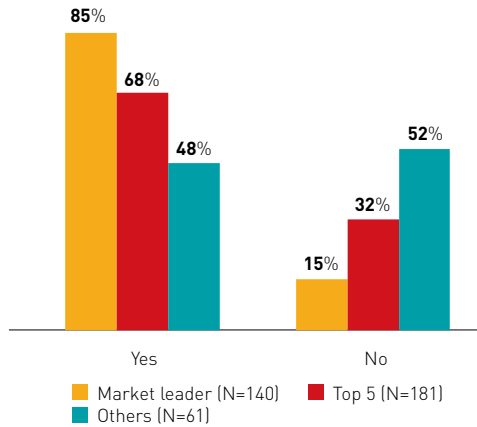
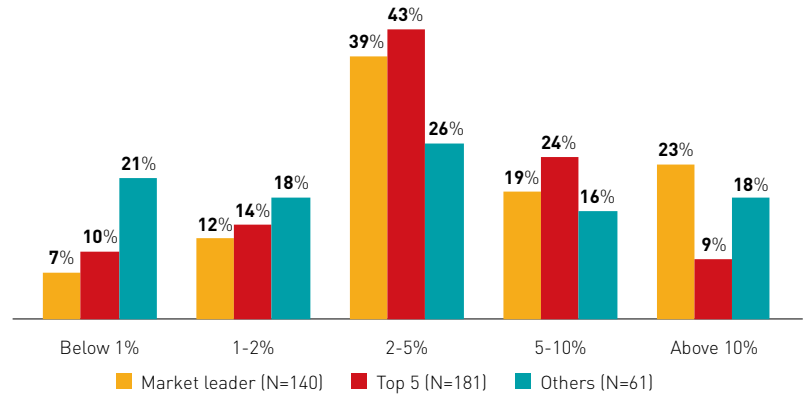


Chart 5:

What is your annual expenditure on R&D as % of revenues?



One of the important reasons why market leaders enjoy a high level of profitability is that they tend to generate more business from the premium segments, while non-market-leaders tend to focus on middle or low-end segments. From Chart 2, we can see that for market leaders, 65% of their business came from the premium segment. This is 30% more than the top 5 (which have 49%), and 60% more than the

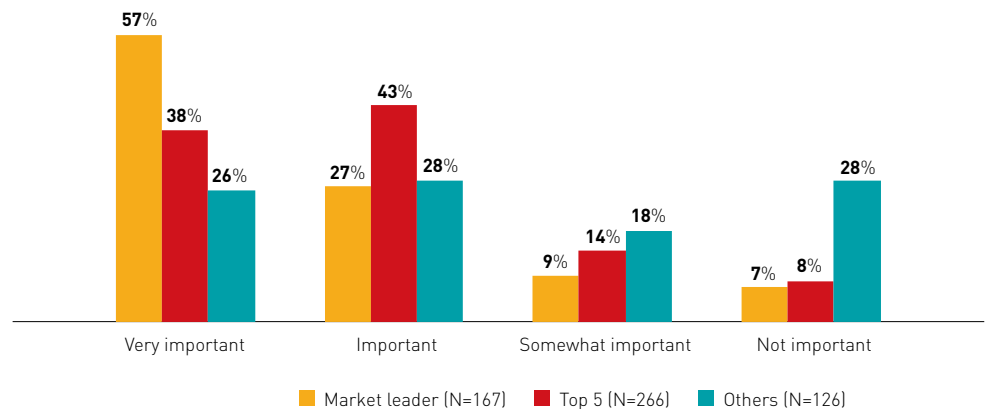
others (which only have 40%).

KEY SUCCESS FACTORS IN CHINA, AND THE UNIQUE STRENGTHS OF MARKET LEADERS

When asked to “choose the most important factors on your sales in China”, the respondents identified three common

Chart 6:

How important is IP to your business in China?



key success factors (KSFs): service, quality, and distribution network. In addition to these common KSFs, the data also revealed some different KSFs for market leaders and non-market-leaders. For market leaders, two unique factors for their success in China are R&D and branding. In Chart 3, we can see that a significant amount of market leaders (58% of them) chose R&D as one of their KSFs, while 43% of the top 5 and only 30% of the others thought R&D was one of their KSFs. Similarly, almost half of the market leaders (49% of them) chose “developing a strong brand” as one of their KSFs, while 32% of the top 5 and only 23% of the others thought developing a strong brand had been important for their success in China. On the other hand, both the top 5 (46% of them) and the others (53% of them) chose “Price/Quality ratio” as one of their KSFs, while only 37% of market leaders think so. These differences suggest that market leaders have used branding and R&D, something that is firm-specific and to a certain extent more sustainable, to win the China market. Meanwhile, non-market-leaders are more inclined to use a value for money (Price/Quality ratio) strategy to compete in China.

Since market leaders ranked R&D as their second most important KSF in China, it is not surprising that our survey has found market leaders have conducted more R&D than both the top 5 and the other firms: 85% of market leaders have R&D in China, while the number was 68% for the top 5 and only 48% for the others. Furthermore, market leaders have spent more money on R&D (23% of market leaders spent 10% or

Chart 7:

How do you evaluate your company distribution network in China?

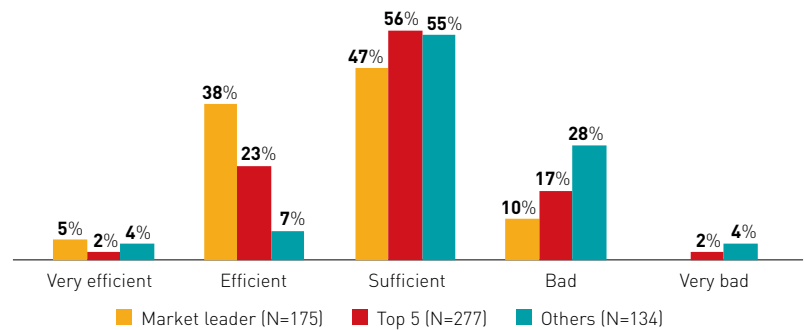


Chart 8:

How intense is the competition you are facing in China?

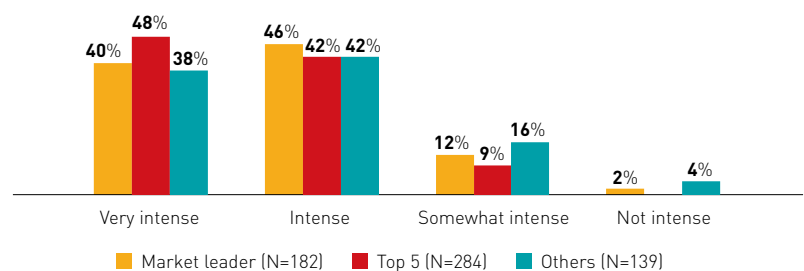


Chart 9:

Who are your major competitors in China (multiple answers possible)?

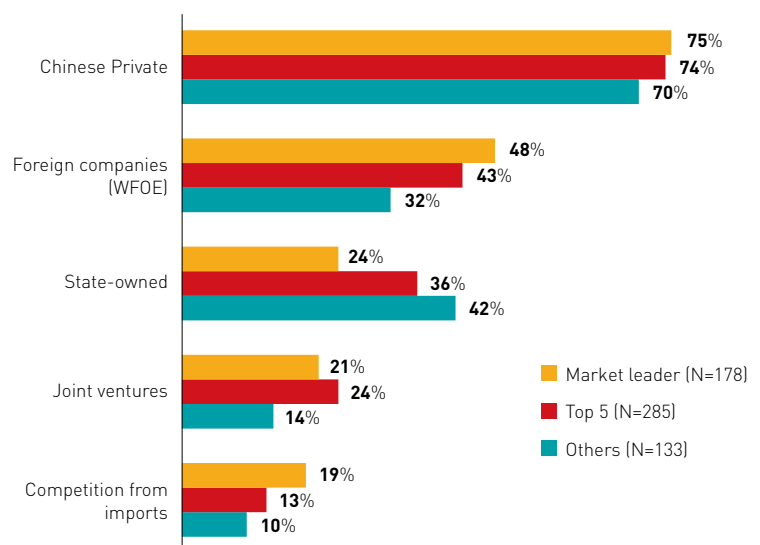


Chart 10:

What are your sales plans for the future?

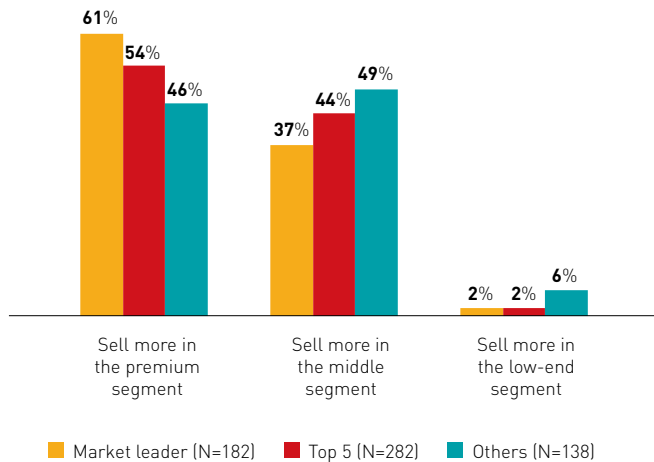
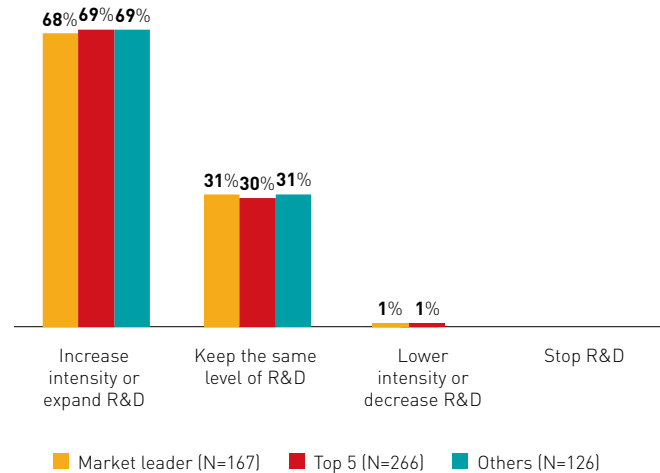


Chart 11:

What are your R&D investment plans for the next 3 years?



more of their revenue on R&D, the highest among all firms), and they have put more importance on Intellectual Property (IP) rights (57% of market leaders thought IP was “very important” to their business in China, far ahead of all other firms).

Given the large size and the significant regional differences of the China market, an efficient distribution network is a necessary condition for success. While all firms think their distribution network is one of their KSFs, our findings suggest that market leaders have done a much better job in building an efficient distribution network. When asked “How do you evaluate your company distribution network in China?” 43% of market leaders chose “efficient” or “very efficient” while the number is 25% for the top 5 and only 11% for the other firms.

CHALLENGES FOR MARKET LEADERS

As China has now become a must-

win market for both global and local firms, the competition has intensified in every segment. When asked “how intense is the competition you are facing in China?” More than 80% of the surveyed firms chose “intense” or “very intense.” When asked “who are your major competitors in China?” over 70% chose “Chinese private firms.” In addition to facing competition from local private firms, market leaders in China (48% of them) are also facing increasing competition from wholly-owned foreign enterprises (WFOE). This is because these WFOE are more likely targeting the same premium segments. Furthermore, non-market-leaders are planning to target more of their business towards premium segments, the key segment that market leaders have focused on (Chart 10).

One of the unique strengths market leaders have in China is their R&D capabilities. But rival firms are catching up. When asked “what are your plans for the next 3 years?” 69% of non-market-leaders

Chart 12:

Do you plan to expand the digitalisation of your business?

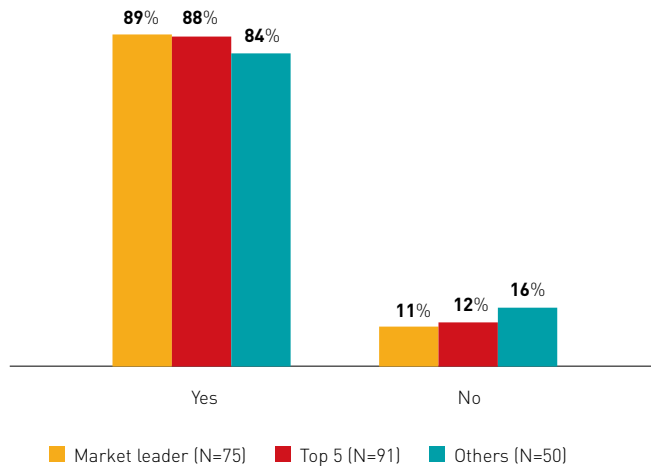
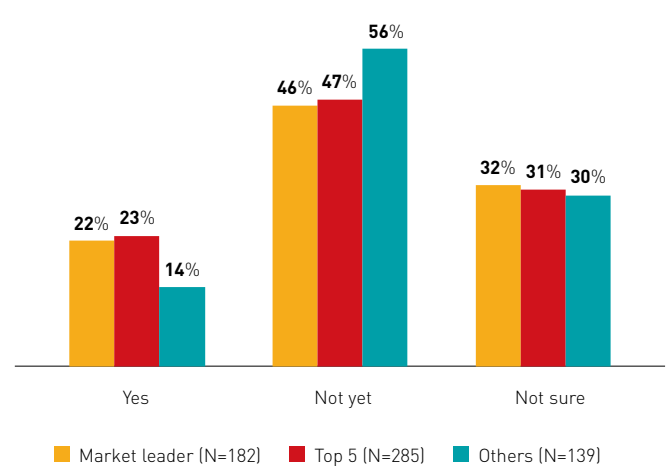


Chart 13:

Did your company benefit in 2014 from any reform policies of the new government?



(both top 5 and the other firms) that have conducted R&D activities chose “increase intensity or expand R&D activities”. This number is slightly higher than that of market leaders (68%). Market leaders’ advantage in innovation may disappear if rivals keep investing more in R&D.

Non-market-leaders are also working hard to strengthen their distribution capabilities. The new sales channels such as the Internet may offer them some shortcut to catch up with market leaders who have already built a strong traditional distribution network. Within just 4 years, Xiaomi, by using an Internet-based direct sales mode, defeated Lenovo, the market leader who has the best traditional distribution network in China. Given the fact that less than 40% of firms have used an Internet based platform to sell their products/services, there still exists plenty of opportunities for all firms in China. It is not surprising that, when asked “do you plan to expand the digitalisation of your business?” 88% of the top 5 and 84% of the

other firms answered “yes”. These numbers are very close to that of market leaders (89%).

The Chinese government has been playing a very important role in business. In 2014, a number of important new reform policies were announced, and the goal of these new policies is to let the market play decisive roles in resource allocation. But the impact of these new policies on business remains to be seen. When asked “did your company benefit in 2014 from any reform policies of the new government?” less than a quarter of the respondents answered “yes.” The new policies and the execution of these new policies will surely bring a lot of uncertainties and challenges for firms doing business in China.

As our Survey shows, this is not the time for market leaders to sit back and count their money. The market is changing, and it’s full of many other competitors looking for a seat at the winners’ table.