

CONFIDENTIAL

# Globalizing from China

Tsinghua University

Discussion document

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# CONTENTS

- **Can Chinese companies create value in going global?**

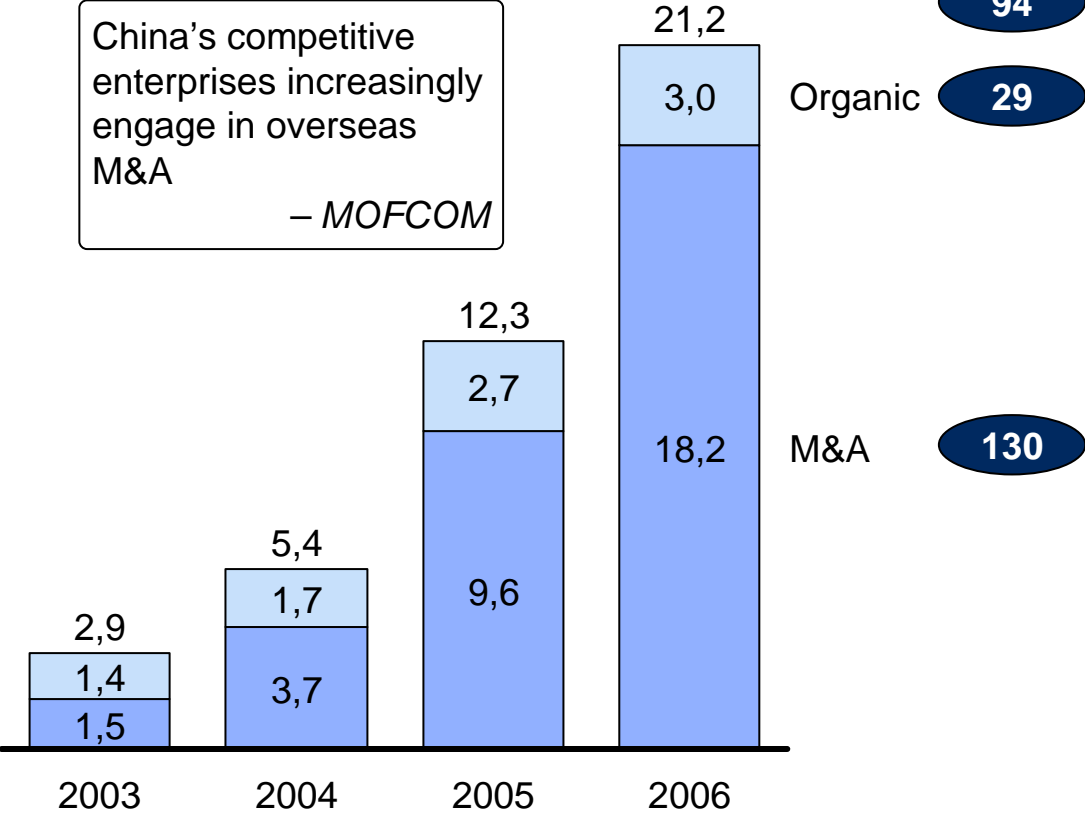
- Key challenges for globalizing Chinese companies and recommended actions
- Q&A

# OUTWARD INVESTMENT BY CHINESE COMPANIES IS INCREASING RAPIDLY, PARTICULARLY IN THE FORM OF OVERSEAS M&A

Chinese outbound FDI  
USD billions

CAGR  
Percent

China's competitive enterprises increasingly engage in overseas M&A  
- MOFCOM



However, there still seems to be a bias towards organic growth...



*"(No) financial strength to acquire any large companies. It's not a major concern for us. We are focused on organic growth ..."*

CE company

*"... not considering M&A, especially after we see what happened to TCL"*

Software company

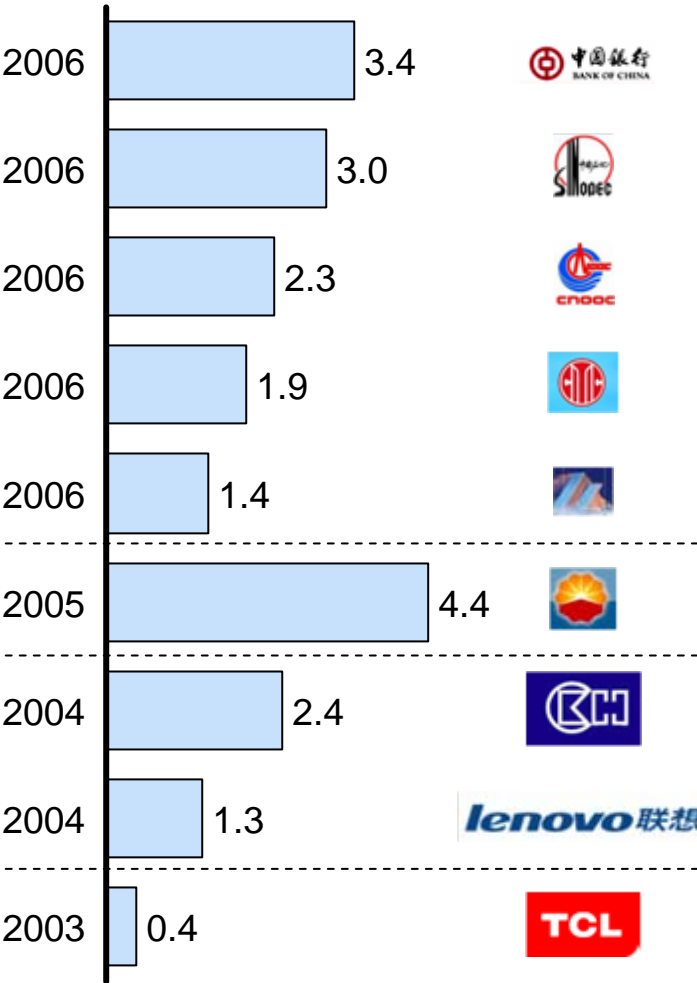
*"... our asset is people which we develop or recruit; buying existing business would be too expensive..."*

MOFCOM

# MORE RECENTLY SEVERAL CHINESE ENTERPRISES HAVE COMPLETED MEGA DEALS

## Arrival of mega deals

USD bn



## Target company and country

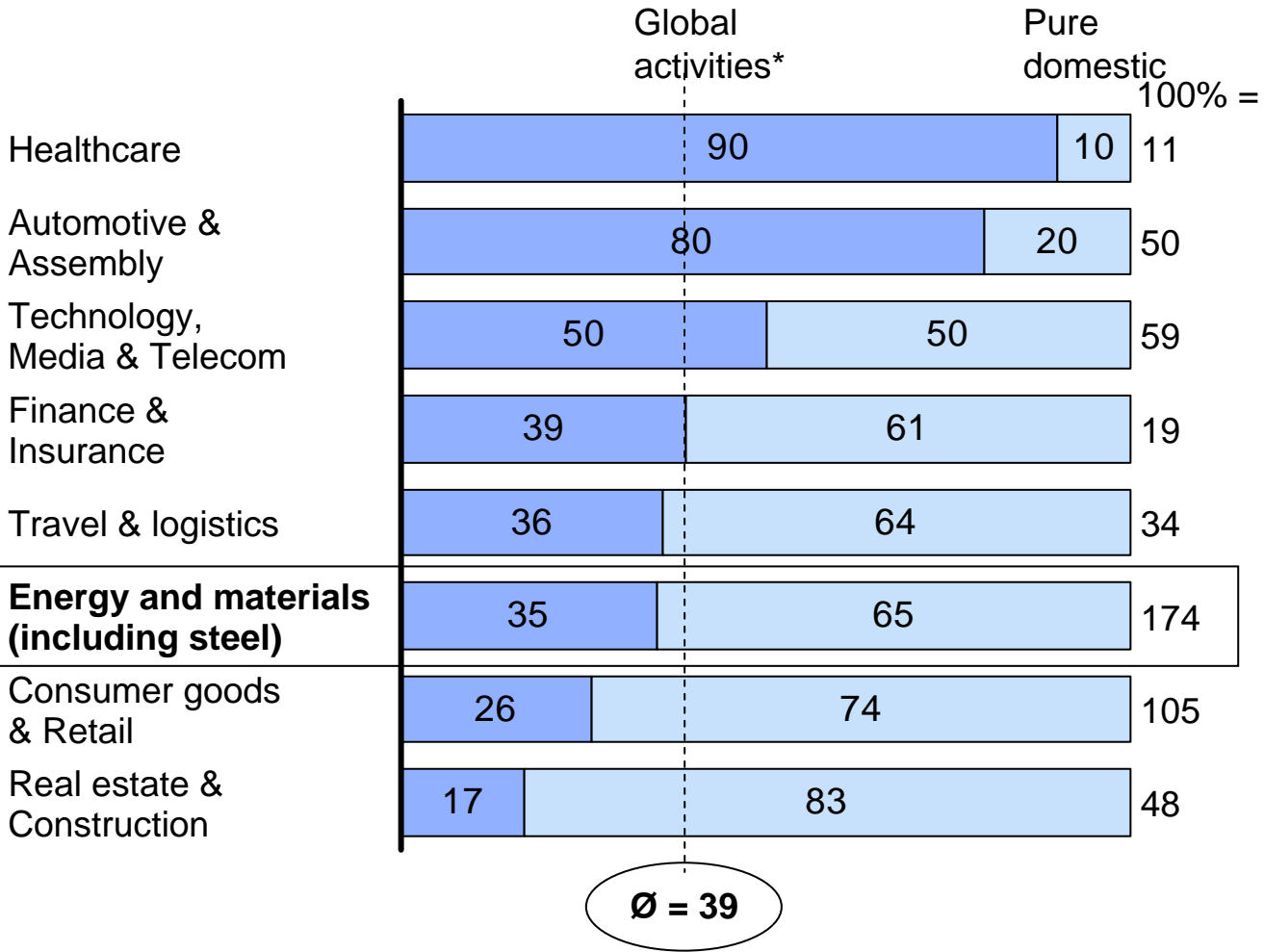
- Bank of China acquired Singapore Aircraft Leasing Enterprise (Singapore)
- Sinopec acquired Udmurtneft OAO (Russia)
- CNOOC acquired South Atlantic Petroleum (Nigeria)
- CITIC acquired Kazakh Oil & Gas Assets (Kasakhstan)
- Aluminum Corp of China co-invested JV with Vietnam National Coal-mineral Industries Group (Vietnam)
- PetroChina bought Petrokazakhstan (Kazakhstan)
- Cheung Kong acquired the North of England gas distribution network from National Grid Transco (UK)
- Lenovo bought IBM PC Division (USA)
- TCL JV with Thomson SA (France)

Source: MOFCOM; literature search

# LEADING CHINESE COMPANIES GLOBALIZE ACROSS INDUSTRIES

Percent

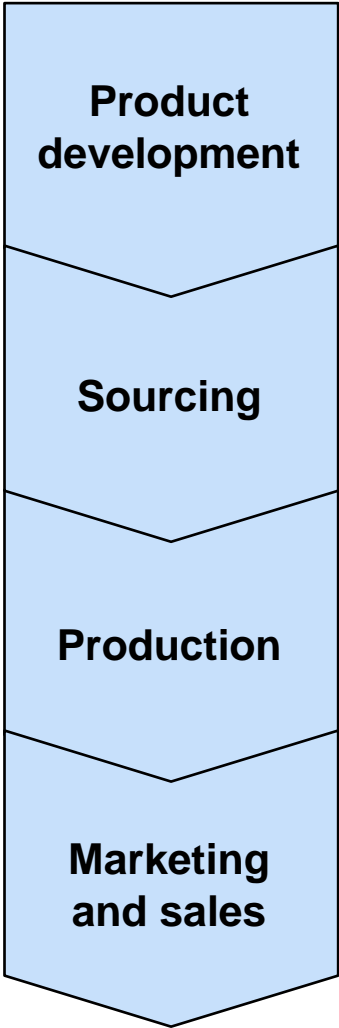
## Top 500 Chinese companies



Among the largest Chinese companies, **only 39% have engaged in globalization activities** (export, investment, sales, production or R&D assets, etc.) by 2006

\* Includes global export, investment, sales and R&D activity

# THE INITIAL GLOBALIZATION STRATEGY IS TO STRENGTHEN/ COMPLETE VALUE CHAIN CAPABILITIES



## Strategy

- Acquire technology/ brand to deploy in China and world market
- Secure natural resource access and supply
- Improve productivity through global scale
- Sustain growth by entering new market and build global brands

## Examples

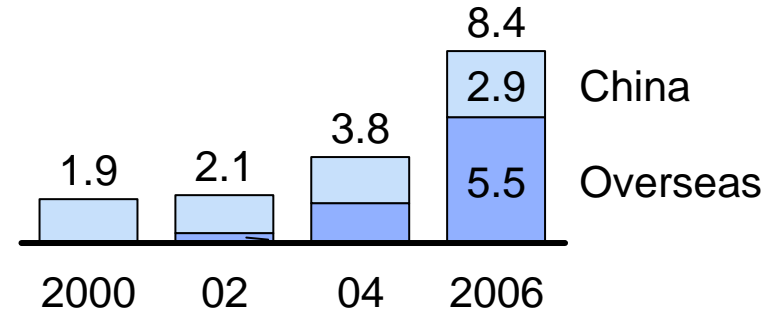
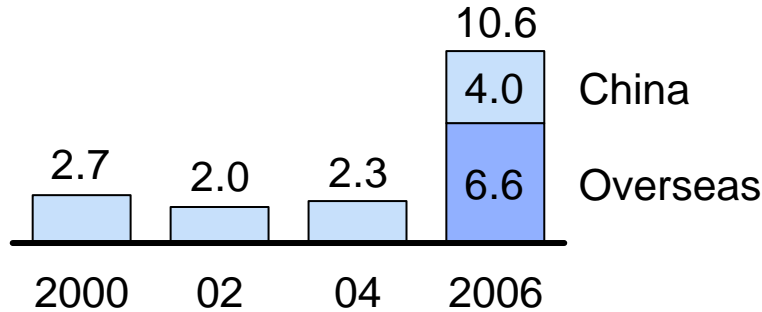
This section displays logos for companies that exemplify the strategies listed. SAIC (Shanghai Automotive Industry Corporation) and CNC (China Network Communications) are associated with the first strategy. Baosteel and Uooc (University of Oil & Gas) are associated with the second strategy. Lenovo and TCL are associated with the third strategy. Haier and Huawei are associated with the fourth strategy.

# GOOD INITIAL SUCCESS ACHIEVED, BUT CHALLENGES REMAIN

EXAMPLE

USD billions

**lenovo**



## Result of globalization so far

- Became global top 3 PC maker with USD10+ billion revenues
- Share maintained; revenue and profit improved

- Sustained 30% CAGR growth
- Regarded as top contender to global telecom equipment market leadership

## Ongoing challenges

How to keep momentum and continue to participate in global industry consolidation

How to conquer the U.S. market?

“Lenovo risks to be overtaken globally by Acer...”  
– CNBC

“Huawei low-cost products are finding few takers among the US telecoms ...”  
– WSJ

# AND SEVERAL CHINESE COMPANIES ARE STRUGGLING IN GLOBALIZING



## Globalization strategy

- Planned to expand declining CRT business
- Organization not ready when conducting M&A

- Strategy to enter branded mobile handset business untested
- Entered M&A without experience and capability

## Globalization execution

- Rushed to deal – a lot of surprises later on
- Little efforts of integration

- Under-estimated, plus mishandled, labor issues in Germany, resulting in big losses within year

## Managing global business

- Losing talents
- Process weakened
- Frequent restructuring

## Result

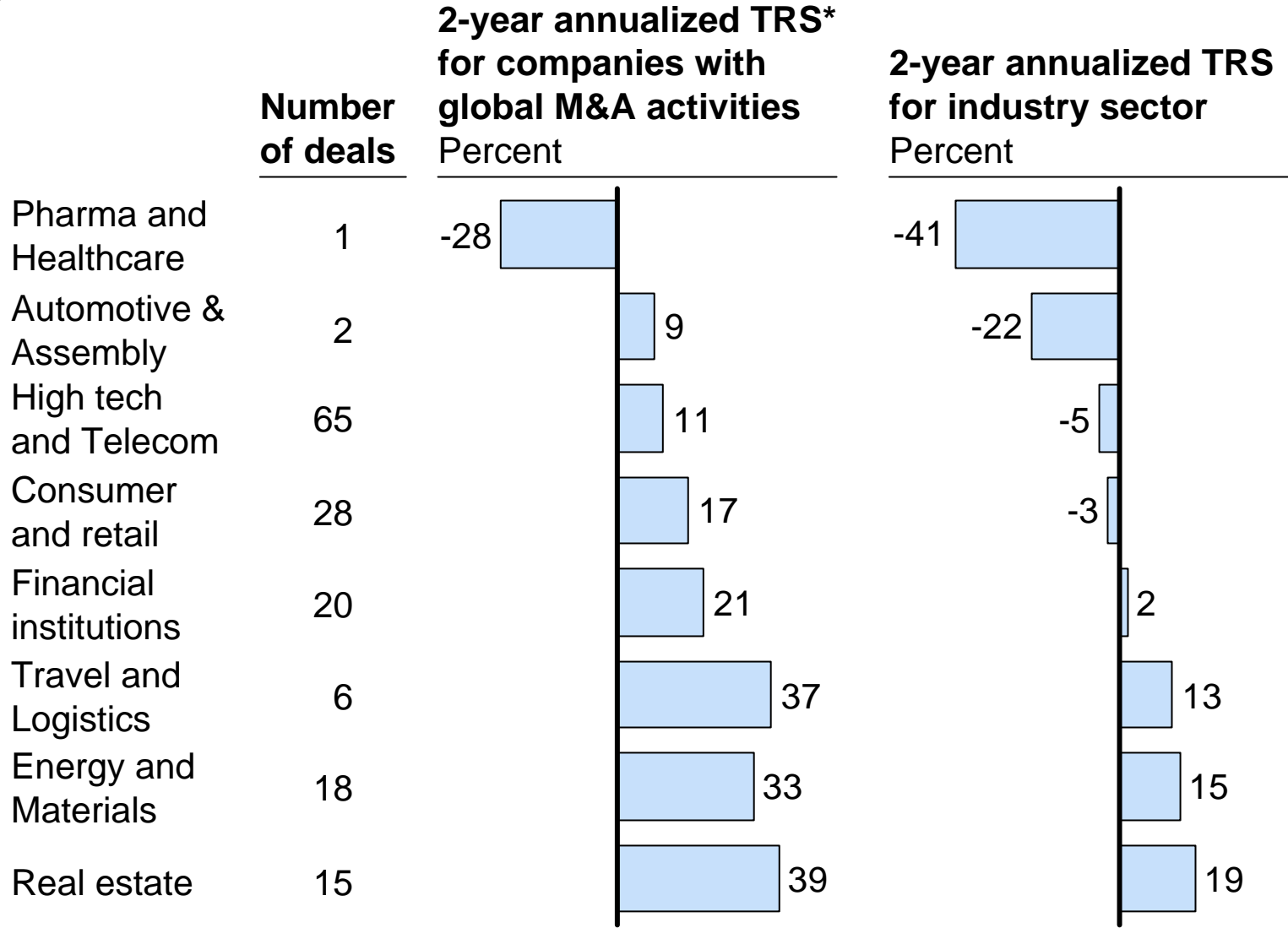
- Big losses
- Unhappy financial market
- Still struggling

- Asset on eBay now!



# ENERGY AND MATERIALS COMPANIES HAVE EXECUTED GLOBAL M&A DEALS BETTER THAN PEERS IN OTHER INDUSTRY SECTORS

January 2002-05

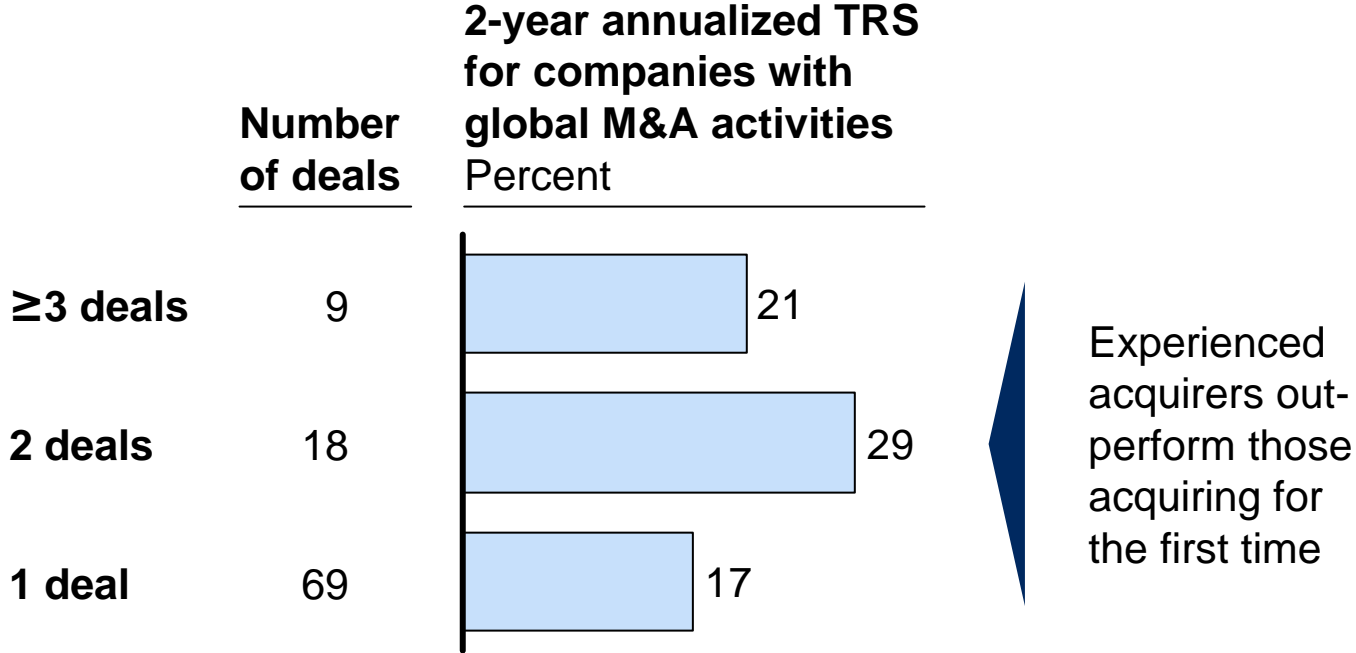


\* TRS = total return to shareholders

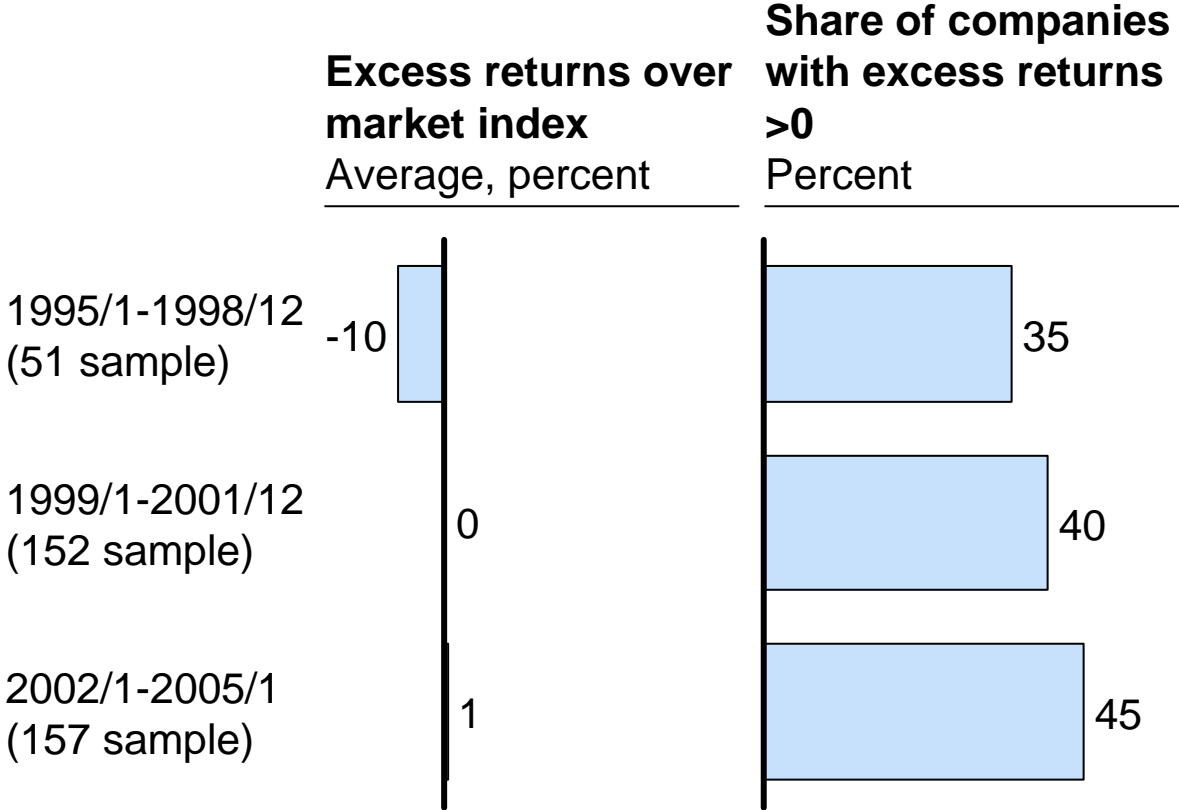
Source: Dealogic database; Datastream database; McKinsey analysis

# SERIAL ACQUIRERS OUTPERFORM FIRST TIME ACQUIRERS ...

January 2002-05

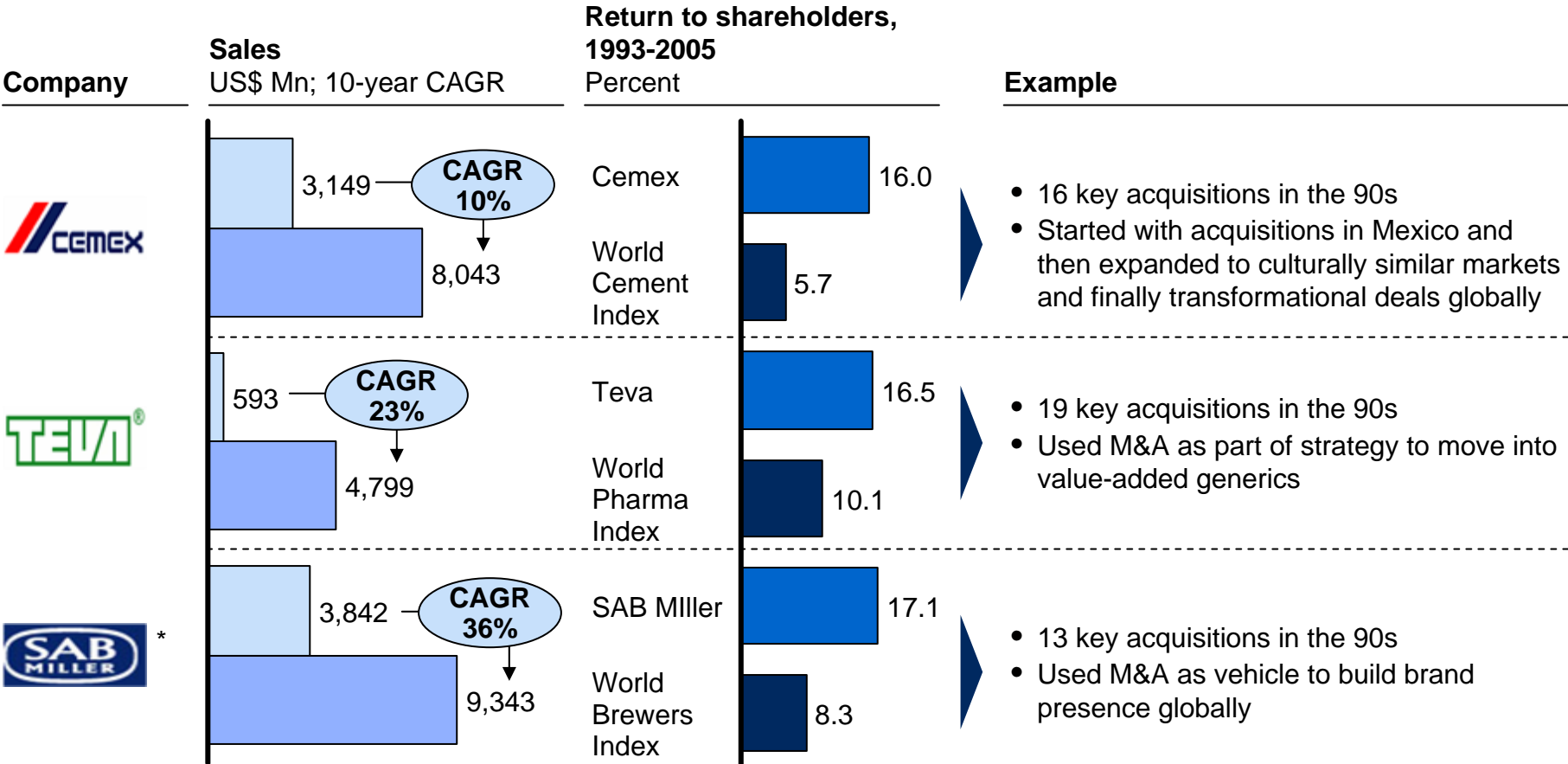
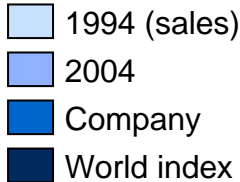


# ... AND MORE RECENT DEALS WERE EXECUTED BETTER THAN DEALS SEVERAL YEARS BACK



Source: Dealogic database; Datastream database; McKinsey analysis

# IN COMPARISON, GLOBAL CONTENDERS FROM OTHER EMERGING MARKETS ARE SUCCESSFULLY GLOBALIZING



\* Sales data from 1996, TRS data from Mar 97 to May 05  
 Source: Bloomberg; Datastream; press articles; analyst reports, McKinsey analysis

# CONTENTS

- Can Chinese companies create value in going global?
- **Key challenges for globalizing Chinese companies and recommended actions**
- Q&A

# EXTENSIVE FIELD RESEARCH WAS CONDUCTED TO ASSESS THE PERFORMANCE AND KFS FOR CHINESE COMPANIES GOING GLOBAL

<b>Topic</b>	<b>Source</b>
<b>Case work and databases</b>	<ul style="list-style-type: none"><li>• 21 companies surveyed and interviewed (3 Automotive; 3 Technology, media and telecom; 1 Travel and logistics; 3 Energy and materials; 1 Finance and insurance; 6 Consumer goods and retail; 4 Real estate and construction)</li><li>• 3 proprietary databases sourced from primary and secondary sources (survey, deal and TRS)</li></ul>
<b>Funding M&amp;A and legal risks</b>	<ul style="list-style-type: none"><li>• 9 PE/VC firms (Carlyle, Warburg Pincus, TPG, General Atlantic, KKR, Goldman PIA, Hao Capital, Merrill Lynch, JP Morgan)</li><li>• 2 Law Firms (Vinson &amp; Elkins, Paul Weiss)</li></ul>
<b>Labor and regulatory</b>	<ul style="list-style-type: none"><li>• 3 labor relations experts (China National Textile and Apparel Council, Renmin University, APCO)</li><li>• 4 law firms (Vinson &amp; Elkins, Paul Weiss, Akin Gump, Clifford Chance)</li></ul>
<b>HR, accounting and public relations</b>	<ul style="list-style-type: none"><li>• 3 HR firms (Korn/Ferry, Hewitt Associates, Ergon Zender); 2 executive program experts (Motorola, Ericsson)</li><li>• 4 public relations firms (Hill &amp; Knowlton, Ogilvy, Brunswick, APCO)</li><li>• 1 accounting firm (Ernst &amp; Young)</li></ul>
<b>Government</b>	<ul style="list-style-type: none"><li>• 8 foreign contractors or Chambers of Commerce assisting Chinese investment abroad (American Chamber of Commerce, American Chinese Business Association, Australian Chamber of Commerce, British Chamber of Commerce, Hong Kong Chamber of Commerce, Korean Chamber of Commerce, State of Kentucky China Office, Larkin Trade)</li></ul>

# KEY SUCCESS FACTORS IDENTIFIED FOR CHINESE COMPANIES GOING GLOBAL

## Don't...

- 1...globalize opportunistically or driven by political agenda
- 2...fail to have strong M&A team and deal sourcing process
- 3...underestimate labor, pension, and other liabilities
- 4...underestimate the difficult of selecting and managing partners in the deal
- 5...underinvest in in brand management
- 6...fail to leverage all funding options, including private equity
- 7...neglect government, labor and public relations
- 8...underestimate the shortage of global-ready talent
- 9...underestimate communication and culture conflicts and efforts required to resolve them
- 10...implement organization structure and business processes poorly

## Do...

- ...globalize based on a comprehensive strategy in line with future growth aspirations
- ...invest in building in-house M&A capabilities
- ...understand location specific liabilities attached in the target company by engaging relevant specialists/experts
- ...proactively seek value adding partner even in the “organic” expansion activities
- ...develop distinctive brand early rather than only competing on cost competitiveness
- ...consider involving financing partners as the can bring capabilities beyond financing
- ...invest early and heavily in in stakeholder management
- ...proactively globalize your organization prior to going global
- ...embrace cultural differences
- rigorously implement performance management for globalization efforts

# 1 “WHAT IS MY GLOBALIZATION STRATEGY?”

## Challenges

- Many Chinese companies take an opportunistic approach, entering the global marketplace without answering key questions like
  - Why globalize?
  - Where to globalize?
  - How to globalize?
- As a result, failure can execution of globalization is common

## Example

**Chinese company strategy and business rationale is frequently questioned...**

“China Mobile is taking its first big step beyond its home markets with the purchase of Paktel, the loss-making Pakistani telecom company”  
~*Financial Times*

**...and increased M&A activity is still new and risky territory for many who lack readiness and capabilities**

“We are not considering global M&A, especially after what happened to TCL”  
~*CE company*

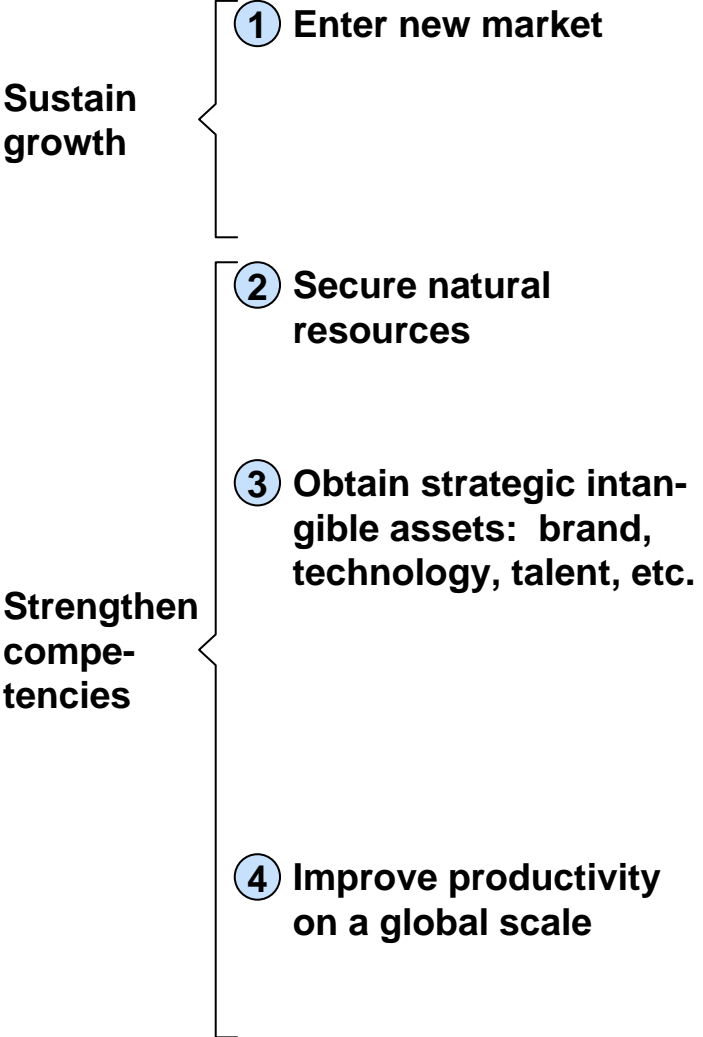
## Best practice in defining globalization strategy

1. Use globalization to build or acquire capabilities along the value chain
2. Follow a rigorous approach to select the next market to enter
3. Master M&A to achieve accelerated growth



# CHINESE COMPANIES SEEK TO GLOBALIZE TO SUSTAIN GROWTH AND/OR TO STRENGTHEN THEIR COMPETITIVENESS

## Drivers of Chinese company globalization



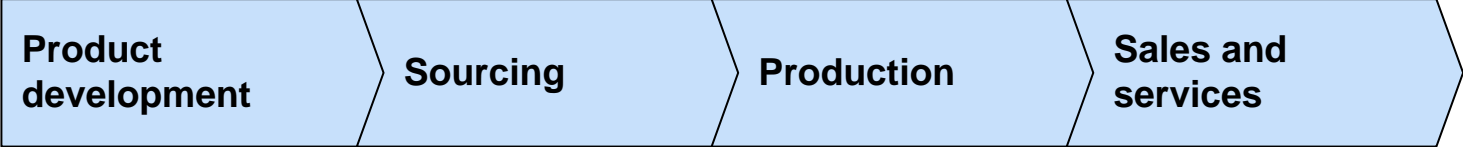
## Rationale (and applicable industry)

- Domestic market is slowing down or very competitive
  - Consumer electronics
  - PC/IT products
  - Telecom equipment
- Chinese projected resource growth exceeds current domestic supply
  - Oil, gas, coal, and minerals, especially iron ore, are in greatest demand
- Entering the global market requires international strategic assets and capabilities
  - PC/IT products
  - T&L
- Supporting and improving domestic market position
  - Machinery
- Sourcing, R&D, and production, especially tax and logistics, and cost savings can improve productivity
  - Automotive

## Recent examples



# GLOBALIZATION STRATEGY SHOULD BE CENTERED AROUND THE WHY, WHEN, AND HOW TO GLOBALIZE – ALONG THE ENTIRE VALUE CHAIN



**Typical Chinese challenges**

- Product development:**
  - Weak IP and brand
  - Domestic MNC competition
- Sourcing:**
  - Shortage of resources to meet even domestic demand
- Production:**
  - Low cost domestic capacity in China
- Sales and services:**
  - Overly competitive domestic market
  - Shrinking share and margins

**Globalization (Why “go global?”)**

- Product development:**
  - Obtain strategic asset such as technology, brand, talent
- Sourcing:**
  - Secure natural resources
- Production:**
  - Improve productivity on a global scale
- Sales and services:**
  - Enter new market

**Applicable geographies (Where to “go global?”)**

- Product development:**
  - Mostly in developed market
- Sourcing:**
  - Resource rich regions
  - Developing countries have lower market entry barriers
- Production:**
  - Target market no matter where it is
- Sales and services:**
  - All new market
  - Developing nations easy to access
  - Developed nations markets are big

**Expansion approach (How to “go global?”)**

- Product development:**
  - Predominantly M&A
- Sourcing:**
  - M&A
- Production:**
  - Predominantly organic
- Sales and services:**
  - M&A or organic depending on actual situation

# 2 “HOW CAN I FIND AND EVALUATE THE BEST ACQUISITION TARGET?”

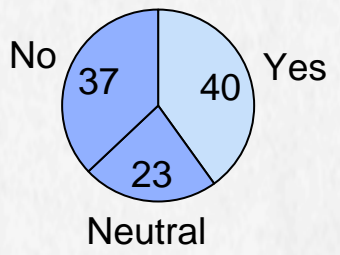
## Challenges

- Typical Chinese companies do not have the right team and process to collect and analyze deal related market intelligence
- In many cases, a systematic approach of target screening is not in existence, even for the biggest companies of China

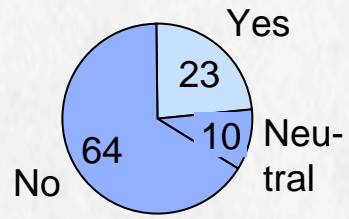
## Example

“I struggle with M&A because I don’t have a team and don’t know where to find the right targets”  
– CEO of High Tech Company

### Used M&A to acquire new competencies



### Used M&A to acquire top talent



## Best practice

- Create in-house M&A team and leverage top external bankers and advisors
- Develop deal flow by networking, leveraging government agencies and database services
- Systematically screen targets to identify best fit

# CURRENTLY, MAKING CHINESE COMPANIES LACK TARGET IDENTIFICATION AND ASSESSING CAPABILITIES

## Challenges

### Passive deal sourcing approach

### Lack of systematic screening process

## Examples

- Typical Chinese companies do not have the right teams and processes to collect and analyze deal-related market intelligence
  - Though national oil companies (PetroChina, Sinopec, CNOOC) continue to acquire oil assets, they rely heavily on asset brokers coming to them
  - “Not in the global T&L deal circle” is the biggest issue currently facing Chinese big port companies

- In many cases, a systematic target screening approach does not exist, even for China’s largest companies
  - A large telco just started to build its overseas M&A screening criteria and process in late 2006 after several failed M&A attempts
  - Companies find it challenging to clarify the criteria and gain management buy-in

## Recommended approach

- Build up opportunity target pool through:
  - Establishing internal deal sourcing process
  - Actively collect external M&A information flow
  - Proactively create M&A opportunities
- Develop systematic screening process to narrow down targets to a shortlist:
  - Develop screening criteria based on corporate strategy
  - Management should focus on a few critical criteria
  - Separate approaches for “reactive” and “proactive” screening
  - Screen and prioritize potential targets to form the shortlist

# 3 “HOW CAN I VALUE AND MANAGE COSTS & RISKS IN A M&A

## Challenges

- Chinese companies generally lack experience and resources to fully quantify synergies
- Chinese companies likely to miss critical risk factors in labor law, retirement benefits and environment
- Chinese companies likely to overlook valuation, operational level negotiation and early termination of transition services

## Example

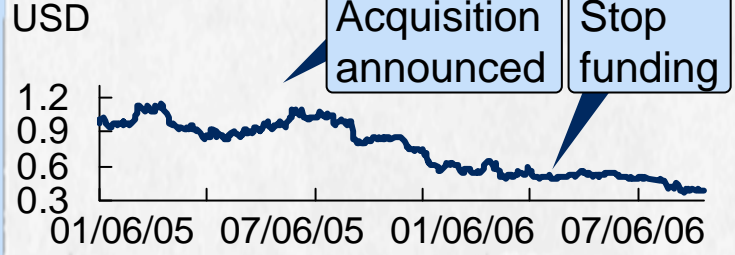
### Deal – June 2005

- Siemens paid BenQ EUR250 million to take over its loss-making mobile phone operations

### Outcome – Bankruptcy!

- German union IG Metall fought with management to obtain job guarantees
- BenQ stopped funding BenQ-Siemens after losses of EUR600 million and delays in product launch
- Assets of BenQ-Siemens to be sold on eBay

### BenQ Stock Price



## Best practice

- Develop awareness of potential risks and liabilities specific to foreign countries
- Engage specialists to assess and manage risks
- Execute brand integration and customer retention carefully

# CHINESE COMPANIES FIND IT DIFFICULT TO PROPERLY ASSESS SOURCES OF SYNERGIES AND POTENTIAL VALUE LEAKAGE

## Challenges

**Failure to identify and capture all cost and revenue synergies in M&A**

**Underestimate the costs/dis-synergies in M&A**

## Examples

- Except in a few successful cases, Chinese companies generally lack the experience and resources to fully quantify and capture all important synergy levers
  - Managing brands is especially challenging, as shown the TTE case

- Chinese companies are likely to miss critical risk factors in labor law, retirement benefits and environment
- BenQ's failed acquisition of Siemens Mobile is a prime example – underestimating the risks (labor related, in this case) could be deadly to the deal

## Recommended approach

- Global benchmarks of potential synergies by function and industry can serve as a starting point
- Chinese companies should consider buying brands whenever possible:
  - Buy the right brand
  - Buy it the right way
  - Protect the brand
  - Migrate the brand
- Thorough due diligence, supported by domain experts (labor, pension, environment), is a must
- Assume and prepare for the worst scenario

# IN PARTICULAR ESTIMATING REVENUE SYNERGIES PROCESS CHALLENGING

## Typical synergy benchmarks

	<u>Function</u>	<u>Range</u>
<b>Cost synergies*</b>	R&D	10-20
	Purchasing	4-25
	Production	2-30
	Marketing	20-40
	Sales	10-45
	Overhead	4-45
	Tax savings	n/a
<b>Revenue synergies**</b>	Cross-selling	n/a
	New markets	n/a
	Brand extension	n/a
	Total	0-10

50% -90% of deals capture at least 90% of expected cost synergies . . .

. . . but struggle to capture revenue synergies

- Not fully reaping benefits of cross-selling and entering new markets due to **customer retention issues**
- Not fully capturing brand extension synergies because of poor **handling of brand acquisition**

\* Percent of combined category cost

\*\* Percent of combined revenue

# UNDERSTANDING AREAS OF VALUE LEAKAGE CAN BE COSTLY

## BenQ acquiring Siemens Mobile

- Jun. 2005, Siemens paid BenQ €250m to take over its loss-making mobile phone operations
- Chairman announced goal to turn around the business in two years and **expected to save USD 500m in costs**
- Staff accepted wage cuts in return for guarantees for 6,000 jobs until Jun. 2006
- Jun. 2005, **German union IG Metall** declared it would work to obtain job guarantees beyond 2006
- Mar. 2006, BenQ posted quarterly net loss of USD 54m
- Jul. 2006, BenQ missed revenue target due to delays in R&D and handset shipment
- Sep. 2006, with **total losses exceeding €600m**, BenQ stopped funding BenQ-Siemens, which filed for bankruptcy
- Oct. 2006, Siemens refused to pay the remaining €100m, while major carriers T-mobile and Vodafone stopped purchasing handsets from BenQ
- Nov. 2006, Siemens **established a €35m fund** to help BenQ-Siemens employees, opened internal job market to BenQ-Siemens, and **threatened to sue BenQ**
- Feb. 2007, efforts to save or sell JV failed and sale of BenQ-Siemens assets on eBay announced

BenQ lacked the capability to handle the labor environment, yet underestimated the potential risks involved, resulting in financial loss and setbacks in its globalization strategy

“BenQ urgently needs to develop **capabilities to deal with the European labor environment**, where workers have much more awareness of their interests and are backed by powerful unions.”

– June 2005, Guy Wittich, CEO  
European Chamber of Commerce Taipei



# 4 “HOW CAN I FIND SUITABLE PARTNERS TO HELP MANAGE AN ORGANIC MARKET ENTRY?”


## Challenges

- Partners are needed in most cases primarily to leverage channel and production capabilities
- Picking the wrong partner is costly to any globalizing Chinese companies

## Example

**VISIONARY VEHICLES** 

- Exclusive agreement to import Chery cars into U.S.
- Breakup after 1 year citing quality and safety standards

**CHANGHONG** 

- Sole U.S. distributorship despite APEX's reputation
- Bad debt of USD500 million
- APEX CEO detained and Changhong CEO removed

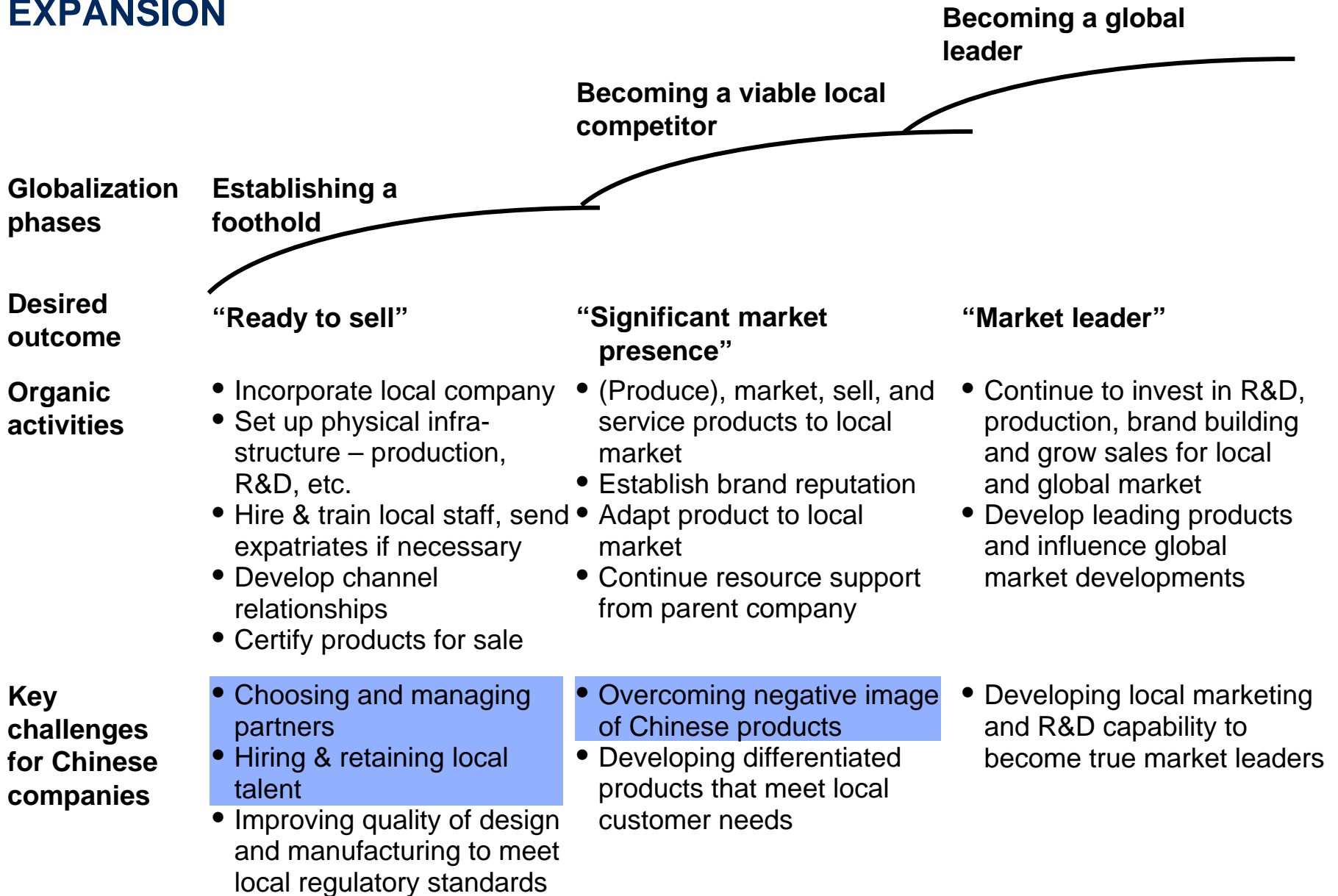
**Lost opportunity and time**

**Lost money and opportunity**

## Best practice

- Select partners that fit one's capabilities and strategy
- Manage partnership flexibly
- Monitor partnership closely

# CHALLENGES CHINESE COMPANIES FACE IN ORGANIC EXPANSION



# KEY CHALLENGES OF CHINESE COMPANIES' ORGANIC GROWTH

## Challenges

### Choosing & managing foreign partners

## Description

- Partners are needed in most cases primarily to leverage channel and production capabilities
- Picking the wrong partner is costly to any globalizing Chinese company, e.g.,
  - Changhong TV using APEX for U.S. market
  - Chery partnership with Malcom Bricklin for U.S. market

## Recommended approach

- Select partners that fit with strategy and capabilities, and to manage risks
- Set expectations and incentives appropriately; manage and grow partnership in phases

### Overcoming negative image of Chinese products

- Chinese goods still have the image of “low price” and “low quality”, a major barrier to achieve fast growth
  - No Chinese companies have built a real global brand yet
  - Limited success achieved by Acer, Haier, Huawei

- For companies that desire to be global leaders
  - Transform business model to premium product & services
  - Manage brands by injecting corporate image
  - If necessary, manage image of China

### Hiring first wave local talents

- Local talent can add unique value that Chinese expatriates cannot provide
- Key challenges include: accessing and selecting right candidate; attracting candidate and, avoiding post-hire disagreement

- Engage search firms to access candidate pool and develop appropriate selection criteria
- Design holistic employee value proposition and adopt world-class business practices to attract talent
- Manage expectations and payroll sensitively

# CHINESE COMPANIES HAVE SEVERAL ORGANIC CHANNELS TO EXECUTE A GLOBALIZATION STRATEGY

## Overseas market (entry) position

### Example

### Key driver and source of value

OEM only

- **Galanz** became the largest global microwave producer via an OEM strategy; they don't have any overseas production and sales
  - Since 1997, Galanz signed OEM contracts with over 248 brand players and has over 45% market share now

- OEM is an easy way to grow business, develop credibility and global scale in production without significant investment in marketing and sales

Sales & marketing only

- **Shanghai Zhenhua Port Machinery's** only presence overseas is sales (74% global share), while design, sourcing, and manufacturing is all conducted in China

- Keeping design, sourcing, and manufacturing in China preserves low-cost structure while maintaining scale and control in China

Sales with production

- **Haier** established a USD40 million refrigerator production in South Carolina with capacity for 400K units per year for the U.S. market in 2001

- Lower shipping costs, leverage local talent, and avoid import tax, while developing good-will and reputation in local markets

Sales with R&D

- **Huawei** has setup an R&D facility in Dallas close to its competitors Lucent and Cisco to leverage talent, and subsequently added sales force to serve the U.S. market

- Leverage local talents for global R&D; this acts as a base for later add on of sales activities

R&D only

- In 2005, **Jianghuai Automobile** established a design center in Turin, the heart of Italy's auto industry while selling only within China

- Leverage local talent to develop good products for China market

# 5 “HOW CAN I BUILD A GLOBAL REPUTATION AND BRAND?”

## Challenges

- Chinese goods still have the image of “low price” and “low quality”, a major barrier to achieve fast growth
  - No Chinese companies have built a real global brand yet
  - Limited success achieved by Acer, Haier, Huawei

## Example

**Global brand practitioners believe that Chinese brands do not score well**

### Survey results of Chinese brand\*

Question	Result
• Do you believe “Made in China” helps or hurts Chinese brands?	• 79% believe that a “Made in China” label hurts Chinese brands
• Top 5 words that represent your impression of Chinese brands today	• Cheap • Poor value • Poor quality • Unreliable • Unsophisticated

## Best practice

- For companies competing high end globally
- Transform business model towards providing innovative quality products and services
  - Inject personality and emotion into offerings
  - Mangle and/or improve China’s image

\* For a period of 2 weeks in Q1 2005, an online survey was made available via [www.brandchannel.com](http://www.brandchannel.com)  
Source: [www.brandchannel.com](http://www.brandchannel.com); Brand Blue; McKinsey analysis

# CHINESE COMPANIES ARE STRUGGLING WITH REPUTATION

Global brand practitioners believe that Chinese brands do not score well

Survey results of Chinese brand*	
Question	Result
<ul style="list-style-type: none"> <li>Do you believe “Made in China” helps or hurts Chinese brands?</li> </ul>	<ul style="list-style-type: none"> <li>79% believe that a “Made in China” label hurts Chinese brands</li> </ul>
<ul style="list-style-type: none"> <li>Top 5 words that represent your impression of Chinese brands today</li> </ul>	<ul style="list-style-type: none"> <li>Cheap</li> <li>Poor value</li> <li>Poor quality</li> <li>Unreliable</li> <li>Unsophisticated</li> </ul>
<ul style="list-style-type: none"> <li>Comments on Chinese brands and their future for competing internationally</li> </ul>	<ul style="list-style-type: none"> <li>Chinese brands are competing solely on tangible dimensions like quality and price</li> <li>Country image is an integral component consumers use to evaluate products (“country-of-origin” effect)</li> <li>Comparison of China today with Japan 50 years ago indicates that China is well positioned for brand success</li> </ul>

The survey results produced some clear conclusions

- Transform business model:** Chinese companies need to move away from being low-cost manufacturers toward creating and managing innovative global brands
- Manage the brands personally and emotionally:** Chinese companies will compete more effectively once they inject personality and emotion into their products and services
- Build China’s image in marketing:** Chinese companies need to improve awareness and impressions of China as they are promoting their companies

\* For a period of 2 weeks in Q1 2005, an online survey was made available via [www.brandchannel.com](http://www.brandchannel.com)  
 Source: [www.brandchannel.com](http://www.brandchannel.com); Brand Blue; team analysis

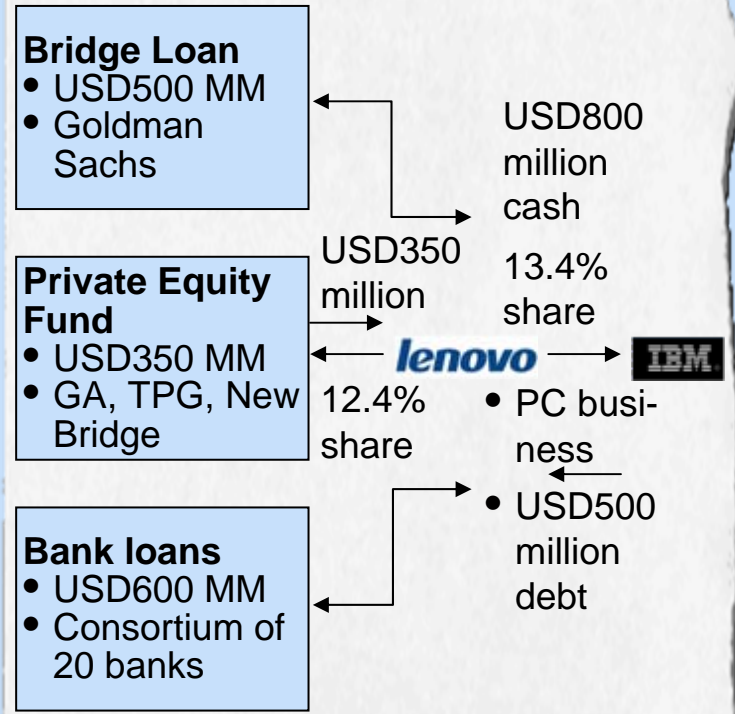
# 6 “WHAT ARE MY FUNDING OPTIONS FOR GOING GLOBAL?”

## Challenges

- Chinese or international bank loans as well as China state financial support is not easy to access
- Equity funding is uncharted territory and higher cost

## Examples

### Lenovo's acquisition of IBM PC



- ### Best practice
- Understand benefits and risks of working with PE firms
  - Understand the investment philosophy and interest in globalization of PE firms

# THREE SOURCES OF FUNDING TO SUPPORT CHINESE COMPANIES' OVERSEAS EXPANSION

## Description

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## Recommendations

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### Commercial loans

- Applies in most cases
- Chinese banks are becoming picky, especially in high-risk overseas deals
- International banks get involved in big deals
- Example: Lenovo got USD600m from a 20 bank consortium for its IBM deal

- N/A

### State support from China or host country

- Available to large SOEs and strategic sectors such as high-tech industry; starting to support private and SMEs but on very small scale
- Cheap funding: 150-180 bp lower than normal loans, additional tax benefits in most cases
- Chexim has funded 87 overseas investment projects by 2003, mostly in natural resources and high-tech industries

- Chinese companies should leverage low-cost state support as much as possible
- However, Chinese policy banks need to better manage risks associated with “Going Global” activities

### Equity funding: public market or private equity firms

- Few Chinese companies know how to approach and leverage PE firms
- PE is expensive but they bring M&A-related expertise
- Recent examples include Lenovo with TPG/GA/New Bridge, and Haier with Blackstone/Bain Capital (failed)

- Chinese companies need to better understand the benefits and risks of working with PE firms
- A select group of the most prominent ones can be leveraged, when necessary and appropriate



# CHINESE COMPANIES NEED TO UNDERSTAND WHAT PRIVATE EQUITY FUNDS BRING TO THE DEAL

## PE value-add

### Before the deal

- Experienced and aggressive negotiators (with targets for the deal)
- PR experience in target's home market
- Global brand name and reputation to provide "seal of approval"

### After the deal

- Governance experience in international companies to actively participate as board members or on strategy/compensation committees
- Industry-specific knowledge and experience in cost reduction (if important) with emphasis on value creation to focus business plan strategy and execution
- Network of top-tier management talent as well as global and local industry experts to select top management to lead operations

vs.

## Potential "cost"

- Most expensive equity; typical PE requires >20% return on their capital
- Experienced and aggressive negotiators (with you for their investment)
- Short timeframe before exit (1-3 years) – you may have to buy in a few years
- Value-add is lower over time once conditions are stable, but they still expect to get paid for their capital
- Lack of cultural sensitivity
- Lack of dedicated resources post deal

# 7 “HOW IMPORTANT ARE GOVERNMENT, LABOR AND PUBLIC RELATIONS?”

## Challenges

- Chinese companies are not experienced and often ignore the management of media, investor, and public perception
- In particular, Chinese companies face challenges with unfriendly government, opposition political forces and typically operating in high risk markets

## Example



**CNOOC**

**Media strategy lessons learned**

- Involve PR firms earlier in process to polish sensitive topics
- Build closer economic ties with foreign governments
- Leverage public opinion shaping approaches e.g., CEO interviewed on TV

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**NFC**

**Labor relations strategy lessons learned**

- Understand the importance of labor unions, emphasizing worker safety
- Leverage third-party experts, e.g., PR
- Build a dedicated, local team with prior experience in managing unions

**Best practice**

- Appreciate risks related to sector, financing, ownership, deal size and competitive pressures within foreign country
- Engage legal and PR experts early in the acquisition process
- Let local partners lead through political and regulatory process
- Develop relationships with key foreign government officials

# PROACTIVE STAKEHOLDER MANAGEMENT CRITICALLY IMPORTANT IN GLOBALIZING THE BUSINESS

## Description

## Recommendations

### Government/ host country political groups

- Chinese companies conditioned to work with strong and business-friendly governments face challenges when
  - The host government is critical/hostile to incoming investment, e.g., CFIUS review in the U.S.
  - Strong opposition political forces lobby against Chinese companies, e.g., Shougang, NFC
  - Entering high-risk markets (Middle East) or when political ties are strained, e.g., China Mobile/Millcom

- Understand importance of an effective government, labor and PR strategy

### Employees and unions

- China HR teams are not experienced with local regulations, e.g., pension benefits, equity compensation, and payroll systems, which are critical to employee retention and can be costly if mishandled
- No experience in working with local trade or labor unions, managing labor strikes and/or labor union negotiation tactics

- Seek third-party assistance to help manage legal, labor union, corporate governance, cultural and PR challenges

### Public/ international society

- Chinese companies are not experienced, and often ignore the management of media, investor, or public perception, especially in crisis situations
  - E.g., CNOOC, NFC in Zambia

- Setup teams with experienced local hires for
  - Government Affairs
  - Human Services/Corporate Social Responsibility
  - Public Relations

# OPPOSITION POLITICAL FORCES IN HOST COUNTRIES CAN BE POWERFUL WHEN COMPARED TO THOSE IN CHINA



Shougang Peru



CHINA NONFERROUS METAL MINING GROUP CO., LTD.  
中国有色矿业集团有限公司

Situation	Government/opposition activity	Impact
<ul style="list-style-type: none"> <li>Shougang (Capital Steel) purchased Hierro Peru, a Peruvian state-owned mine and steelmill, for USD311 million in 1992</li> </ul>	<ul style="list-style-type: none"> <li>Peruvian regional and congressional governments and local NGO activists                             <ul style="list-style-type: none"> <li>– Declared environmental emergencies to oppose standards violations (Mar 2006), e.g., waste water pumping into San Nicolas Bay</li> <li>– Disputed disregard for labor rights (~2003-06), e.g., breach of contract</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Increased costs, e.g., fines for environmental infractions</li> <li>USD4 million loss due to labor union and contract worker strikes (Jun 2006)</li> </ul>
<ul style="list-style-type: none"> <li>NFC purchased Chambishi in 1998 for USD20 million</li> <li>Mine accident and union dispute damaged relationships with local society recently</li> </ul>	<ul style="list-style-type: none"> <li>Zambian presidential candidate Michael Sata ran on fall 2006 anti-China platform</li> <li>Broad anti-Chinese sentiment in Zambia's municipalities and neighboring countries, encouraging violent union counter-reactions</li> </ul>	<ul style="list-style-type: none"> <li>Chinese president's planned visit in Jan 2007 was called off due to deteriorated situation</li> </ul>

Chinese companies are used to dealing with strong and business-friendly governments in China, and underestimate the negative impact of host countries' opposition political forces

# CHINESE COMPANIES CAN LEVERAGE HUMAN RESOURCES EXPERTS TO BETTER MANAGE LABOR AND UNIONS

	<u>China-specific issue</u>	<u>Approach</u>
<b>Human services</b>	<ul style="list-style-type: none"> <li>• Lack of awareness of local HR regulations</li> <li>• Integrating two companies' HR systems</li> <li>• Internal communication strategy</li> </ul>	<ul style="list-style-type: none"> <li>• Reconcile regional differences in HR policies and benefits, e.g., pension benefits, equity compensation</li> <li>• HR services decision making around in-house vs. outsourcing</li> <li>• Design and structure HR services administration, e.g., payroll administration</li> <li>• Establish an understanding of perceptions on both sides and create a communication plan for overcoming biases</li> </ul>
<b>Corporate social responsibility (CSR)</b>	<ul style="list-style-type: none"> <li>• Insufficient experience working with labor unions, NGOs and local employee needs</li> </ul>	<ul style="list-style-type: none"> <li>• Conducts perception audits to identify issues and crafts implementation strategies, for example               <ul style="list-style-type: none"> <li>– Coach local Chinese managers and employees on union and NGO communication strategies</li> <li>– Conduct cultural sensitivity training</li> <li>– Work with executive management to ensure the unions are apprised of and responsive to ongoing challenges</li> <li>– Craft employee benefits, including security, compensation, and wages</li> <li>– Support company business plans and objectives with timely and accurate advice and counsel on labor implications</li> <li>– Guide management in day-to-day use of labor agreements</li> <li>– Ensure appropriate grievance management</li> <li>– Monitor workforce issues through open communication with HR team</li> <li>– Drive successful contract negotiations</li> </ul> </li> </ul>

**Key lessons learned**

- Post acquisition, employees should be retained and leveraged to provide institutional knowledge and an understanding of existing processes
- In time, work to integrate two company systems with third-party assistance

# 8 “WHAT TYPE OF TALENT DO I NEED?”

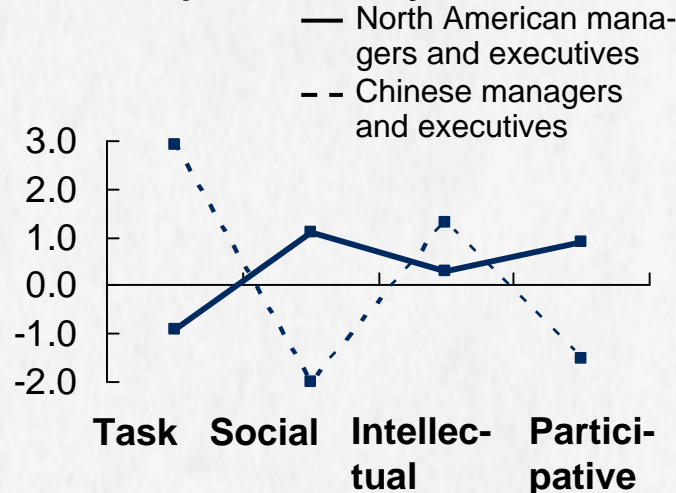
## Finding and developing global executive talent

- Global companies need an international management bench to provide global vision and local market understanding
- Many Chinese executives still have gaps in cross-cultural experiences, breadth of leadership styles and specific functional skills

## Examples

**Chinese executives tend to be authoritative and task oriented even at senior levels**

### Leadership decision styles



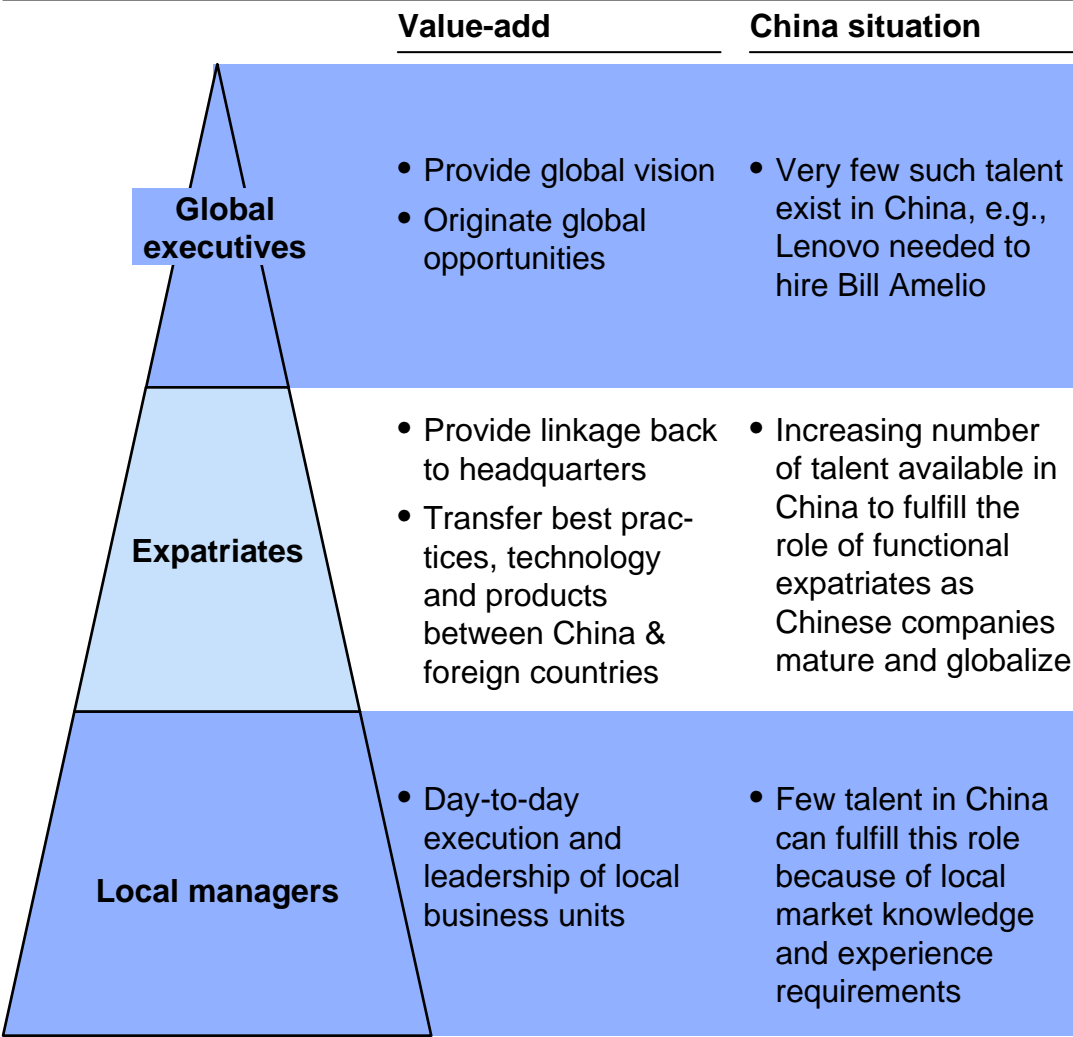
**Internationally, managers tend to use more social and participative styles as they move up**

## Best practice

- Engage search firms to access and screen candidates
- Adopt global standards for payroll and recruiting practices
- Develop integrated talent development program

# CHINESE COMPANIES NEED A MIX OF CHINESE AND FOREIGN TALENT IN THEIR GLOBAL OPERATIONS TO SUCCEED

An international management bench is needed ...



... which requires Chinese companies to hire globally; expatriates have limitations

- Insufficient exposure to cross-cultural challenges and/or command of foreign language to lead and manage foreign teams effectively
- Limited global network of external relationships to capture business opportunities and tackle challenges that happen in a foreign country
- Limited global exposure that enables them to understand complex business trends and create winning business strategies that exploit differences across geographies

“Chinese companies still prefer to send their own executives overseas. They face problems because these executives have limited experiences in cross-cultural and complex business issues. Business in China was relatively simple until a few years ago”  
 – A global executive search firm

# 9 “HOW DO I MANAGE CROSS-CULTURALLY IN FOREIGN COUNTRIES?”

## Managing cross-culturally in foreign countries

## Examples

- Chinese managers lack confidence and structure in presenting in English, resulting in difficult working relationship
- Differences in cultural norms result in misunderstanding in multicultural teams
- In M&A, differences in organizational culture can lead to conflict & confusion

“Vocabulary is my biggest problem with spoken English”

– *Chinese manager*

“Chinese don’t understand what stretch targets mean”

– *U.S. manager*

“It’s really confusing. We’ve just gone through a merger and they’ve brought in management from a third company. We have three cultures !”

## Best practice

- Top management takes an active interest in foreign culture and language
- Management enrolls in language and cultural workshops as well as professional rotation programs
- For M&A, conduct culture diagnostic and integration



# CHINESE COMPANIES NEED TO ADAPT TO THE GLOBAL BUSINESS CONTEXT TO SUCCEED

## Challenges

### Managing communication and culture issues

## Description

- Chinese managers lack confidence and structure in presenting in English, resulting in difficult working relationships
- Differences in cultural norms result in misunderstandings in multi cultural teams
- In M&A, differences in performance culture can lead to conflict and confusion

## Recommendations

- Communication workshops on English presentation skills
- Workshops to build awareness of cultural norms
- Conduct culture diagnostic, develop and execute a performance culture integration plan

### Grooming global executives

- Chinese executives need to develop cross-cultural sensitivity, breadth of leadership style and functional skills to become good global executives

- Bridge talent gaps through formal education, workshops and job rotation

### Managing by systems

- Systems, e.g., structures and processes, must be in place to manage a global company

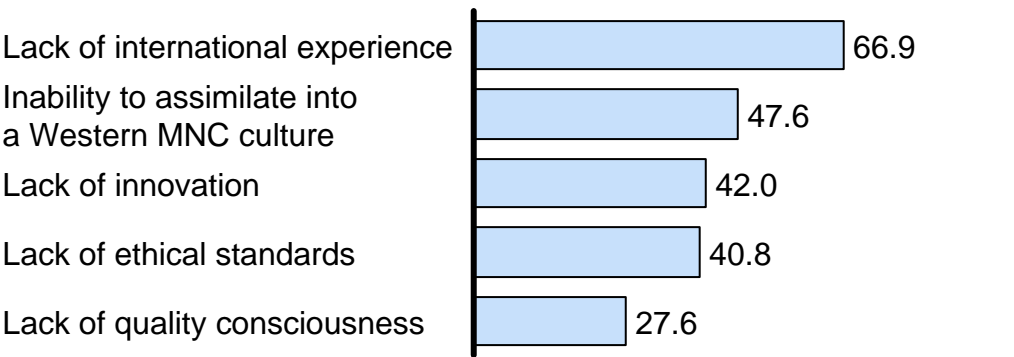
- Choose an appropriate organization archetype, division of accountabilities and role of corporate center
- Implement operational and management processes that are simple, linked to performance review and performance culture

# CHINESE EXECUTIVES NEED TO BRIDGE SIGNIFICANT CAPABILITY GAPS TO SERVE AS GLOBAL EXECUTIVES

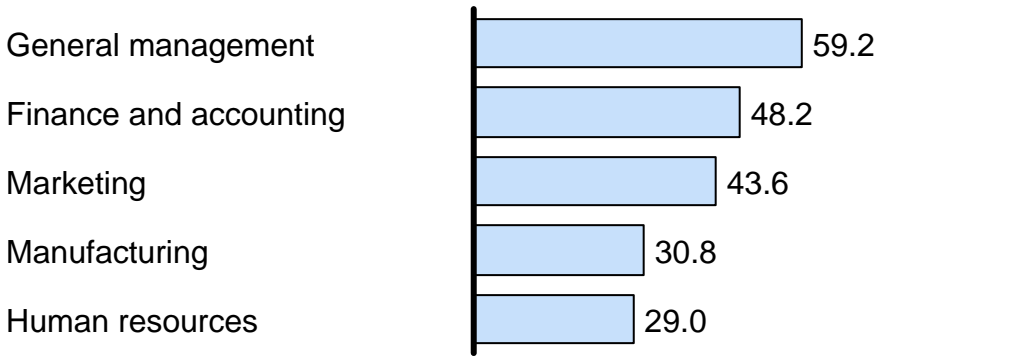
## From interview and analysis, we found 3 capability gaps

- ① **Cross-culture and language ability**  
Due to mono-ethnic environment and limited overseas experience, Chinese executives need to develop keen interest in foreign cultures and language to overcome cultural barriers and misunderstanding
- ② **Breadth of leadership styles**  
Chinese executives need to develop a fuller suite of leadership styles and skills as they start to manage people from a different country/culture
- ③ **Functional skill sets**  
There is an overall shortage of Chinese talent with specific skill sets such as finance and accounting, human resources, marketing and sales, and global R&D and supply chain

## Challenges in finding business leadership in China Percentage of respondents, n = 326



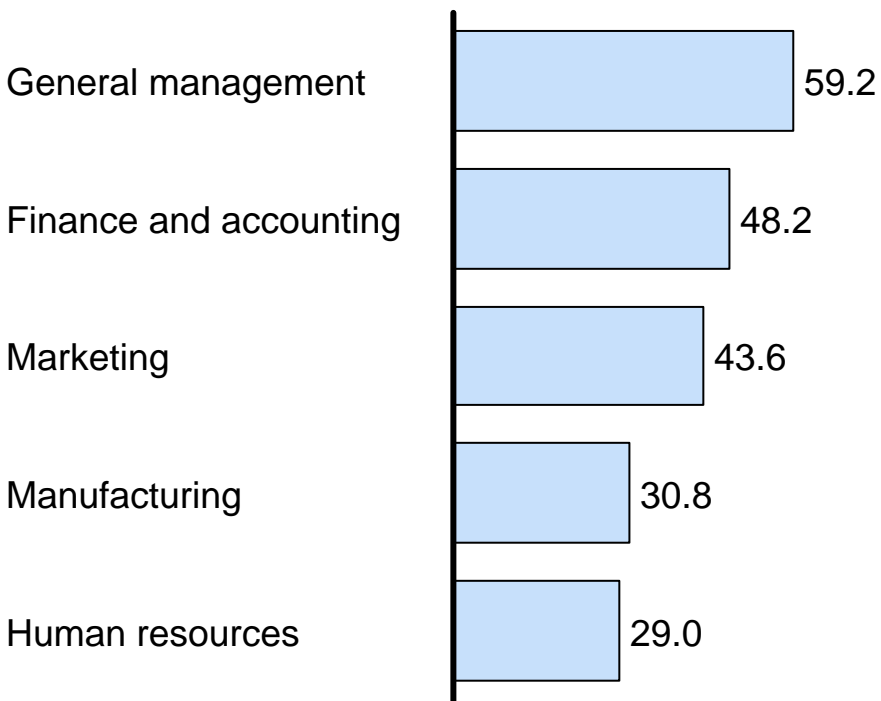
## Functional roles with the greatest demand in next 3 years Percentage of respondents, n = 328



# THERE IS A SHORTAGE OF CHINESE TALENT WITH THE SPECIFIC FUNCTIONAL SKILLS REQUIRED IN GLOBAL MARKETS

## Functional roles with the greatest demand in the next 3 years

Percentage of respondents, n = 328



### Why are Chinese manager's functional skills insufficient?

#### Different standards

- Few Chinese executives have deep qualifications and a familiarity with foreign accounting standards, reporting and auditing requirements, and the regulatory and labor environment

#### Specific market conditions

- Marketing and sales require an intimate understanding of local consumer and business buying needs and behaviors that Chinese executives are unfamiliar with

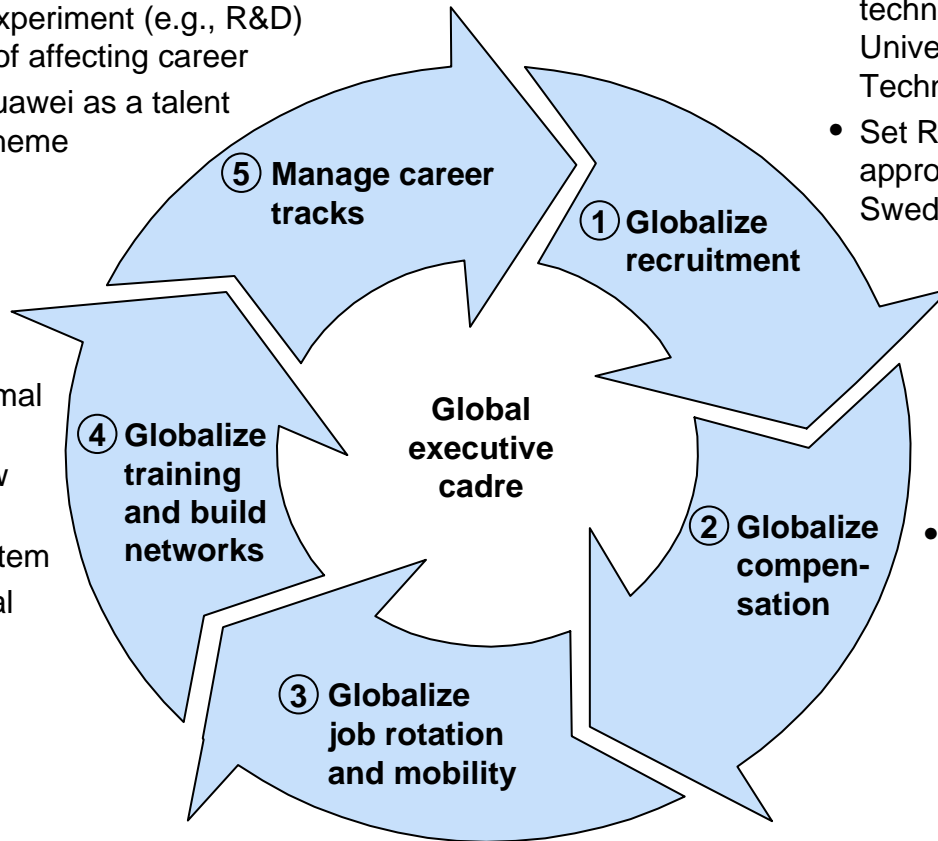
#### Global complexity

- Activities at an international level involve a larger scale and complexity than most Chinese executives are used to

# HUAWEI HAS ESTABLISHED A SUSTAINABLE SYSTEM FOR TALENT RECRUITMENT, DEVELOPMENT AND RETENTION

- High-potential candidates are allowed to experiment (e.g., R&D) without risk of affecting career
- Shares in Huawei as a talent retention scheme

- Recruit from top Chinese technology universities (ie., University of Science and Technology of China 中国科技大学)
- Set R&D in locations with appropriate talent (such as its Swedish wireless R&D center)



- Mix of formal and informal training
  - Formal: 5-month new hire training program
  - Informal: mentor system
- Significant role of global networking in training programs

- Huawei pays more than industry average, e.g., monthly wage for R&D and sales personnel of ~RMB8,000-9,000 vs. industry average of 4,000-5,000

- Huawei sends its best employees overseas for exposure to new markets
- There are already four generations of “overseas pioneers”

# 10 “WHAT SYSTEMS DO I NEED TO MANAGE BY GLOBAL COMPANY?”

## Challenges

- Systems, e.g., structures and processes, must be in place to manage a global company

## Example

Case	Impact
<ul style="list-style-type: none"><li>• <b>Bad structure</b> A teleco had multiple operating units offering similar products to the same customers</li></ul>	<ul style="list-style-type: none"><li>• Unnecessary duplication of resources, internal price competition and customer confusion</li></ul>
<ul style="list-style-type: none"><li>• <b>Poor process</b> Adhoc R&amp;D changes without change management at a consumer electronics firm; cross border coordination breakdown between R&amp;D and manufacturing</li></ul>	<ul style="list-style-type: none"><li>• Losses resulting from product delays and poor product design</li></ul>

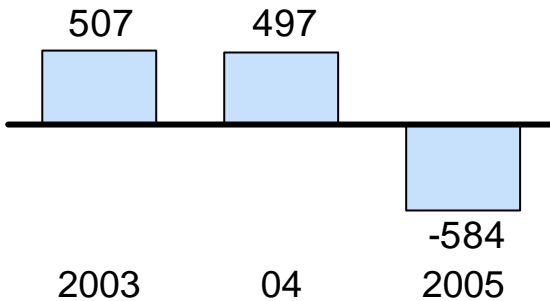
- ### Best practice
- Well aligned organizational structure
  - Effective operational processes and procedures
  - Integrated performance and health management

# GLOBAL COMPANIES NEED FORMAL SYSTEMS TO MANAGE COMPLEXITY AND SCALE



## TCL faced losses after acquiring TV division of Thomson Electronics

**Profit /loss**  
HKD millions



- Employees after acquisition: 29,000 with 8,000 in Europe

“Firm’s buying spree has become a cautionary tale about the limits of Chinese companies’ **management capabilities**”  
– *Financial Times*

## Diagnosis revealed key reasons behind delays in time to market and poorly designed products

- No unit responsible for product-line strategy resulting in suboptimal product roadmap
- New market learnings directly incorporated into R&D pipeline without change management process
- Poor project planning based on rough milestone dates
- No resource planning
- Breakdown in cross-border coordination between R&D and manufacturing

“Chinese companies are prone to “managing by people” and (人治) need to pay particular attention to systems. Global companies need formal management systems to function effectively cross-border”

– *Wu Hai, TTE President*

# PERFORMANCE CULTURE INTEGRATION IS CHALLENGING IN CROSS-BORDER M&A SITUATIONS

## Cross-border M&A can result in big differences in performance culture...

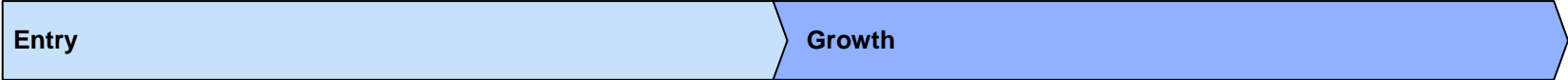
	Acquirer	Target
<b>Core values</b>	<ul style="list-style-type: none"> <li>• “Operational focus”</li> <li>• “Customer focus”</li> <li>• “Long-term orientation”</li> </ul>	<ul style="list-style-type: none"> <li>• “Results oriented”</li> <li>• “Bureaucracy”</li> <li>• “Slow-moving”</li> </ul>
<b>Mind-set and beliefs</b>	<ul style="list-style-type: none"> <li>• “Prepared to sacrifice short-term earnings”</li> </ul>	<ul style="list-style-type: none"> <li>• “We let red tape get in the way”</li> </ul>
<b>Organizational practices</b>	<ul style="list-style-type: none"> <li>• “Management emphasize efficiency and productivity”</li> </ul>	<ul style="list-style-type: none"> <li>• “Company develops standard operational procedures throughout all parts of the company”</li> </ul>

## ...resulting in poor performance and failure in M&A

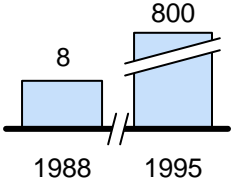
- “The key issue is the loss of trust and collaboration among the leadership team”
  - *A senior manager*
- “I know there is a strategy out there, I am not sure what it is”
  - *An engineer*
- “A third M&A failed due to cultural problems”
  - *PMM survey*

- **A systematic process is required to integrate culture**

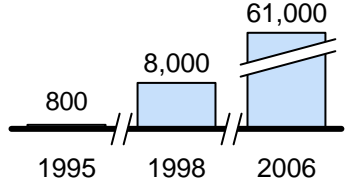
# HUAWEI EVOLVED ITS STRUCTURE AS IT EXPANDED



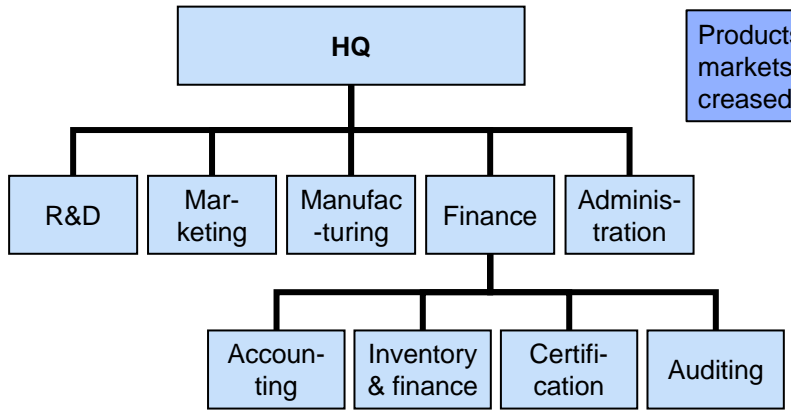
- Situation**
- Before 1996
  - Product: 1 product
  - Market: China
  - Number of employees



- Situation**
- From 1996 until now
  - Product: 6-product portfolio
  - Market: over 100 countries
  - Number of employees

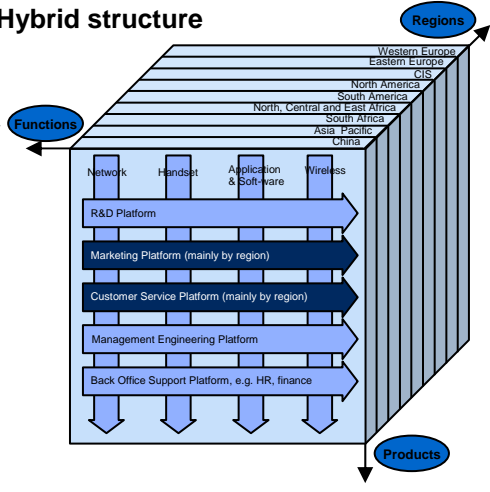


**Structure** Functional structure



Products and markets increased

**Structure** Hybrid structure



- Decision making**
- HQ is the only profit center
  - Decisions are segregated by functions with cross-functional decisions made by HQ

- Role of corporate center**
- Manages coordination between divisions

- Dual profit centers: geography subsidiaries and product divisions have P&L responsibilities
- Product division drives product and sales strategies while geography subsidiary implements and is responsible for local human capital decisions
- Establishes overall strategy and corporate policies
- Searches for new product line or business opportunities and creates task force and new division to tackle opportunities

Source: Literature search; McKinsey analysis



# CONTENTS

- Can Chinese companies create value in going global?
- Key challenges for globalizing Chinese companies and recommended actions
- **Q&A**