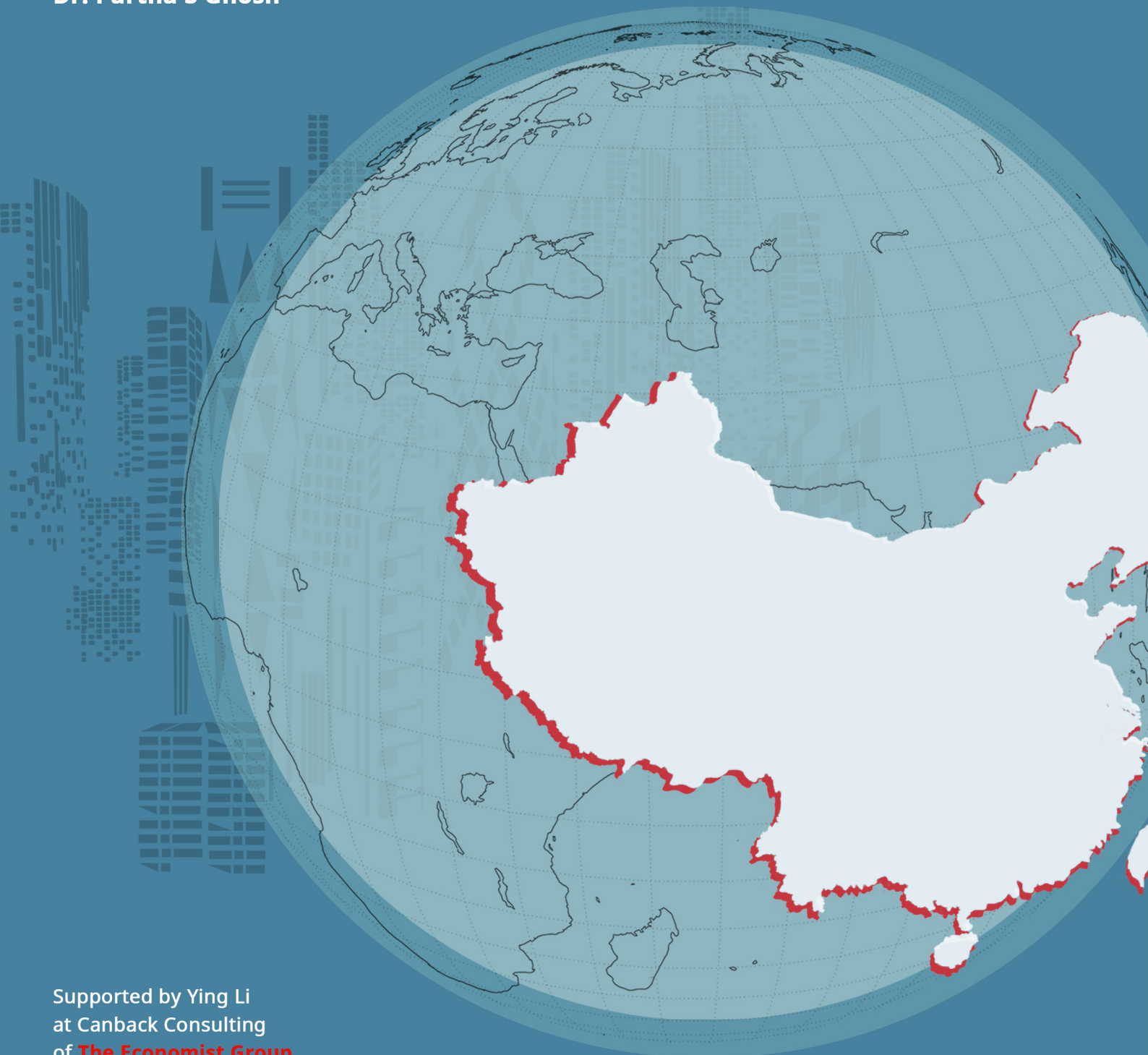

Next Phase of Chinese Economic Miracle:

How must multinationals make strategic adjustments?

Dr. Partha S Ghosh



Supported by Ying Li
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Next Phase of Chinese Economic Miracle: How Must Multinationals Make Strategic Adjustments?

Partha S Ghosh

China has proven to the world that it is possible to pull millions of people out of poverty, become a major global manufacturing hub and develop an innovation culture in the span of just decades. This has prompted multinationals headquartered in the West - US, EU - and in the East - Japan, South Korea - to actively engage with China to both source manufactured products for the world and to serve the rapidly growing Chinese market. Indeed, in design of global strategies, understanding the dynamics of Chinese socio-economic shifts (now the largest global economy on a PPP basis) is perhaps becoming increasingly the most *significant requirement*.

Given the rapid transformation of the country throughout the past four decades from an agrarian society to a significant force in the global knowledge economy, China has been in *a continuous state of flux at an unprecedented speed* along multiple dimensions: (i) *shifting consumer preferences for different socio-economic segments*, (ii) *deepening fragmentation of consumer aspirations and consumption instincts in different regions of China*, (iii) *increasing sophistication of local competition leading to rise of local brands*, (iv) *changing government regulations in response to trade wars and recent coronavirus related tensions*, and in its pursuit of leadership role in emerging technologies and, (v) *accelerating attractiveness of domestic companies as desirable employers - limiting availability of talents for overseas companies*.


Particularly, as Phase 1 of the new trade deal between the US and China is adopted and the deals that might follow are framed, the local “playing field” will be further leveled; it will in turn present significantly more opportunities for multinationals to deepen and broaden their engagement within the Chinese socio-economic dynamic. Of course, the competitive landscape will become even more intense and complex, in terms of (i) *how the contour of the playing field will change (?)*, and (ii) *how the rules of the plays will become increasingly complex and fuzzy (?)*.

Accordingly, we do believe that in order to develop a profitable, meaningful and sustainable presence in the emerging Chinese business landscape, multinationals must design and execute strategic moves fundamentally different from the formula they have followed for the last two decades. If the new formulae are well thought through, the upside could be significant, so significant that China could not only account for more than one third, if not one-half of a company's revenues, but more importantly offer companies access to sources of competitive advantage which they could leverage worldwide.

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These sources of competitive advantage include China's commitment to building advanced manufacturing and next generation innovation/R&D infrastructure and further developing large-scale experiments/programs¹ that the Chinese government will be investing in over the next 25 years. Given this backdrop this paper addresses three questions:

1. As China adjusts to the changing geo-economic and geo-political shifts and consumer preferences become more complex and sophisticated, what challenges might multinationals face to *effectively participate* in the next phase of China's economic development?
2. How do these challenges lead to *the new set of strategic imperatives* that incoming multinationals should adopt to enhance their penetration in the Chinese market *in a competitive and profitable fashion*?
3. Are there a set of "*universal governance guidelines*", specific to China, that multinationals should consider adopting to actively shape and contribute to the "*dynamics of change*" in China?



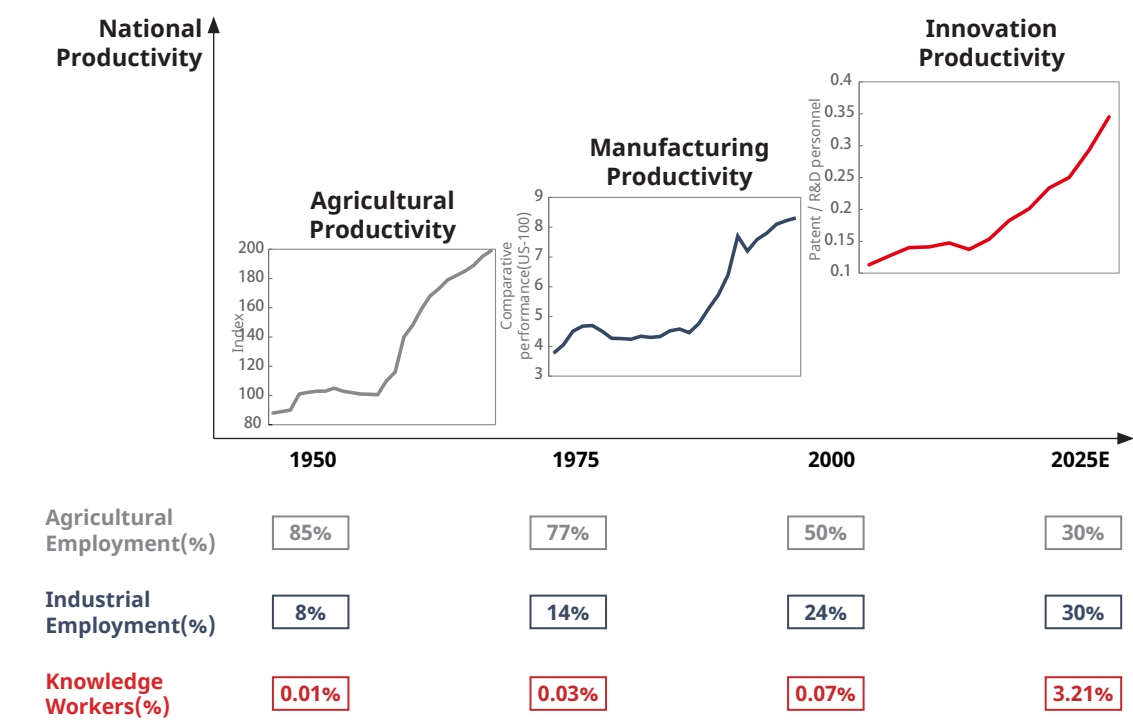
¹ To name a few projects and *mega scale experiments* on (i) renewable energy systems connected through intelligent grids, (ii) smart cities to significantly advance living and working conditions of average citizens, (iii) high speed transportation systems and (iv) the development of innovative "cross country trade and investment routes"; together such projects could involve \$40 trillion (based on provincial government statistics of China) of investments in the next ten years. Even if the US, EU and East Asian (from Japan, South Korea) multinationals could participate only in 10% of such investments, more forward-looking companies could carve out \$4 trillion of revenues from such projects over the next decade.

Next-Phase of Evolution of Chinese Market?

Since the founding of the People’s Republic of China, its socio-economic development has been impressive. Following the economic reforms in the early eighties leading to its entry into the WTO, China’s presence in the global economy and its economic clout has been on an unprecedented upward trajectory. Now, in retail stores across nations, it is difficult to find quality affordable products which are not manufactured in China. China is the largest trading nation and second only to the US both as a source & recipient of Foreign Direct Investments (FDI).

Significant increases in agro sector productivity in the fifties through mid-seventies and massive productivity in the manufacturing sector from the early eighties until the present have together shaped the economic landscape of the nation. In the last two decades, with increasing emphasis on new technologies, China has also witnessed a clear rise in innovation productivity as measured by the number of R&D patents filed. Exhibit 1 illustrates how the economic development progressed through various eras of productivity gains.

Exhibit 1: Productivity gains in various sectors of the Chinese economy



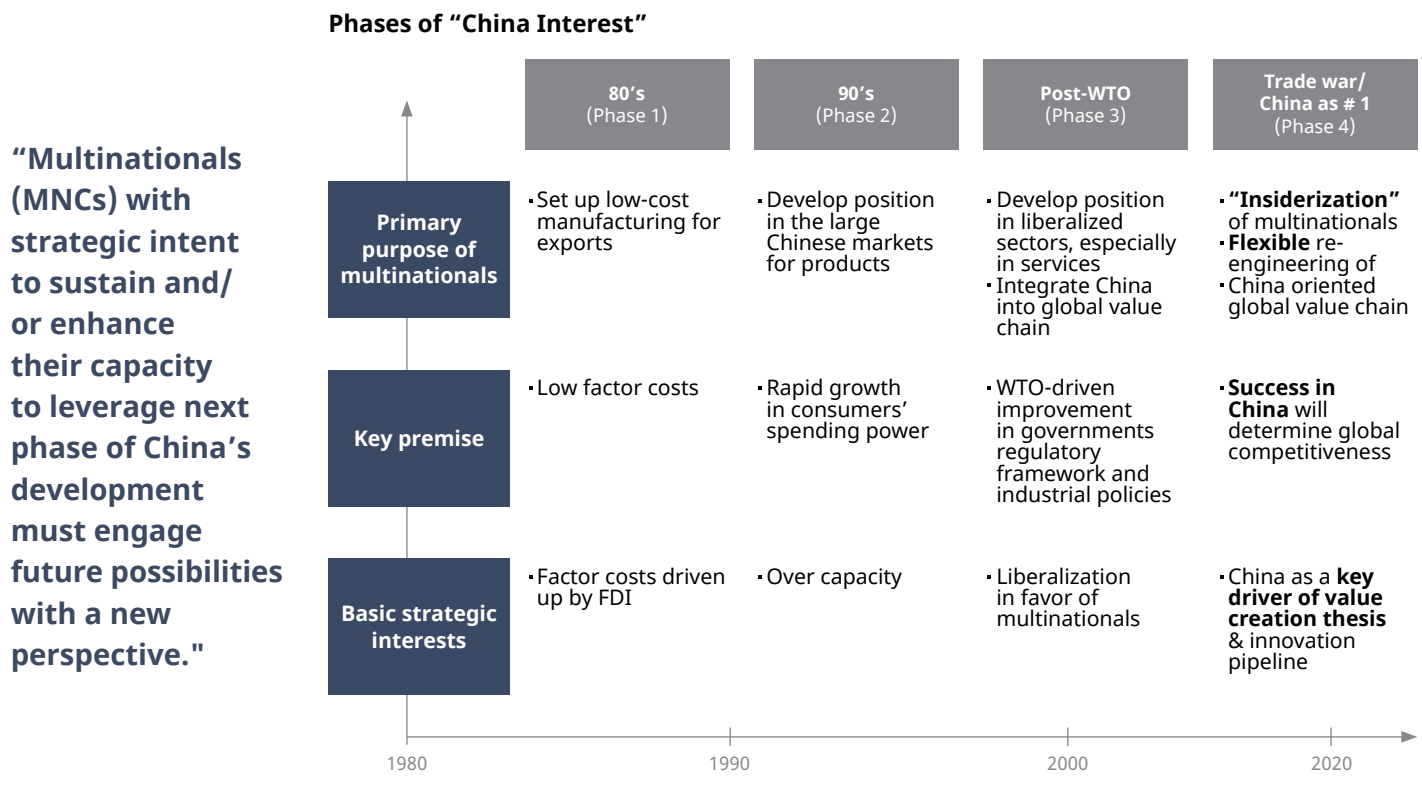
Source: China statistical Yearbook; China Agricultural Statistical Year Book/ World Bank;
Harry.Xu "Comparative labor productivity performance in Chinese manufacturing, 1952-1997: An ICOP PPP Approach"

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While growth in all around productivity has helped China to become a middle-income country on a PPP/capita basis, its socio-economic development has been uneven. Chinese government and corporates have to examine how, through new policy measures and strategic mechanisms, wealth creation can be more inclusive. As new policy mechanisms are put in place, consumer preferences continue to become more sophisticated and complex, domestic competition becomes technologically and managerially more advanced, - competitive dynamics across various segments of the shifting Chinese socio-economic construct will change in dramatic ways.

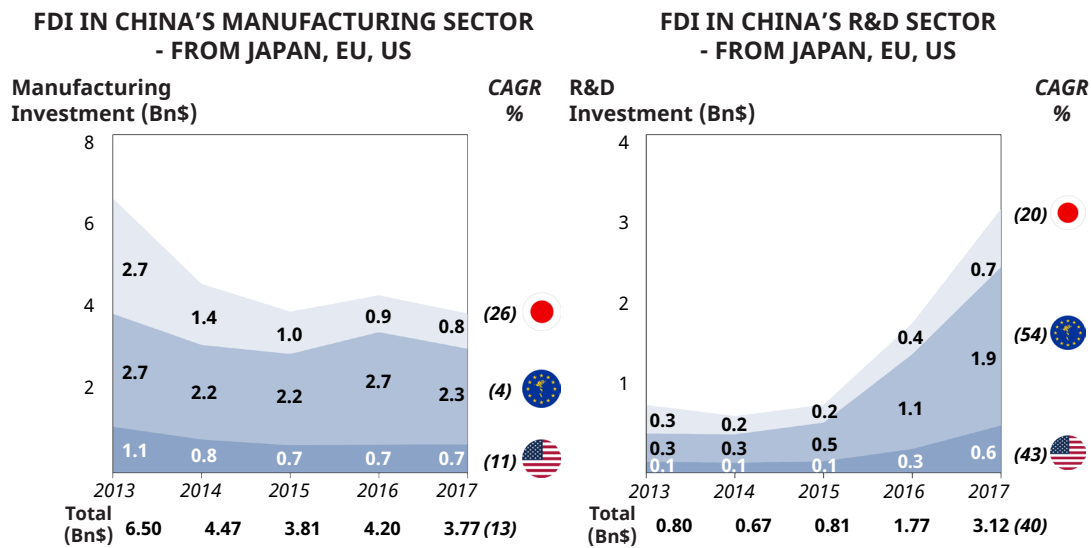
Multinationals (MNCs) with strategic intent to sustain and/or enhance their capacity to leverage the next phase of China's development must engage future possibilities with a new perspective. As Exhibit 2 illustrates, MNCs having travelled through three distinct phases of evolution in China are now entering a new phase, centered around complex trade and investment issues and further complicated by the unfortunate politics of COVID-19.

Exhibit 2: Multinationals' evolution in the Chinese economy



Indeed, as illustrated in Exhibit 3, over the past 5 years multinational investments in China have been shifting from the access to low cost manufacturing to the investment in R&D and innovation management.

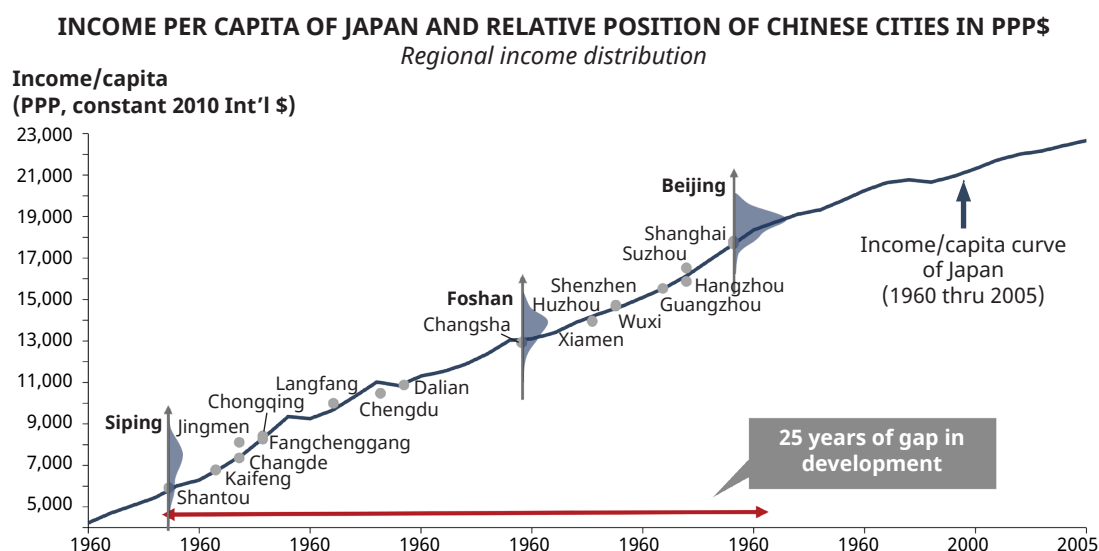
Exhibit 3: Multinationals’ investments in the Chinese economy



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- a) *Engagement with Chinese marketplace:* As China transitions from a middle-income to a high-income economy, multinationals will be increasingly presented with high value add, but significantly more fragmented opportunities. In order to benefit from the increasing disposable income across various cities/towns which are at different levels of development, multinationals will be required to be more sensitive to a widening range of consumer preferences (Exhibit 5).

Exhibit 5: Income per capita of select cities & towns across China



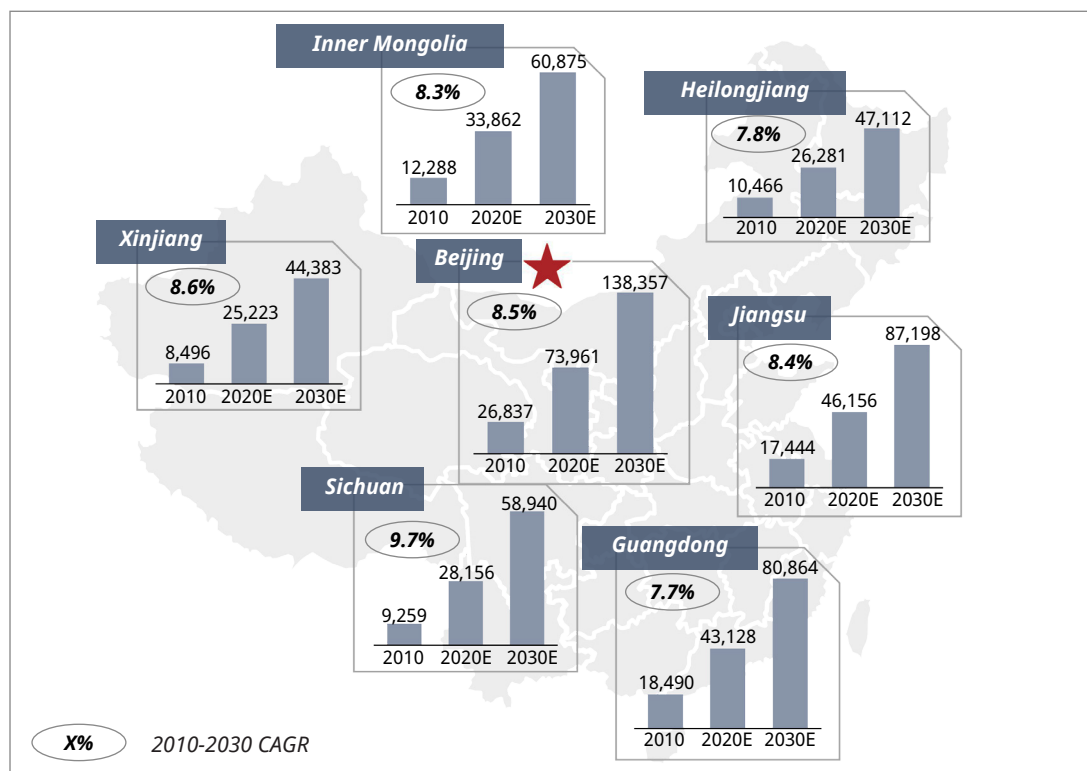
Source: EIU data

As Exhibit 6 indicates, while the per capita income in various provinces will enjoy impressive growth, it is important to recognize that provinces such as Xinjiang, Inner Mongolia, and Sichuan, which have lagged behind those in the eastern part of China, will reach per capita income levels similar to the current per capita levels in Jiangsu and Guangdong provinces by 2030.

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Exhibit 6: Disposable income changes across provinces in China

Disposable income per head of key provinces



- Disposable income per head of western provinces in 2030 will reach 2020 coastal provinces level
- Rapid growth rate of western and middle provinces will benefit from urbanization
- Future growth of northeastern provinces will slow down without industrial transformation

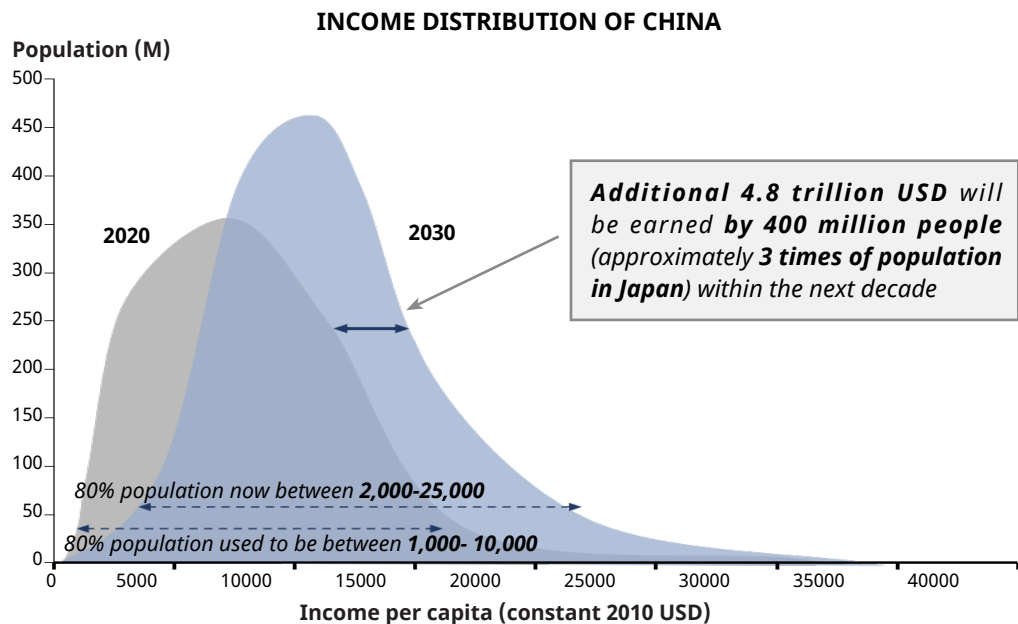
Leading local brands

	AUTO	FOOD/ BEVERAGE	HOME APPLIANCE
Beijing	Changan	Huiyuan	Xiaomi
Guangdong	Byd	Ganten	Media
Heilongjiang	Hafei	Firmus	/
Inner Mongolia	Hawtai	Yili	/
Jiangsu	Naveco	Yurun	Ecovacs
Sichuan	Yema	Viee	Changhong
Xinjiang	Haval	Terun	Huazhu

Source: EIU data

While both domestic Chinese companies and multinationals will be presented with a widened economic base, it is important to realize that in the next ten years close to an *additional 125-150 million* people will move into economic zones where the per capita income is in excess of \$12,500 and those consumers' preferences will be influenced by new trends (Exhibit 7).

Exhibit 7: Strategic implications of the shifting economic base



STRATEGIC IMPLICATIONS

With the shift in the income distribution curve, consumer aspirations will be increasingly sophisticated and diverse. **Several emerging themes** (not comprehensive) that will impact consumers differently are:

- **Self-expression** – conscious of being different and need to express individuality
- **Adventurism** – desire for new experiences (enabled by new technologies) explore “unknowns”
- **Spirituality** – inner search for purpose/meaning
- **Connectivity** – in need of an antidote to loneliness in a modern society – new forms of socialization (?)
- **Confidence** – renewed faith in cultural heritage
- **Balancing** – preservation of mental and physical fitness

These trends will require companies to be in a constant state of innovation in order to keep consumers engaged.

Source: CGIDD

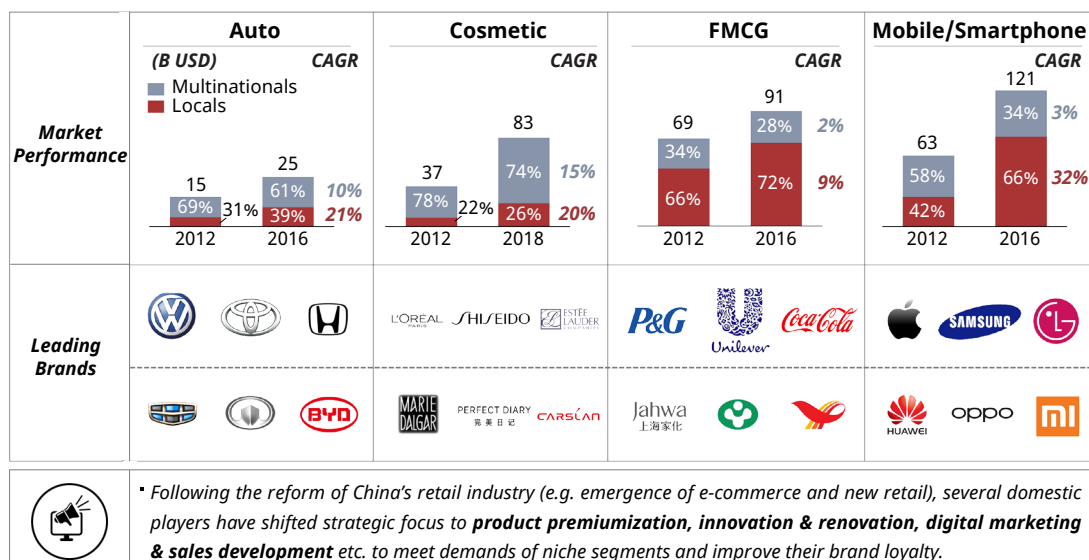
“In several important sectors of the economy, Chinese customers’ trust and confidence in local brands have been on the rise.”

Accordingly in order to (i) sustain, if not deepen, their position in the first tier cities such as Beijing, Shenzhen, and Shanghai and (ii) engage with more dynamic market segments in the second, third and fourth tier cities, it will require multinationals to examine how to differentiate against not only each other, but more importantly, domestic (national and local) companies, who have a deeper understanding of the user segments they serve. As Exhibit 8 shows, in several important sectors of the economy, Chinese customers’ trust and confidence in local brands have been on the rise. It will be natural to expect, as the size of the economic pie grows and the income distribution curve widens, competitive intensity will continue to increase in both B2C and B2B.

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Exhibit 8: Competitive dynamics across select sectors (illustrative)

Competitive landscape for select industries in China



Source: Desktop research

Clearly, multinationals will need to further sharpen their capabilities to *dynamically localize* product and services with “*differentiated value propositions and intelligent price points*” to serve fragmenting but financially more active socio-economic segments in China.

b) *Engagement with Chinese and provincial governments*: As the Chinese government (including the provinces) drive the next phase of China’s socio-economic development, multinationals should be sensitive to local and central government policies. Examples of policies that will be addressed over the next decade are:

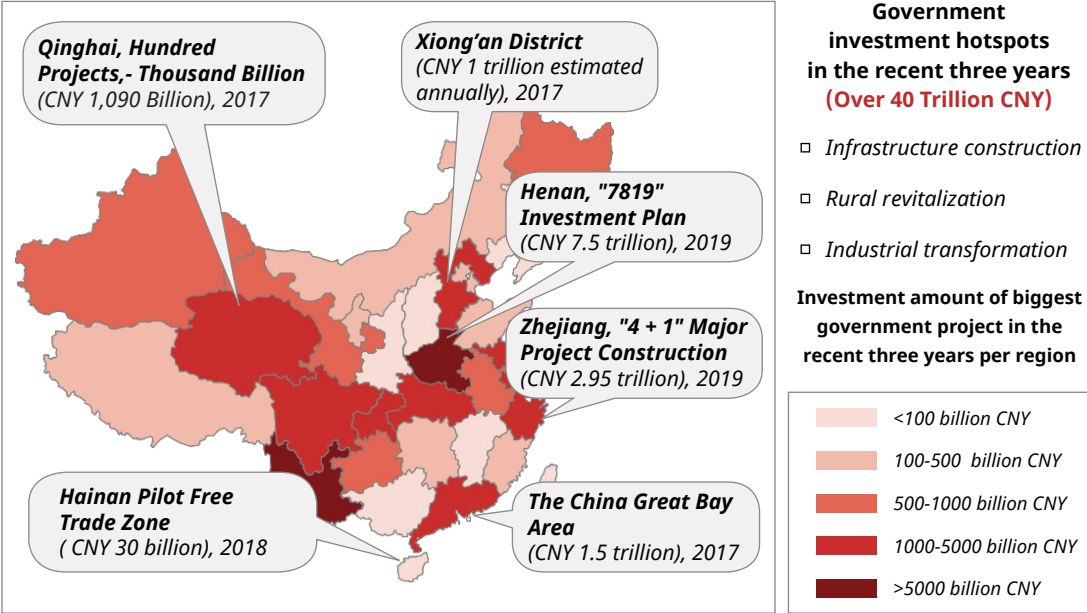
- Spurring *even distribution* of socio-economic development between regions through strategic investments in select regions (such as the development of local SMEs in Western China), which will stimulate domestic demand, and reverse rising Gini index trend
- Opening new trade possibilities with Central Asia and Europe and enabling development of economic buoyancies in multiple nations in South & South East Asia and Africa, thereby improving *the geo-economic and geo-political power balance* with various regions of the world
- Developing new “*high value added*” products/services which are less dependent on cost advantage and more driven by innovation in “*value creation*”

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In this context, multinationals will be well served to explore ways to engage with the mega government projects such as The Belt and Road, Smart City, AI application for educational reforms, and the development of Intelligent Cities. Together they will offer both domestic and multinational companies significant opportunities to work on state-of-the-art transformational projects which could have significant strategic implications in other markets – both advanced and less developed economies. Exhibit 9 illustrates large-scale Chinese government projects which could be of interest for overseas multinationals; they all address issues, which, though China specific, could be of major strategic value in different regions of the world.

Exhibit 9: Large-scale Chinese government projects across select provinces

Scale of government projects across regions



Source: Chinadaily

Exhibit 10 provides some of the essential features of the initiatives that will be launched by the central government of China in collaboration with provincial governments – which multinationals should find ways to engage with.

“Together they will offer both domestic and multinational companies significant opportunities to work on state-of-the-art transformational projects which could have significant strategic implications in other markets – both advanced and less developed economies.”

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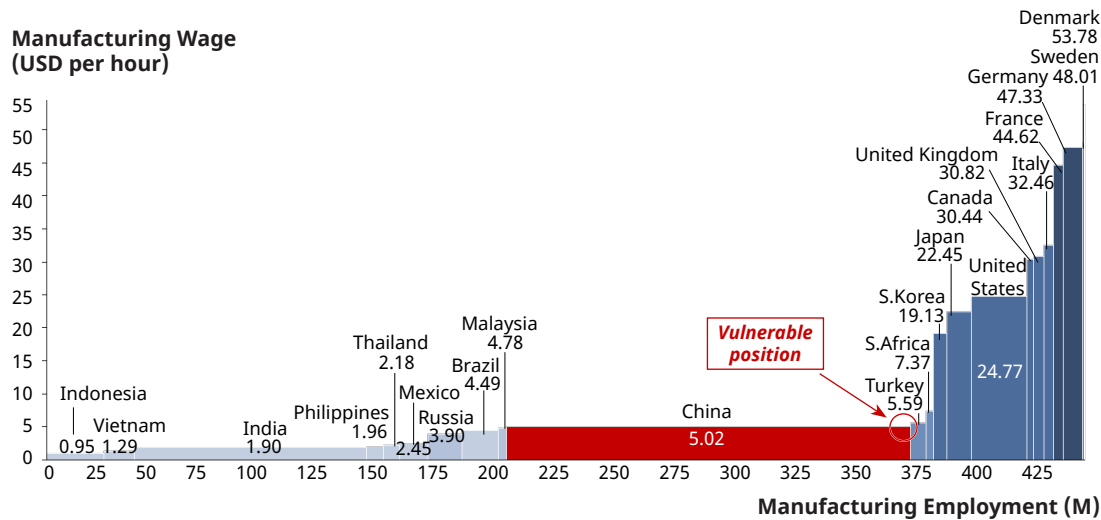
Exhibit 10: Mega Chinese government projects to address strategic issues (illustrative)

		<i>Synopsis of projects</i>	<i>Illustrative implications</i>
Mega project	The Belt and Road Initiative 一带一路	<ul style="list-style-type: none"> Promote infrastructure construction across Asia, Europe and Africa Strengthen the network connection between involved regions 	<ul style="list-style-type: none"> ✓ Will enable application of smart infrastructure technologies? ✓ Investment in high-tech projects will accelerate innovation in AI technologies
	Made in China 2025 中国制造 2025	<ul style="list-style-type: none"> Reduce China's dependence on foreign technology Promote industrial transformation 	<ul style="list-style-type: none"> ✓ Open up opportunities in new energy vehicle, advanced robotics and AI ✓ Enable participation in "industry upgrade and transformation" programs
Key policies	Strengthen weak areas 补短板	<ul style="list-style-type: none"> Reduce poverty with heavy investment of infrastructure construction Boost rural revitalization 	<ul style="list-style-type: none"> ✓ Significant investments in transportation, energy, and environmental protection nationwide will offer range of possibilities
	Internet Plus 互联网 +	<ul style="list-style-type: none"> Adapt integration of the Internet and traditional industries Elevate information technology industries 	<ul style="list-style-type: none"> ✓ Next stage development of cloud computing, big data, and IoT integration ✓ Develop disrupted channel along with the elevation
National strategy	World-class city cluster 国家级城市群	<ul style="list-style-type: none"> Coordinated development of regional economy Promote regional trade and industrial cooperation 	<ul style="list-style-type: none"> ✓ Take part in industrial transformation ✓ Explore business opportunities in infrastructure construction

- c) *Reconfiguration of global supply chain*: As the average wage rate of the manufacturing sector rises (Exhibit 11), the politics of tariffs and trade disputes become more intense and complex. In addition, the coronavirus further triggered the need for diversification in global sourcing options meaning that multinationals in China must reconfigure their "global supply chain thesis". They will need to reassess *how their engagements with China in the context of global marketplace have to be reformulated*.

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Exhibit 11: Size of manufacturing labor pool and wage rate of select nations
GLOBAL SUPPLY OF MANUFACTURING LABOR SUPPLY VERSUS WAGE RATE (\$/HR) 2018



Source: International Labor Organization; ILOSTAT; China Statistical Yearbook; U.S. Bureau of Statistics; Ministry of Labor, Employment of India; Central Bureau of Statistics Indonesia; Instituto Nacional de Estadística y Geografía; General Statistics Office of Vietnam; Philippine Statistics Authority; Statistics South Africa; Federal State Statistics Service; Department of Statistics, Malaysia; KOSTAT; Ministry of Health, Labour and Welfare; World Bank; Our World in Data

Accordingly, during the next phase of China’s development, the leaderships of multinationals will be required to re-examine their approach to China with a fresh perspective along multiple dimensions.



Strategic Imperatives for Multinationals: Need for High-resolution Dynamic Strategic Management Process?

In view of the discussions above and our experience in serving companies in China, the traditional practice of strategic management process which often is “headquartered centric” and based on high-level segmentation of the Chinese market is no longer sufficient. It is important for companies to develop necessary systems and skill sets to harness the power of high-resolution strategic models so that they can form strong, sustainable bonds with the local consumers, and governments as well as innovatively fuse both bottom-up and top-down perspectives.

For example, changes in the apparel & fashion, food & beverage, personal & healthcare markets and the likes, are driven primarily by the boom in the disposable income in different provinces in China. This new and somewhat unfamiliar socio-economic dynamic has indeed raised the bar in terms how companies must prioritize and time their value propositions for the right/target segments against multiple and different competitive instincts. Winning this new game with superior volume and margin growth will require multinational companies to build options into the value proposition and asset mix for enhanced strategic flexibility. *This provides a company with access to a strong hand of cards to play with – vis a vis four types of competitive instincts (multinationals, national, regional and local companies).*

We have observed that the traditional strategic management processes and organization models which are headquarter centric, implicitly overlook the complexities and uncertainties associated with various micro-segments in different provinces throughout China – as well as the resulting intensity of competitive dynamics. As a result, MNCs which had a head start because of the novelty of their value propositions are increasingly playing catch-up.

It is important to realize that conventional strategic management processes (SMPs) of MNCs in China, which are essentially geared to serve the headquarter’s operational and budgeting plans, are often limiting. Such processes may work when industry outlook is generally linear and the line management has the necessary insights and analytical capabilities to convert the corporate strategic direction into long-range game plans for local markets. Otherwise, we have observed that conventional SMPs typically fall short of their critical mission of enabling the national level management to make quick decisions when competing against local rivals and multinationals with localized business processes.

“It is important to realize that conventional strategic management processes (SMPs) of MNCs in China, which are essentially geared to serve the headquarter’s operational and budgeting plans, are often limiting.”

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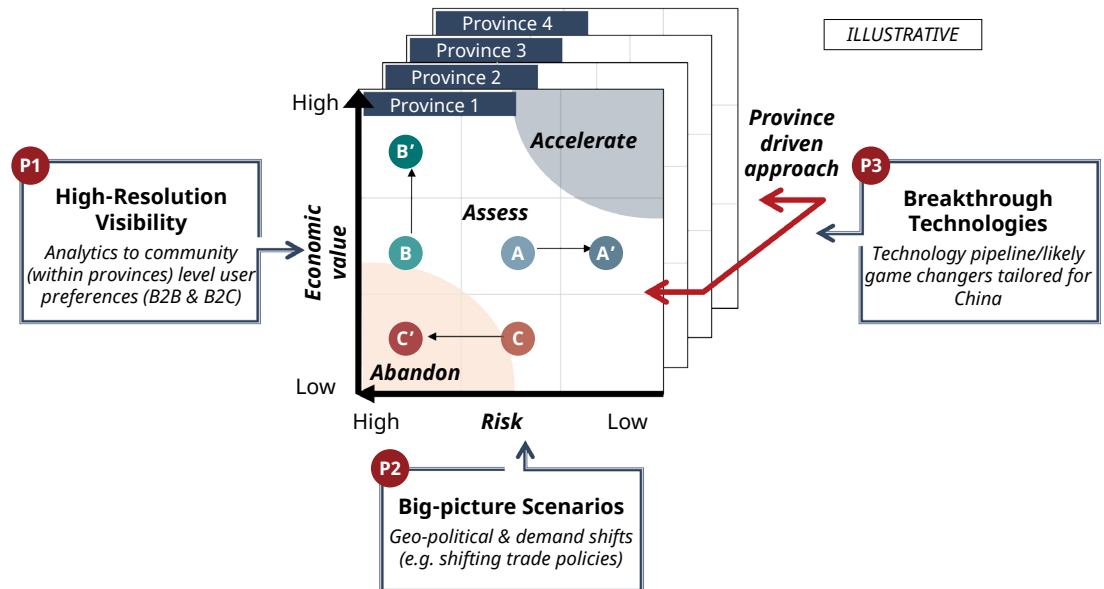
In fact, not infrequently must the dynamic executives of MNCs in China go around the traditional planning process, regardless how masterfully orchestrated for making ad hoc decisions (in responses to local competitive forces) without sufficient analyses and debates. This is because the annual process is not agile enough to respond to new information. Another reason is that planning is in general done at MNC headquarters by business units that executives focus on individually. Indeed, most executives often do not have the bandwidth to develop deep enough knowledge of every business unit in the context of China's competitive dynamics and, as a result, the process unfairly appears cumbersome and time-consuming.

Looking ahead, it is important to recognize that the SMP's role should not be to predict the future and eliminate management's fear of the unknown by putting on paper the strategic direction that has already been set. Instead, given the strategic significance of China, the role of SMP should be to provide leadership in China and at the headquarter analytically-sound understanding of the dynamics of the competitive marketplace and guide management to structure and make hard decisions and place bets, in view of increasing uncertainties in the future.

Accordingly a robust strategic management process must power the local leadership at various levels of decision-making hierarchy to (i) develop high resolution understanding of market dynamics and stronger strategic resilience through smarter structuring of realistic choices, (ii) examine "big picture" scenarios as they relate with geo-political risks vis-à-vis China and (iii) develop and leverage breakthrough technologies ahead of competition. As shown in the Exhibit 12 through responsible integration of the three different perspectives, leadership of MNCs in China should define a portfolio of initiatives/capital programs in each province that innovatively balance economic value and risks across different provinces.

"Accordingly a robust strategic management process must power the local leadership at various levels of decision-making hierarchy."

Exhibit 12: Essential perspectives to manage strategic initiatives
Three Key Perspectives for Dynamic Portfolio Management Across Provinces



Particularly for technology-based businesses, it should be no surprise that quantifying the value of technology for different businesses/asset types is critical to building future flexibility and agility to stay ahead of, or respond to, competitive moves. Our experience in helping clients has consistently underscored how well-structured decision analytics and thinking could provide sharper understanding of dynamics between various technical and market/channel variables in structuring and making choices. In turn this understanding, particularly in capital intensive businesses, advances the likelihood of improving economic outcomes of capital projects.

In short, a forward-looking strategic management process must provide leadership of MNCs in China certain essential features. These are:

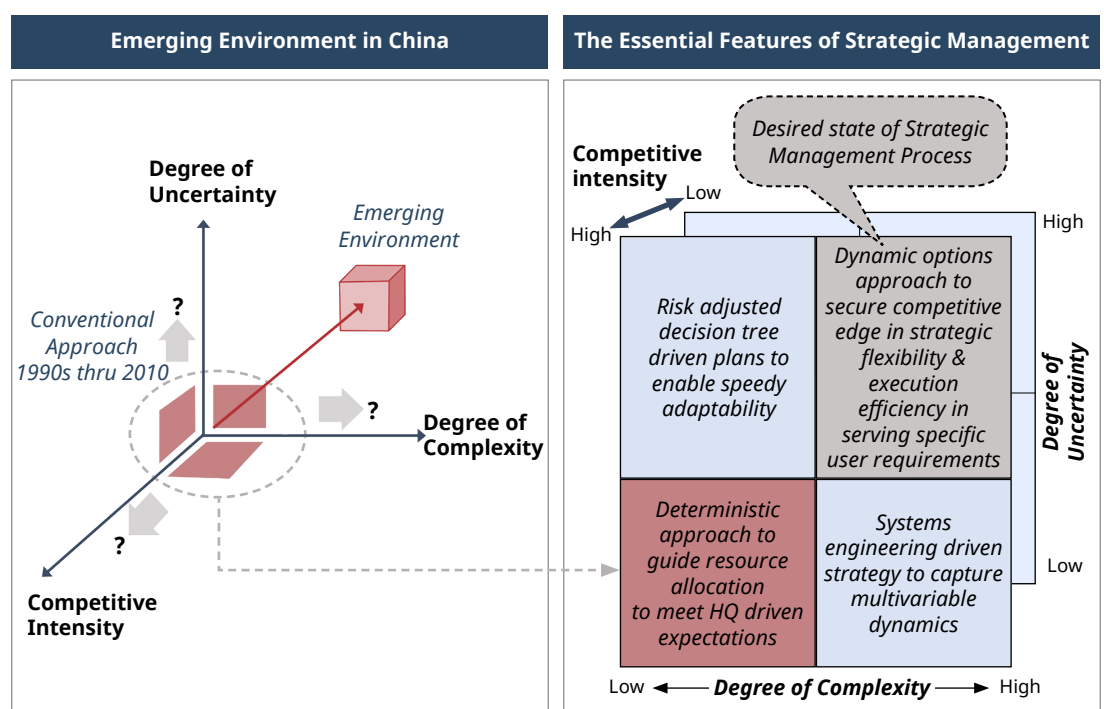
- Full visibility into various variables that drive uncertainty at micro-segment levels and how the interactions between them influence complexity of user preferences
- Improved understanding of the economics of various assets/channels for different technology outlooks as new information becomes available over the operational life of an asset vis-a-vis competitive moves at local and national levels
- Continuous focus on company-wide issues with relevance to multiple business units, and synergies between them at headquarter as well as field levels

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- Analytical discipline to enable practical and results oriented discussions/decisions relative to competitive moves and/or changes in government regulations (province and/or central)
- Enhanced organizational capability not necessarily to enable “more, better and faster” of the same, but to trigger “smarter game changing moves”, leading to decisions linked to the strategic management process

The above list is just a thought starter, and of course not comprehensive. To break old habits and to realize the value of flexibility in today’s dynamic environment, an MNCs’ strategic management that is China centric and is in sync with headquarter processes must capture possibilities with a rigorous analytical discipline, deploy new ways to guide management with options and choices, and help improve strategic decision-making process. Given that the competitive environment in China is transforming in a rapid fashion, it is indeed timely to reconsider the essential features of the SMP. Exhibit 13 illustrates how a relatively complex, uncertain and enhanced competitive environment will require MNCs in China to shift SMP’s basic architecture from “deterministic” to “dynamic options based” to improve strategic flexibility and capital efficiency.

Exhibit 13: Strategic management to reflect changes along 3 critical dimensions



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In the current competitive environment characterized by the possibilities of sudden game changes and heightened uncertainties, a robust SMP must acknowledge that there should be no one perspective on different dimensions that shape the future possibilities or risks. It is my belief that the renewed SMP must enable MNC's senior management to dynamically link its sources of competitive advantage across assets (outlets or factories) with its capital and technology programs in the MNC's global ecosystem.

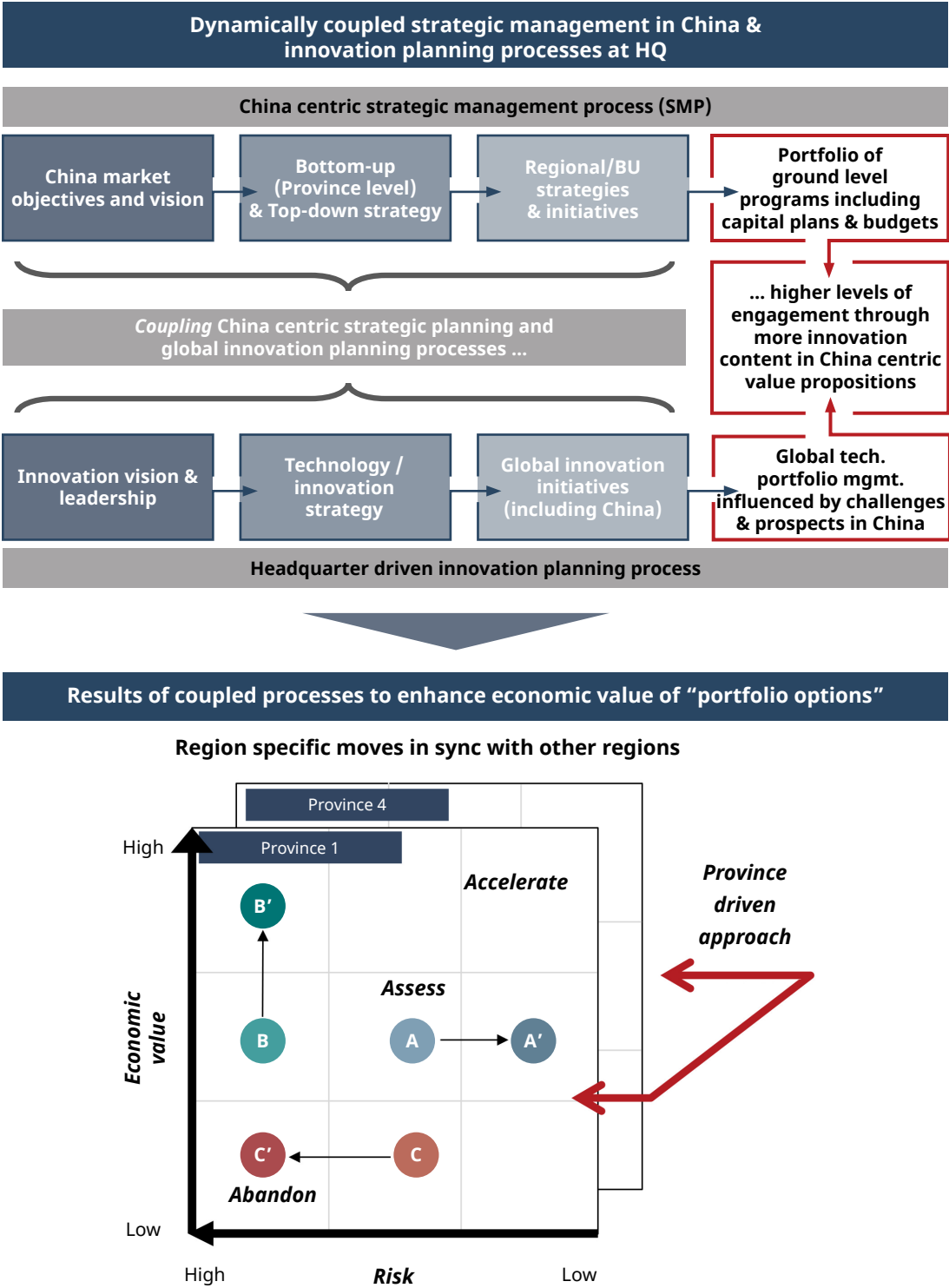
In practice, a robust SMP should provide business units and the leadership group the basic guidelines that will drive the strategic review process, leading up to 3 to 5 year operating plans (embedded with options) and finally the annual budget for the next year. All along the annual cycle it is important that planning process reflects the fresh information from the latest experiments, pilots and projects from all the assets vis-a-vis competitive moves and market conditions.

In addition, developing insights and making decisions on investment portfolio requires rigorous management debate against a background of an often fuzzy and ambiguous environment. Therefore, one critical building block at the starting position of the process should facilitate discussions on value creation thesis based on multiple scenarios, and deep understanding of the underlying factors that drive uncertainty. With this approach, the planning process could enable transformational/strategic plays in acquisition and development of assets as well as deploying speedy tactical moves.

As a result, the value of the revamped SMP will be increasingly defined by how various steps of the process could systematically reflect technological inputs from an MNC's global technological assets; it is essential that China SMP directly links to HQs' global SMP. As Exhibit 14 illustrates the coupling between the two processes has to be clearly defined, designed and deployed.

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Exhibit 14: Coupling of China SMP with headquarter driven innovation process



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Given that new technologies with game changing possibilities are rapidly emerging, either changing the economics of legacy assets and/or triggering viability of new assets, the annual planning process should be viewed as a dynamic journey, not just a bounded exercise. In practice, through such an understanding, tools like Monte Carlo simulation can be applied to quantify levels of uncertainty in cash flows and then factor in real options algorithms to value strategic alternatives that management could execute in response to, or, preferably, stay ahead of competitive moves within each micro-segment.

For the development of a China centric “dynamic SMP”, the application of advanced analytics could not only enable sharper strategic decisions in deploying a portfolio of value propositions, but also result in efficient management practices in operations and in conduct of pilots and CapEx projects. Powered with insights into what drives value creation across different assets across provinces, the proposed “SMP concept” will enable executives at the corporate center and BU leaders to successfully intervene in and/or contribute to the China centric planning process and decision making, thus challenging operational plans and resource requirements/allocations for various initiatives.

In summary, leaderships of MNCs in China through the proposed dynamic SMP should enhance and leverage their “high-resolution analytics horsepower” to accurately read early signals from the market, especially in unfamiliar territories, to credibly serve local consumers and minimize errors in design of experiments or launch of new value propositions, thereby staying ahead of competition and driving the innovation of value propositions.

Organizational Guidelines of The Future: Becoming An “Insider”?

Accordingly, in order to effectively participate in the next phase of the Chinese miracle, MNCs must embrace a variety of business and organizational models that are each adaptive towards each other and, as a whole, adaptive to the emerging socio-economic dynamics in China. Strategies must be integrative, yet distinctly customized to local communities in both China and international environments.

Our experiences serving MNC leaderships in China suggests that in developing scenarios, structuring choices, making judgment calls, and guiding HQ management, forward-looking organizations must learn to come to terms with the complex dynamics and spectrum of hard and soft variables – some internal and several external to the organization. Such variables include: *(i) the formal and informal interfaces between corporate HQ and China HQ, (ii) regular operational challenges such as infrastructure inadequacies/disruptions and their effects on supply chain linkages (local, national and international), (iii) changes in community-level expectations, local political instincts, local management and labor aspirations, (iv) shifts in regulatory challenges, national political expectations and (v) complex interfaces with ever-increasing international advocacy groups.*

As a result, to be strategically and operationally effective in China, multinationals have to embrace a few essential imperatives:

Leadership development for improved engagement with China:

In order to achieve such a dynamic state, leaderships of multinationals have to ensure that organizational capabilities in terms of sensing, processing and pursuing opportunities at different levels of integration and decision-making hierarchy are continually renewed as well as sensitive to the emerging complex dynamics in China.

Multinationals will need to develop several innovative mechanisms to cultivate leaders (both located in China and at the headquarter) with a wider skill set and “behavioral and attitudinal” resiliency. Accordingly, local talents with a deep understanding of the local environment will need to seamlessly integrate with global management so that the vertical and horizontal synergies become natural within the organizations.

For example, Unilever believes that a localized workforce and management can better address the demands of Chinese consumers; in fact, ninety percent of the current management team is recruited and trained locally. Such mechanisms should include:

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1. *Revamped recruiting processes* that, in addition to conventional approaches, should include universities in the second and third tier cities so that multinationals can bring together technical and managerial talents from different regions of China;

2. *Career development process* should be managed such that, in the long-term, a significant percentage of senior managers at HQ, as well as China's leadership team are Chinese nationals;

3. *Executive development process outside of China* should ensure that a significant percentage of personnel who take on leadership roles have a deep understanding of China.

We do believe that as companies tailor their recruiting and development of scientific, technical and management talents in China, a well-designed communication system could help multinationals to develop more positive goodwill (relative to the prestigious organizations in China) with universities and trade schools. For example, Unilever in China organizes multiple campus recruitment programs, including Elite Training Camp, and U Family Training Camp to develop active communication channels with local graduates in various universities across China.

Executive development programs that help country-level CEOs/leaderships of MNCs in China, cultivate the confidence and analytical rigor to embrace complexity, are essential. Such programs must help the "CEO designate" or country CEOs to develop the art and science of tracking, calibrating, and analyzing variables from multiple domains. Such specialized training programs must help leadership of MNCs in China to sense likely opportunities, make intelligent judgment calls in structuring choices, and guide corporate management on important geo-political and geo-economic issues – which are China centric.

Operational Dos and Don'ts: Managing "bottom-up" and "top-down" strategic moves

In order to secure long-term relationships in the local environments in various provinces in China, which are all rapidly transitioning from the old socio-economic structures to the new ones, national leaderships of MNCs must track, understand, and analyze such changes closely. This will help them both develop new opportunities and be accepted as an organization interested in the well-being of local communities. We have frequently heard from several senior managers who hail from local environments, that often managers when assigned from HQ have difficulty appreciating the subtleties of the local environment, often leading to situations that are easily exploited by local competitors.

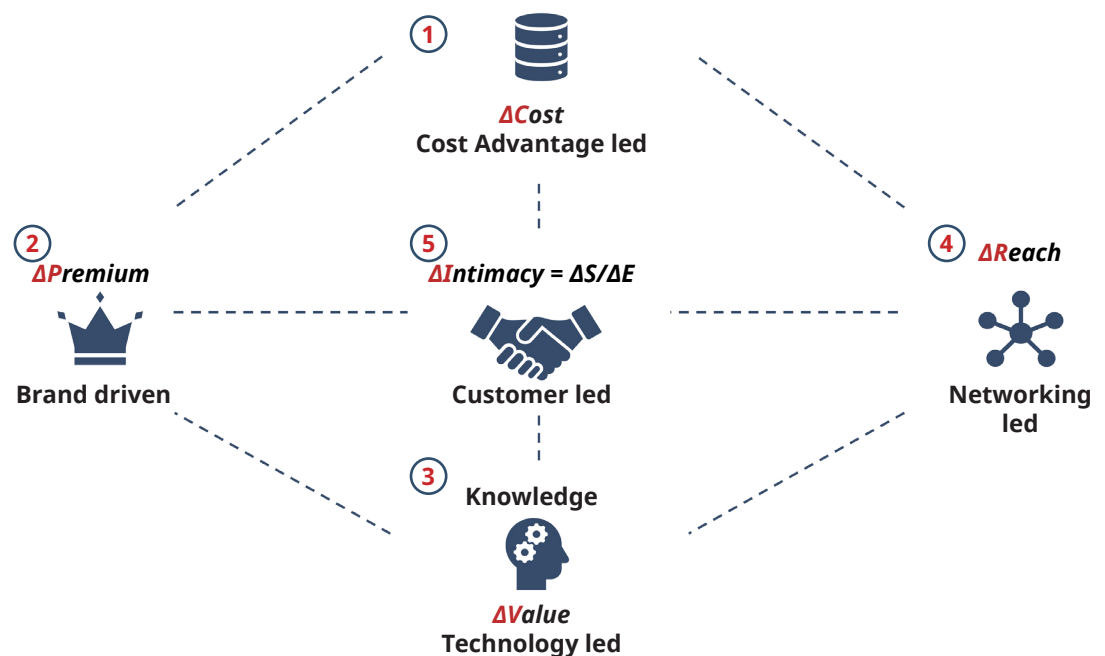
NEXT PHASE OF CHINESE ECONOMIC MIRACLE: HOW MUST MULTINATIONALS MAKE STRATEGIC ADJUSTMENTS?

One of the biggest challenges for MNCs is to develop the skills of earning trust in different cultural settings in a genuine fashion. Particularly in the B2B space in local environments, Chinese companies, particularly the SMEs (as competitors), are more responsive to local B2B customer requirements, in turn better positioned to gain that trust. In fact, while established MNCs rely on their brands, marketing, and cutting-edge technologies, local companies are more engaged with customers in the problem-solving process and, in turn, build trust-based relationships with target customers.

In view of the above, as multinationals localize, perhaps the most difficult task for country heads will be balancing standardization with customization and integration of the other nations with the overarching global strategy. A CEO working with the local marketing team will need to continually extend the unique brand experience through customized channels and offerings maintaining the global brand aura and still appealing to customers in the authentic local way. Accordingly, for each of the local markets MNCs will need to learn how to innovatively orchestrate the five sources of competitive advantage (Exhibit 15) in a dynamic fashion.

Exhibit 15: Strategic differentiation driven by the combination of different factors

Partha Ghosh **Pentagon Model**



$\Delta S / \Delta E$ = Service/Customer experience advantage

NEXT PHASE OF CHINESE ECONOMIC MIRACLE: HOW MUST MULTINATIONALS MAKE STRATEGIC ADJUSTMENTS?

The multinationals that will be able to build sustainable and competitive business models will be those which can both take full advantage of their global scale and corporate IPs and respond better than local competitors in serving specific requirements unique to the local environments in China.

In order to reach such a state, as discussed earlier in Exhibit 14, MNC leadership in China must formally integrate bottom-up innovation into the strategic management process often led by senior management. In doing this, a two-way innovation process from the corporate center to the market and from the market to the corporate center would need to be established, managed, tracked, and measured as a “core system” within the enterprise. In the process, country-level leadership can make better use of existing (and often untapped) local talent for innovation in various provinces, particularly from those segments of society who have traditionally felt overlooked.

Indeed, in the emerging competitive environment in China, there has to be a shift in the relationship between business and society. Country CEOs of MNCs will be increasingly expected not just to meet top- and bottom-line targets, but to help solve social problems in various communities in which they operate, in turn managing the “insiderization process” in the diverse communities throughout China. Accordingly, HR and CSR policies of MNCs need to be adjusted to the local cultures if MNCs wish to develop a high-quality presence and effectively become insiders in different local communities.

“Plus sum” engagement with Central and Local Governments: Calibrating political and government policy instincts in a proactive fashion

Political and bureaucratic leaderships within China realize that failing to achieve an optimal balance between free market forces and policies to guide those forces in various provinces could be a risk to the political and socio-economic stability. Clearly as China’s socio-economic miracle moves onto the next phase of development, the local, provincial and central governments will become increasingly more sophisticated in using their “visible hand” alongside the “invisible hand” of the market to guide corporate behaviors.

As a result, in the rapidly changing economic environment, CEOs of MNCs in China operating in various regions in the nation must develop the ability to proactively sense political instincts at multiple levels and analyze policies that governments wish to promote accordingly. MNC leadership must be able to guide various corporate interfaces with different political and government constituencies (formal and informal) in such fashion that judgment calls both at the country level and at the corporate center are based on a 360-degree understanding of the complex dynamics between various environments on a wide range of policy and political issues.

NEXT PHASE OF CHINESE ECONOMIC MIRACLE: HOW MUST MULTINATIONALS MAKE STRATEGIC ADJUSTMENTS?

Moving forward multinationals in China will have to be extremely sensitive to the emerging geo-political dynamics. Given higher degrees of political and economic complexities, and the current US-China trade tensions, multinationals must nurture a greater willingness to innovate, experiment, and develop new models of engagement with different targeted communities and user segments in China, while ensuring that the political equations between governments are not upset, if not diplomatically coordinated.

Most importantly, as the mutually suspicious and often adversarial relationships (such as trade wars, Coronavirus related geo-politics, IP related tensions) that have become increasingly visible across governments and companies, multinationals have to work towards securing mutually respectful and complementary relationships. Multinationals have to increasingly demonstrate that they understand and empathize with:

- The socio-economic and political priorities of the Chinese government at the central, province, and even local levels;
- The cultural differences between communities, particularly in terms of how people in the local environment relate to the workplace and the communities they represent;
- Social and political constraints that are invisible to outsiders, yet real because of the beliefs and values specific communities have inherited from the past.

As multinationals develop a more balanced global presence, astute leaders (particularly country heads in China) must take strategic positions that allow for flexibility—maximizing economic benefits from visible growth opportunities, but also minimizing potential risks from sudden policy or political shifts.² Furthermore, as local governments attempt to manage certain social and political tensions within local communities, country heads—with the support of HQ leadership—will, instead of being passive observers, need to carefully and diplomatically participate in government initiatives, which in normal situations may be viewed as out of their scope.

Finally, multinationals will need to learn how to develop and operate new forms of alliances with governments across multiple provinces often including multiple stakeholders and guided by multilateral agencies. These alliances would assist in modulating markets in addressing issues related to global finance, global warming, carbon trading, global logistics, cyber security systems and global pandemics.

² It is important to note that politicians and bureaucrats in developed and developing regions in China will face a very difficult balancing act to sustain the economic development while developing international trade and investment flows. Securing the right balance between different stakeholders and population segments will not be easy, and accordingly, sudden shift in political priorities should not be ruled out.

NEXT PHASE OF CHINESE ECONOMIC MIRACLE: HOW MUST MULTINATIONALS MAKE STRATEGIC ADJUSTMENTS?

Multinationals such as Caterpillar, GE, ExxonMobil, Phillips, Siemens, and Royal Dutch Shell, to name a few have demonstrated significant strategic and operational resiliency in innovating different “government-cooperation” models, which could offer multinationals a few hints on how to shape their global strategies. Of course, companies with different leadership aspirations will need to innovatively tailor specific approaches which respect distinctive characteristics of specific industries.

* * *

The changes that are taking place in the Chinese economic landscape are indeed significant. Equally significant will be the nature of changes organizations must undertake to serve the emerging opportunities in both China and global markets. Moving ahead, leaderships of overseas multinationals have to become more selective in making strategic choices and increase flexibility to speed up or slow down, expand or defer, or restructure development of major programs. With increasing complexity of market behaviors, rising capital costs of technologies, and most importantly accelerating convergence of multiple technologies from both obvious and unobvious technological disciplines/domains, leaderships of companies in China will need to strategically sort through difficult issues related to game changing technologies while at the same time navigating through the shifts in geo-political instincts and biases relative to China.

Experience has repeatedly underscored that such transitions are difficult to manage, needing a compelling effort sustained over extended periods (such as 3 years) until the new rhythm becomes natural across different assets and the decision-making hierarchy of the organization. It will require not only introducing the new frameworks and analytical tools to different organizational units, which directly and/or indirectly drive the planning process, but also ensuring that management discussions and decisions continually reflect and are sensitive to the profound changes that are underway in China.

About the Author

Partha Ghosh is a management consultant and policy advisor with an extensive record of solving strategic, operational, and complex organizational issues in technology-based industries. He has consulted extensively in the Americas, Africa, Asia, Australia, and Europe. His clients view him as a “creative problem solver” and a “visionary leader”. He is currently in an advisory role with multiple organizations worldwide, and runs his own boutique advisory firm, **Partha S. Ghosh & Associates**, focused on policy and strategic issues. Previously, Ghosh was a partner at **McKinsey & Company**.

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