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TOMORROW'S CHALLENGES

HOW NOKIA SUCCEEDED IN CHINA

4 ESSENTIAL TIPS FOR MAKING STRATEGY WORK IN THE MIDDLE KINGDOM

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Winning in China is a top priority for senior executives at most Western multinationals but many are frustrated at their lack of penetration into regions and cities beyond “first-tier” cities including Shanghai, Beijing and Guangdong.

Worse than that, less profitable and less advanced market segments that were previously ignored by such companies have proved an effective training ground for local rivals such as Lenovo, the Chinese PC maker. In the past, the company wasn’t able to compete head-on with HP and Dell in these cities, so it concentrated instead on China’s rural retail sector; it did this so successfully that when it finally entered the Shanghai and Beijing markets its cost structure gave it a hard-to-match competitive advantage. It is now the world’s second-largest PC manufacturer.

So what should Western multinationals take away from how Lenovo – and numerous other Chinese businesses – are operating in these markets? The most important lesson is clear: they cannot wait for emerging segments to become attractive and then hope to sell their existing products there. They must instead grow alongside these seemingly unappealing but rising markets in order to preempt emerging competitors.

This logic is simple but executing such a strategy is far from straightforward. For a start, the Chinese government still exerts a critical influence across numerous sectors of the economy. Alongside this, any strategic initiative in these markets must be profitable, as no company can fund an unprofitable venture indefinitely. Finally, Western companies need to understand that the requirements of customers in these markets will differ from those elsewhere, and that growing here will require them to adapt their business model (often significantly) and to delay standardization and embrace practices that they would shun in mature markets.

Lessons from Nokia
Nokia may not be the first company people think of today when they look for business lessons. After all, a prolonged period of stagnation in its smartphone segment has forced the company to sell its entire mobile business to Microsoft.

Despite this, Nokia’s approach to winning the Chinese market, particularly the entry-level phone category, was nothing short of remarkable. It successfully established itself as the first mover in China to penetrate cities beyond the coastal areas; no local competitors – not even Chinese giants Huawei and ZTE – were able to unseat it until smartphones emerged in China and replaced the entire basic-feature phone category. From 2003 to 2008, Nokia China’s market share grew from 16% to 42%, not only surpassing other Western competitors but also preventing local firms from encroaching on its top position in the feature-phone market. If Nokia had not played its Chinese strategy so well it may well have ceased to exist a long time ago.

Our research has identified four key areas where Nokia did particularly well at the time, lessons that Western multinationals should pay attention to:

1. Enlist a cross-cultural ambassador. In 2004 Nokia appointed David Ho as the president for Greater China. Ho was raised in Hong Kong but spent his early career working with US multinationals, where he developed an appreciation of the subtle cultural differences. “In a complex organization like Nokia, who you know is far more important than what is written on paper,” he said. “You’ve got to understand the motivation of your counterparts, their fears and their hopes.” Hiring a leader that truly understands China and at the same time that can build unquestionable trust at the highest levels of the HQ is a decisive enabling factor for any MNCs success in China.

2. Clean up the house. When Ho was appointed Nokia China was involved in four joint ventures, each with their own geographies, local partners, manufacturing facilities and sales functions. There was little cross-coordination and a great deal of duplication in the management system. The joint ventures were even competing for sales with Nokia’s own sales force. Ho said: “Some customers had three different sales teams knocking on their doors - two from our joint ventures and one from ourselves. This could not work. We were fighting for margins against each other and it was simply too confusing for our customers.” After extensive negotiations, Nokia China consolidated the four local ventures into one, and later became the majority shareholder. “You really can’t do this overnight, but by offering something tangible to [our] counterpart from day one and building a reputation of fair play, we were able to cut out a lot of inefficiency and move to where we wanted to be,” said Ho.

3. Shift the center of gravity. Nokia was using cheap Chinese labor to assemble its final products but relying on foreign imports for components, making it impossible for it to compete effectively with local rivals. This changed when Nokia moved the design of its entry-level handset from Copenhagen to Beijing. With 40% to 45% of Nokia's annual sales generated by the entry-level segment, this radical shift brought Nokia important long-term advantages.

4. Demonstrate unflinching pragmatism. By the end of 2004 Nokia China had built a complete value chain for its local operation, which enabled its team to keep a close eye on local competitors and react quickly to changes in the market environment. For example, through field research in rural cities Nokia discovered that its Chinese competitors hired a lot of merchandise support staff on the ground but typically gave them little support. When it emulated the local strategy, Nokia provided its 7,000+ merchandise staff with an IT system, and each staff member monitored four or five shops to capture the daily sales volume across different brands and models. Armed with the daily data, Nokia was able to act faster than its local competitors in a rapidly changing environment.

The Nokia case delivers one last important message: multinationals have to keep an eye on two strategic imperatives. Becoming successful in emerging markets is a must, not just to increase revenues but also to be able to learn from and deal with the competitors of tomorrow. In addition, multinationals must continue to commercialize other cutting-edge technological innovations – just think of the way in which Nokia lost market share when smartphones stormed in to play.

A number of companies stand out in this area: IBM, GE, Unilever and Nestlé seem to have mastered the ability to advance the technological frontier in generating demand in developed markets while simultaneously innovating relentlessly in emerging markets. Reintegrating different business models to achieve scale and scope in their global operations is not easy, yet this is no longer an option for aspiring managers.

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