



CLUSTER COMPANIES IN CHINA'S ZHEJIANG PROVINCE - PART III

Will they take on the world?

By Professor Jean-Pierre Jeannet - July 2009

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In the last of three articles on industry clusters in China's Zhejiang Province, Professor Jean-Pierre Jeannot looks at the impact of today's economic downturn and how Chinese firms could switch from suppliers to competitors in a bid to grow business.

As Chinese companies developed cluster by cluster, they were mostly engaged as contract manufacturers for Western firms. Their "private label", or OEM (Original Equipment Manufacturer) strategies required them to deliver on time and at a low cost.

However their customers are precisely those firms rocked by the recent global economic crisis. No surprise then that order volumes from these companies to the Chinese OEM firms have declined by around 20%.

Whether in the consumer or industrial sector, these companies are now reviewing their strategies. For Western firms this should signal the end of the unlimited contract manufacturing drive with larger Chinese suppliers diverting capacity into their own brand development.

"Famous Chinese Brands"

So far, any own brand activity has focused on the local China market and less on exports. The Chinese government has even implemented a "famous Chinese brand" policy identifying and endorsing leading companies based on their quality of products.

Most of these brands can be considered "source brands", or "branded commodities", and do not yet live up to branding strategies developed in the US or Europe. It may help the leading companies or "cluster captains" achieve a stronger status, better pricing and preferred supplier status with Western customers. However the notion of supporting such suppliers with "famous Chinese brand" status and subsidies has been challenged by the US government at the WTO.

Some companies have already done well using Western branding approaches and competing in the local market against leading global firms, such as Nestlé, Danone, Procter & Gamble and Unilever. In the book "Made in China: The Secrets of Chinese Entrepreneurs" by IMD Professor Winter Nie and Dr Katherine Xin it appears a community of brand building experts is developing in China who are engaged in brand-intensive marketing and product development.

The Chinese cluster captains in our research study are aware that OEM branding is more subject to the global trade up (and down), and that firms who have their own brands are stronger. In fact, while OEM-based companies saw orders decline, some of the brand-oriented companies remained stable or continued to grow.

Babei, the leading men's tie manufacturer, has until now done most of its business through OEM contracts. The company is now developing its own brand globally with plans to open shops in key locations abroad and to expand into home furnishings.

Two leather cluster leaders, shoe company Kangna, and leather sofa manufacturer Mengnu, both operate from the leather cluster in Hainin. They are also planning to build their own brands globally, including opening stores abroad.

Our research suggests that we will see more cluster captains beginning to develop their own brands abroad with a “good quality for a reasonable price” strategy.

While many small companies will still depend on export orders, the best firms will move towards alternative business models. Cluster captains who are building brands may not do so in New York or London, but may pick Korea, Russia and Middle Eastern markets as their first targets.

Once successfully tested here, these branded-product exporters are likely to target Europe and North America with refined marketing and branding strategies. It may take no more than two to three years until will see a second wave of Chinese companies competing in developed economies.

Turning inwards

When Chinese contract manufacturers in the many industry clusters built their business, domestic business was not attractive. It was low volume and did not compensate adequately for capital investments. “Turning inwards” is now a new battle cry, and many firms we investigated are expecting the next phase of growth to come from the domestic market.

Shejiang Socks operates in the socks cluster - yes, there is such a cluster employing some 100,000 people and producing up to 30 billion pairs of socks a year (one in every three pairs of socks sold in the world).

The company began developing its domestic business two years ago and grew 250% in the first two months of 2009. Shejiang Socks now supplies international supermarket chains active in China (Walmart, Carrefour, Hymall, etc.) and plans to build its own stores. With the "famous Chinese brand" label it will eventually begin to build a global brand.

When cluster captains such as these begin to develop their domestic business, they do so in a market that has been upgraded through global companies coming to China, and a retailing infrastructure developed by global mass retail chains. Needless to say, this experience in the domestic market will be relevant to other parts of the world.

Lasting impression

So what is the lasting impression I am left with from my research and time spent in the Zhejiang Province? It's that any company in Europe or the US would be well advised to monitor the market behavior, branding and design strategies of potential Chinese competitors.

Many of these now "faceless" suppliers to the world have the desire to become global players and global brands. My advice? Underestimate them at your peril.

Jean-Pierre Jeannet is Professor of Global Strategy and Marketing. He teaches on the Strategic Marketing in Action (SMA) and the Orchestrating Winning Performance (OWP) programs.

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