LOW COST COMPETITION IN CHINA

Lessons from Saurer

By Professor Adrian Ryans - October 2009

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One of the distinguishing features of many markets in China is the presence of a large segment for "good enough" products – safe and acceptably reliable products that provide basic functionality and usually have some basic level of service and support. Initially, this is often the fastest growing segment of the market, and local Chinese competitors usually dominate it. While most European, North American and Japanese companies have historically competed in the premium segment of the market, an increasing number of these companies are exploring entry into the good enough segment.

The Saurer experience

Saurer Twisting Systems (now part of Oerlikon Textiles), a German-based yarn-twisting machine manufacturer, provides a useful example. Its Volkmann brand was the leader in the premium end of the market, both in China and globally. But, it saw little opportunity to take market share away from its premium Japanese and European competitors in China. The good enough segment, however, had grown rapidly in recent years, so Saurer's senior managers considered introducing a new, low cost machine targeted at Chinese and Asian customers who could not afford their high-end products.

There were distinct risks with the plan. Margins on the new product were likely to be significantly lower than on their existing products, and even if they managed to achieve some aggressive cost targets, there was a concern that the new product could cannibalize their high margin, premium machines. And, it was unclear how Chinese competitors would react to the launch of the new product.

Understanding Chinese customer needs

One of the challenges that Volkmann had faced since entering China was understanding the needs of its customers, particularly those in the good enough segment. Contrary to Western companies, many of these customers paid much less attention to the total cost of ownership. Instead, they focused on how long it would take for the machine to pay for itself. In many cases, they only ordered new machines after receiving orders for yarn, which meant that they then needed very quick delivery. Additionally, they tended to be less interested than their Western counterparts in machine ergonomics – labor costs were low and replacing workers was easy – although some had begun to appreciate that more efficient machines could enable them to increase revenue.

The attitude of most Chinese customers to after-sales support and service was also different. In North America and Europe, customers invested in preventative maintenance to avoid any unplanned machine downtime. They sometimes contracted with Saurer to do this work, and these service contracts, along with the consumables and spare parts, constituted a profitable business.

In China, however, there was little interest in preventative maintenance or after sales service and support. Instead, the machines were used until they broke and then they were repaired as needed, often using parts made quickly in nearby machine shops rather than purchasing them from the original manufacturer. The end result for Saurer was that its after-sales spare parts and service revenues per machine in China were about one-third the level achieved in Western countries.

Additionally, Volkmann's usual position in the high-end market meant that identifying and reaching customers for low-end solutions would be challenging for its sales force. It was also clear that engineering a good enough solution at low cost would be a challenge for Volkmann engineers who were accustomed to designing products that used the latest technology.

The threat from domestic competitors

Volkmann's other major consideration was the threat from the domestic Chinese competitors that dominated the lower end of the market, some of which showed little respect for intellectual property. In the late 1990s, most of the locally made twisting machines were copies of those manufactured by Volkmann or a Japanese competitor. In some cases, the colors of the machines and the brochures – including printing errors – were reproduced. On one occasion, a Saurer salesperson asked a customer how a new machine was performing, only to be told that it was not yet in use. It turns out a team of engineers from a textile technology institute had taken the machine apart and was making drawings so that the design could be made available to Chinese manufacturers.

Volkmann also had to take into account that local manufacturers focused on winning contracts, even if margins were very low. They seemed to be driven by revenue growth rather than profit growth.

By 2003, it was clear that one or two of the bigger and most sophisticated Chinese players were beginning to invest in R&D and develop machines aimed at capturing market share in the premium end of the market. They were also starting to export some of their products to neighboring countries in Asia.

Saurer responds

Saurer felt that it had to respond by moving into the good enough, mid-performance tier of the market in order to challenge its local competitors on their turf before they began to gain traction in the premium market. It was still an open question as to whether or not Volkmann could profitably enter the low end of the market. Even with relatively high prices for the new machine and an aggressive cost-reduction program, the margins would likely be only a fraction of its main high-end products. There was also concern that local competitors would drop their prices in response to the new entrant in their market; their vertical integration and use of some lower-quality components certainly made this possible.

Once the decision was made, Saurer moved quite rapidly and on multiple fronts. In several of its business units including Volkmann, it developed a mid-performance product to address the needs of the good enough segment. In some business units, it introduced new technology that was valued by some of its Chinese customers. It opened new sales offices to get closer to its customers. And, in a couple of cases, it entered into joint ventures with Chinese companies.

In retrospect – flexible response and speed to market are key

The results were generally quite positive with Saurer generally maintaining and, in some cases, enhancing its position in China. In the case of Volkmann, having a good enough machine in the product line actually helped sales of the premium machine. This was because some of the Chinese customers attracted by the good enough machine ended up recognizing the superior value of the premium one for their particular applications.

Saurer recognized that there was no one standard solution for the complex Chinese market. The strategy of each business unit had to be responsive to its particular market and competitive situation. But in most cases there was a significant shift in resources and activities from Europe to China. The only regret of some senior Saurer executives was that they had not moved more quickly and more aggressively into the lower tiers of the market.

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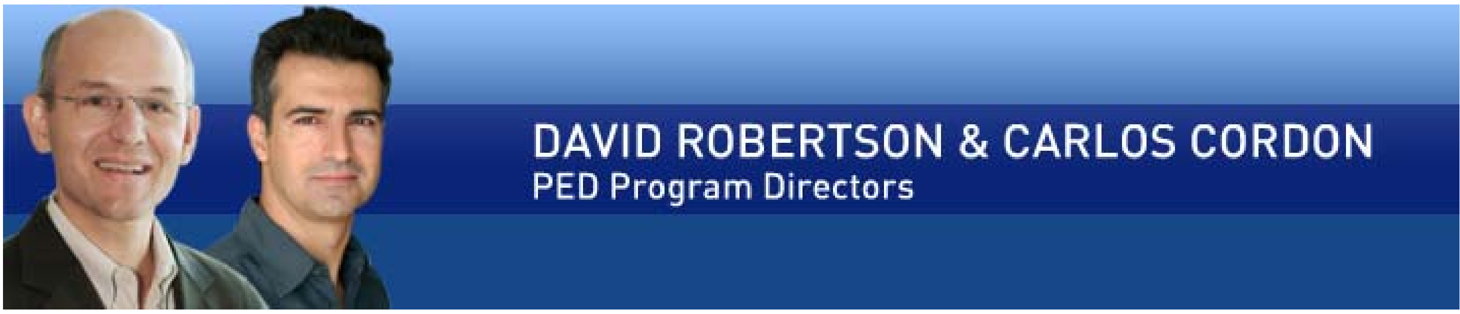

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