

Early Birds China's Mice, Part 2

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The emergence of the Chinese firms described above poses two significant challenges to western firms. The first of the challenges involves the new face of the global competitive environment. We have written previously about the emerging wave of Chinese competitors that are not only being successful in China's broad middle market, but also gaining stature around the globe [2]. We have labeled the emerging global competitors from China as Second Mouse firms, drawing upon the saying, "The early bird gets the worm, but the second mouse gets the cheese" and reflecting the fast-learner and fast-follower capabilities of these firms.

There are many such Second Mouse firms around -- Huawei in telecommunications equipment, Haier in appliances, Sany in construction equipment, Mindray in medical equipment, Geely in autos, among many other examples. All of these firms got their start in China, learning from western firms, showcasing strong manufacturing and economic competencies, and establishing a strong position serving those Chinese consumers below the points on the income distribution where western products were an option.

Our characterization of these companies as Second Mouse firms doesn't just reflect their ability to learn from and follow the leaders from the West. They were also genuinely second in the race, faster than the many other Chinese contenders who started up at the same time and with the same roots. They grew to significant scale in China's markets, and evolved from their early position as contract manufacturers to become legitimate firms. But for many years, their focus remained centered on the middle markets of China, and over time they evolved products that were "almost as good at an incredible price point," a considerable improvement over the early knock-offs belittled by the western firms in their industries. In part, their ability to achieve nearly comparable products was due to their mastery of "China economics," but a significant factor reflected important elements of China's business culture, including an ability to think far outside of the box, processes that allowed progress at "China speed," insights about what actually mattered to customers in their target market and a willingness to engineer unnecessary

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features out of the product and out of the cost structure, and service competencies that redefined relationships with customers, and allowed the substitution of low-cost labor for high-cost product elements and business processes.

These Second Mouse firms are no longer constrained to China's markets. As the examples cited above suggest, they are now significant global players. Some, like Huawei and Haier, are among the leaders in their industries, having surpassed well-established western firms in terms of sales and global market share. The transition of these firms into global markets has been gradual, with most of them first venturing into other developing markets in Asia, then into developing markets elsewhere, and only recently into the developed country markets of North America, Europe and Japan.

In many industries, these Second Mouse firms haven't yet arrived in the developed markets of the west, allowing western firms to continue to embrace the fiction that they aren't serious global competitors. But it is more likely just a matter of time until they arrive and become the most serious competitors of the coming decade.

Western firms face a second challenge, one that reflects the difficulty they will face in terms of getting to the point where they can compete with Second Mouse competitors. What western firms didn't recognize was that in their strategy for entering into China's markets, they fell into the "first mouse trap." By entering the high end of China's markets and prospering there, these western technology and design leaders, with their advanced products and high price points, had created a conundrum for themselves.

To later enter the broad middle market, where almost-as-good products at very attractive prices are prerequisite to success, they would have to take actions that would threaten their income and profit streams from the elite market segments, and from their China operations oriented towards serving western customers. And doing so would disrupt the steady growth expected from these firms' China operations. Since the elite segments of the China market were initially the fastest growing parts of the market (in percentage terms), growth rates in sales were impressive indeed. Naturally, most of these western firms remain focused on the elite segments of China's markets, earning solid margins and continuing to grow at reasonable rates, but without an ability to expand into the broad middle markets of China without compromising their position -- and their profits -- in China's elite market segments.

As a result, the broad middle markets of China remain the territory of the Chinese Second Mouse firms. Fortunately for the Second Mouse firms and unfortunately for their western competitors, those markets are where most of the growth of the next decade will be found. It will be hard for any firm to be among the global market leaders in 2020 unless they have a meaningful share of the broad middle markets of China (and India, Brazil, etc.). Ceding these markets to the Second Mouse firms not only most likely hands over global leadership to them, but also enhances their abilities of the Second Mouse firms to compete in the West, both as a result of the earnings from emerging markets and from their continued access to the world's best laboratory from which to evolve products that can compete and win around the

globe.



Evidence of this is already plentiful, as a quick reading of press releases describing Second Mouse investments and acquisitions in the west will verify. And even in the elite segments of China's markets, the future will begin to threaten the western companies in terms of market share, and sustained impressive growth rates and profit margins. As China's income distribution continues to shift, the new entrants into the elite segment will face a choice between western brands and those "almost as good products at a great price point" from the Second Mouse companies, an option much different from the earlier choice between western brands and laughable knock-offs.

The strategic implications of these two challenges are clear. Future growth will require western companies to develop the ability to compete in the broad middle segments of emerging markets like China. And future competitive success in even traditional western markets will require responses to new Second Mouse competitors that will quickly offer western customers "almost as good" products at highly attractive price points -- a value proposition likely to find as many takers in the west as it did in China and other developing country markets. Those that are skeptical of this should reflect on western firms like Southwest Airlines and Vizio that generated great success using what is basically a Second Mouse business model.

For most firms in most industries, while this challenge is on the way, there is still time to shape a response to these challenges. We believe that an effective response will require western businesses to evolve, blending what they already do well with the competencies that characterize Chinese Second Mouse firms. It will no longer be enough to be an "early bird" leading the way with innovative technology and design. The growth markets of the future will place a much more significant premium on price, with the competitive winners far more likely to be those with "almost-as-good products at a great price point" than those with state-of-the-art technology.

This prescription is very different from the mantra that most western companies have repeated over the years: "We must step up our innovation capabilities in order to maintain our lead on the Chinese competitors." The global leaders of the future will have to figure out how to blend both competencies, sustaining leadership over the full technology life cycle.

To accomplish that, most western firms will have to bring what the Chinese do so

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well into their own firm's cultures, most likely through acquisition of companies from developing markets like China. Doing so will require a different perspective on acquisition strategy and about what is to be accomplished in the integration process. Acquisition priorities must be refocused on strong Second Mouse companies, and integration priorities must emphasize not just retaining, but fully assimilating, the core competencies that these acquired firms can bring to the firm that acquires them. The task ahead is monumental, but it is one that must be tackled by western firms aspiring to sustained global leadership.

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[2] See George F. Brown, Jr. and David G. Hartman, They Aren't Who We Thought They Were, Industry Week, January 2011; George F. Brown, Jr. and David G. Hartman, The Second Mouse Gets the Cheese, Sales and Service Excellence, May 2011; and David G. Hartman and George F. Brown, Jr., Change Before You Have To, Business Excellence, August 2011.

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