

A straightforward look at China

Selected viewpoints presented by Roland Berger Strategy Consultants

A straightforward look at China

Selected viewpoints presented by Roland Berger Strategy Consultants

Content

Introduction	3
Looking behind the figures: the Chinese consumer goods markets	4
Global champions are growing in the giant's shadow	6
Urgently seeking innovation	9
China in figures	12
Don't move everything to China	14
Rethinking efficiency	17
Commodities buoyant worldwide	19
Conclusion	22
The project team	23

Introduction

"Rumors will abound where there is a lack of information"

Alberto Moravia

China is in great shape, even in purely statistical terms: for the past 25 years, the Chinese economy has been growing by nine percent annually. The Middle Kingdom is today the sixth largest economy in the world and will become the largest by 2030. At the same time, the disposable income of its billion-strong population is growing at double-digit rates. Hardly surprising, then, that every week over a billion US dollars are invested in the country.

China is part of every strategy and on everyone's lips. But precisely because so much is written about China and because everyone has something to say, only one message emerges loud and clear: China is important. The country offers most companies opportunities for profitable business. But not for all companies. And there is no standard strategy for entering the Chinese market.

We must therefore rein in our enthusiasm about the Chinese economic miracle. This is the only way to clearly defined goals and strategies. The basis for these is information and solid estimates – not overoptimistic forecasts and crash scenarios. This study thus offers you our perspective on the matter – an unbiased view and fact-based analysis. A straightforward look at the realities in China.

Looking behind the figures: the Chinese consumer goods markets

China is a sales market with enormous potential, and European companies are now making bigger profits there than ever before. However, firms that want to sell their products or services in China must be clear in advance about the limits, challenges and risks the market entails. Only then can they achieve acceptable profits in China.

The size and growth of the Chinese market are unrivaled: in 2004, the country's population reached 1.3 billion and is rising by nearly 8.5 million each year. Since 1990, the average purchasing power has risen sixfold and is continuing to grow. Global companies are excited about the prospects for selling their products in such a huge market. But they should not lose sight of the reality behind the figures. The Chinese market may be large, but is not yet as mighty as many think.

Limited income

There is certainly a middle and upper class in China today who can afford western consumer goods and who satisfy their urge to catch up and need for prestige with western products. This income band covers many people: in the prosperous eastern regions, around 13 million people have enough money to follow western patterns of consumption. But this group is a minority in this vast country and will remain so in the medium term. The much-heralded middle class does not exist throughout the country.

Last year, average disposable income per head in China was 889 US dollars per year, approximately five percent of the average disposable income in Western Europe. Economists, however, say that people must earn 5000 dollars or more before they will spend money on consumer goods above and beyond basic necessities – food, clothing, a roof over their head. The average Chinese is still a long way from western-style consumption.

This applies in particular to inhabitants of rural areas, who make up three fifths of the total population. Their average disposable income last year was 316 dollars per person. Rural households spent half of this on food and less than 15 percent on cultural pursuits, education or entertainment. The market potential for products of western origin remains minimal.

In terms of purchasing power parity, today over 50 million people in the richer eastern provinces have a disposable income of over 11,200 dollars, i.e. around 10% less than in Portugal. But for European companies this is not a yardstick they use – they calculate their sales in real terms and not according to PPP.

The savings rate of 40 percent, relatively high compared to other countries, further reduces income available for consumption. Citizens now have to pay for their own healthcare, retirement and periods of unemployment – and therefore have saved the equivalent of 140 percent of GNP over the past 20 years. The savings rate will remain as high until China reaches international benchmarks for household savings of between 300 and 400 percent of GNP.

A varied market

When companies look at China, they often see one market – but in reality there are huge differences between different parts of the country. China's climatic zones range from polar to tropical, 50 dialects are spoken and only 90 million people are native speakers of Mandarin Chinese. The vast land is divided into 31 provinces each with its own government and laws. Income, educational levels and lifestyle vary massively between peasants and urban dwellers – as do the differences between the rich east coast and the poor regions of the west and northeast. There is demand for every product in China – but a national market probably for very few.

Tough competition

China is probably the most competitive market in the world. Foreign and domestic providers meet here, as well as state-run companies for whom employment and reputation are more important than profit.

This leads to huge overcapacity, which in turn affects market shares and prices. The car industry, for example, will have 90 percent overcapacity next year, and this will probably increase further, as foreign manufacturers have already announced over USD 20 billion in new investments.

The Chinese market is tough and will not be as powerful in the medium to long term as often forecast – but can still be lucrative. To win over Chinese customers, international companies must precisely analyze their current products and Chinese customers before starting out in China. They must ensure that they enter the market with the right offerings. As previous market experience shows, three products groups are successful:

- > Purely western products, often representing western values, which Chinese consumers want to emulate by buying these products. They do not need to be modified because Chinese consumers already accept them.
- > Modified western products whose basic value proposition also appeals to Chinese clients, but which need modifications, for example in terms of product quality, features and prices, in order to be sold successfully in China.
- > Products specifically developed for the Chinese market which serve specific Chinese needs or respond to local regulations and requirements.

Global champions are growing in the giant's shadow

Although the Chinese economy is already a giant on the global stage, Chinese firms are not yet major-league players on an international scale. This is set to change: China's hidden champions are already showing what will make companies from the Middle Kingdom strong in the future.

On paper, the Chinese economy looks robust: China is the world's largest producer of copy machines, cameras, textiles, refrigerators, paper, shoes, toys and many other goods. But it is usually foreign manufacturers that are responsible for much of this production. Western firms control around 85% of all high-tech exports such as motherboards and routers.

Chinese companies are currently relatively small by global standards. Few Chinese firms appear in relevant league tables; the Fortune 500 has just eleven and the Financial Times 500 only two. And these companies generate almost all of their sales on the domestic market. The main reason behind their failure to make the jump to the global arena is easy to identify: Chinese firms in general lack the expertise in sales, marketing and development necessary to become a global success.

However, the Chinese know their own shortcomings. They are looking increasingly beyond their own national borders and expanding abroad. Firstly because local resource shortages are forcing companies to procure raw materials on the world markets; but also because local markets (e.g. steel, cars, electronic products) are increasingly marked by saturation and overcapacity. Those that set themselves up internationally can look to the firms that have already become champions – because there are certainly some Chinese firms that are world-class players in their industry. Haier is the world's fourth largest producer of household appliances and the market leader in the US in small refrigerators and wine refrigerators. TCL is the world's largest TV manufacturer and Huawei has a successful international profile as a network equipment manufacturer.

These companies benefit greatly from their huge domestic market when expanding internationally. The Chinese consumer products market is one of the most competitive in the world and thus an ideal training ground for the rest of the world. In addition, companies which are successful in the Chinese market can use the profits made in their domestic market to finance their international expansion.

The champions' strategies

These companies, however, are not satisfied merely with the advantages of their domestic market. They take a different strategic approach to the majority of their competitors on the home market. They differ in four main considerations:

Firstly, they invest in research and development (R&D). Worldwide, companies invest an average of five percent of their sales in research and development. Chinese companies rarely invest this much and thus produce few innovations. Companies with international ambitions have recognized this and invest more in R&D than their domestic competitors, in some cases up to ten percent of sales.

Secondly, Chinese companies are traditionally weak on marketing and branding, despite the Chinese obsession with brands. For example, the brand consultancy Interbrand does not list a single Chinese brand among the hundred most valuable brands in the world. This will change as Chinese firms start spending more on advertising, making China the world's third largest advertising market last year. Internationally operating firms such as the computer manufacturer Lenovo, which, together with Coca-Cola, will be the main sponsor of 2008 Olympic Games, are setting the pace in this field.

Thirdly, China's champions have made up for their internal weaknesses in branding, marketing, sales and R&D primarily through takeovers and joint ventures. TV manufacturer TLC, for example, took over the brands Schneider, Thomson and RCA one after another in order to sell its TV sets in Europe and America under these brand names. And Lenovo has taken over the PC business from IBM, thus creating the third-largest PC firm. The act of buying in know-how and brands through mergers and acquisitions and also through cooperative ventures and networks will continue. The Chinese will try to use this as a way of establishing additional strategic pillars for their business in the west.

Fourthly, Chinese firms have recognized the fact that local adaptation of their products is key because customer demands and needs vary between markets. Companies with an international outlook such as Haier therefore develop products in the countries where they sell them.

European companies should keep a close eye on these Chinese champions, because their strategies are not a one-way street. If Chinese companies rely on partnerships, research and local development when expanding abroad, this can be a good way for European firms to enter the Chinese market.

History repeated? No – any comparison with past Asian expansion doesn't pay off

In Japan, the way to expansion was triggered by trade barriers with a few highly interconnected big firms as the drivers. Korea's expansion strategy was driven by the government with the underlying principle of achieving a strong international presence for Korean companies but preventing foreign presence on the domestic market. Taiwan wasn't able to keep pace because of its underdeveloped home market and the limited size of its companies.

The basic local parameters in China differ from those in Japan, South Korea or Taiwan. China is bigger and extremely heterogeneous. The Chinese government is very active in deregulation programs and open to foreign investments and international trade. China's former state-owned firms are big and the home market is growing.

The global economic environment has also changed since the days when Japan and Korea were expanding. Today we find an open global economy offering considerable opportunities for making the value chain more flexible, a situation mainly based on rapid advances in information technology.

Unlike Japan and Korea, Chinese companies can use this environment to their own benefit when they expand.

Urgently seeking innovation

In the medium term, the Chinese economy aims to play a key role in the high-tech and service industries, rather than remaining the world's extended workbench. The crucial question is: Will China's gradual transformation from imitator to innovator open up opportunities or pose a threat to European and US companies?

A giant of high-tech, but poor on innovation

At first sight, China is already a high-tech nation. Advanced technologies as a proportion of total exports is higher in China than in the EU, and in 2003 China was the fifth largest exporter of high-tech products after the US, Japan, Germany and the UK.

But at the same time, China has a 15 billion dollar trade deficit with the rest of the world in the area of technology. And almost 85% of the country's high-tech exports are controlled by foreign companies. In China's special economic zones the focus is on assembling products developed elsewhere.

The country is certainly not widely known as a nation of innovators: in 2002 some 17 billion dollars were spent on research and development, while in the same year the EU plus its accession candidates invested ten times that amount and the US as much as sixteen times.

In terms of the number of global patents granted, China is also a novice in innovation: while in the EU (prior to its recent enlargement) some 15,000 patents were registered last year, China only managed 90. This equals 0.07 per million Chinese – versus 38 per million EU citizens.

This may also be because companies in Beijing and Shanghai place little emphasis on innovation – China's companies employ some 1000 office workers for every researcher, while the US figure is ten times as high.

Urgently seeking innovation

China has little choice but to drive innovation and economic growth. It must continue to grow as strongly as in previous years in order to solve its social problems. There are striking economic inequalities between the poor western provinces and the flourishing east coast, and in the coming years 300 million Chinese will need a job.

Political leaders in Beijing want the Chinese economy – today reliant on cheap labor – to focus more on innovation in the long term. It has therefore made innovation the central element of its tenth five-year plan. In this plan, the focus of research is on advanced technologies such as automation, biotech, aerospace, IT, materials science, optic devices and nuclear technology.

The desire for innovation is clear – not just in government plans, but also in statistics. China's R&D spending may be behind that of western nations in absolute terms, but in relation to GDP, it is rising fast. Since 1997 Chinese relative R&D investment has doubled and reached around 1.3% of GDP. The US invests 1.9%, so the gap is obviously narrowing.

China has identified the need to put more emphasis on its R&D capabilities. European companies should thus monitor China's development from imitator to innovator in order to seize the opportunities arising. There are three strategic options:

Option 1: Cooperating with Chinese innovators

European companies can supplement their portfolios (sold in Europe) with the products and services produced by Chinese partners, and thus outsource some of their innovation work. The Chinese partners can tap into new markets for their products via European cooperative ventures and benefit from their European partners' experience in branding, marketing and sales. Conversely, European firms entering the Chinese market can also go for cooperative ventures. In the medium term, they can thus stop competitors from the same industry from growing in the Chinese market and potentially becoming global competitors.

Option 2: Using China as a source of innovation for European products

European consumer-goods companies can set up their own research and development centers in China to better tailor their products to the Chinese market. This will also help them keep their Chinese rivals on their market under better control and anticipate their international ambitions.

In the long term, European companies may want to use China's location and cost benefits to develop products for the international market in China. For that to happen, however, China would have to build up intellectual and research capacities that can live up to global standards.

Option 3: Using China's potential for process innovation

In the medium term, China could develop into a location for process innovation. The more China uses the growing international value-creation activities that are taking place within its borders to build up its own expertise, the more it can join in traditional process innovation (designed to boost productivity and engineering processes). It is quite conceivable that China develops into a fully fledged center of excellence for engineering and related areas within the space of a generation or less.

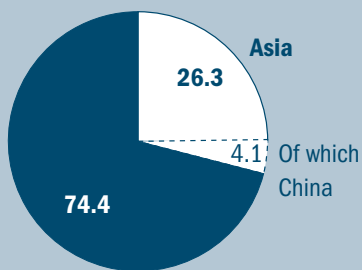
Joining this process could turn out to be a strategy that helps European companies replace traditional innovation activities on their home turf.

Companies facing tougher global competition in innovation proactively drive the innovation activities in their industries and thus race ahead of the competition – in China too. Such top innovators permanently improve the quality of their products and services, boost production efficiency at the same time and focus on product lines with high potential for innovation. In this type of company, this strategy leads to high performance, internal creativity and ensures resources are invested in training employees.

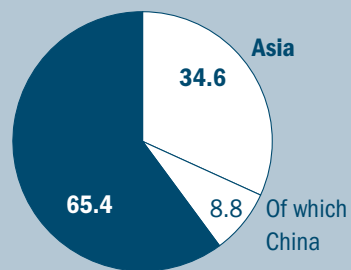
China in figures

Asia, especially China, is the no. 1 growth engine worldwide

Asia's share of world GDP in 2004 [%]



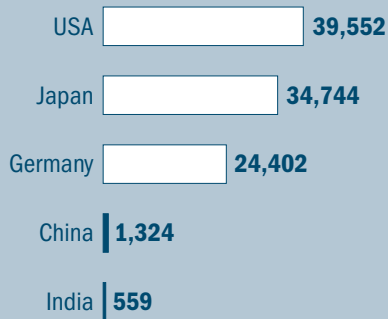
Asia's contribution to worldwide economic growth in 2004 [%]



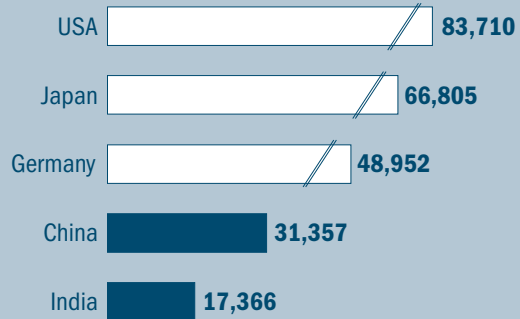
Source: EIU

Asia is quickly becoming more affluent

GDP per capita in 2005e [USD]

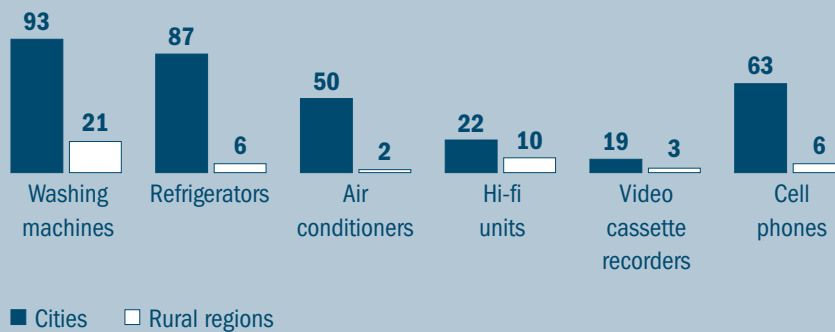


GDP per capita in 2050e [USD]



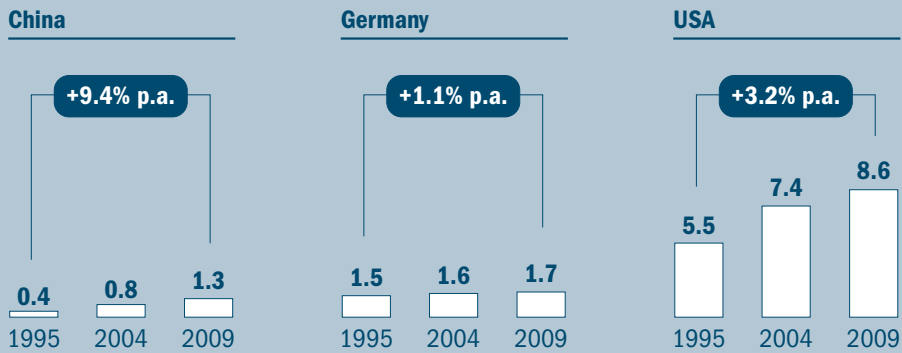
Source: Goldman Sachs

Consumer goods will continue to grow because rural regions are catching up
[Units per 100 individual households in China, 2002]



Source: China Statistical Yearbook 2003

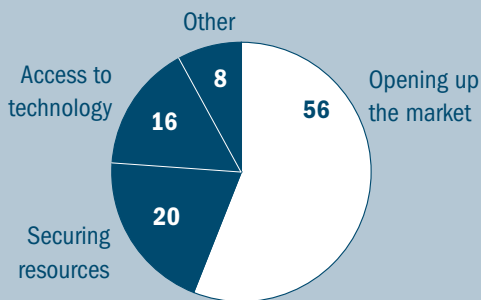
Real disposable income in China will continue to increase [USD bn]



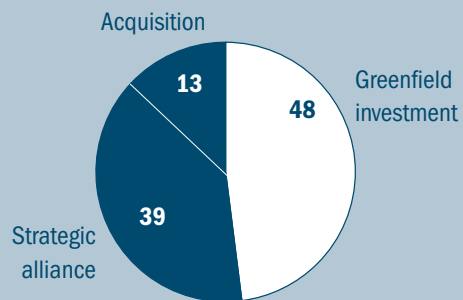
Source: EIU

Market entry is the main goal of Chinese direct investment in other countries

Reasons for expansion



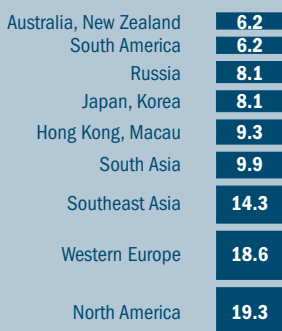
Ways of expansion



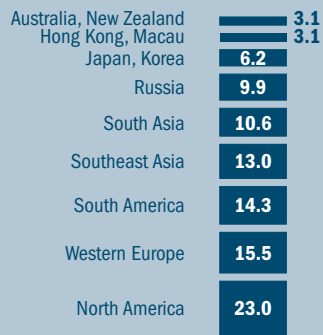
Source: Roland Berger survey among 50 Chinese top companies

North America remains the main investment destination, Latin America is catching up quickly

Main investment regions today [%]



Investment regions tomorrow [%]



Source: Roland Berger survey among 50 Chinese top companies

Don't move everything to China

China is becoming the workshop of the world. But it can't do everything. For now, there is no threat to a lot of the value that is added in Europe.

For European companies, manufacturing in China is an attractive option. By our reckoning, they can shave considerable amounts off their costs by manufacturing (or subcontracting manufacturing) in China. Companies based in the USA and Japan have so far made better use of this cost advantage than their European rivals.

Getting in shape for China

If companies want to make optimum use of China, the products that they want to produce there must meet a number of very clear-cut requirements:

Production processes should be very labor-intensive. The key advantage of producing in China is wage differentials. Operations must therefore be geared to benefit from this factor. At the same time, companies must give due consideration to the additional overhead and capital costs that commitments in China will incur.

Products must be largely standardized. China is strong on manufacturing highly standardized products. Products that are extensively tailored to the needs of specific customers and generally require close collaboration with those customers are rarely suitable for production in China.

Products must be tailored to big markets and/or growing demand. Demand must be on the rise if companies ponder moving operations to China. If demand is weak or declining, production startup costs and investments can be too heavy a burden.

Products must be profitable enough to be worth the logistical effort: Sharp fluctuations in demand or the short lead times required by some products would make production in China inordinately expensive and, in some cases, utterly impossible. This is especially true of products whose manufacturing and consumption interlocks tightly with other processes. Just-in-time production is a good example.

The need to be close to the customer must not be an important factor: China is good for straightforward products that can be made without much customer interaction. Products that are developed in close collaboration with the customer or that involve ongoing and intensive coordination during the development process require (geographic and cultural) proximity to customers on their domestic market.

This point is valid in particular for business relationships in which the customer takes a negative view of production in countries with low labor costs.

Value chains must be loosely integrated: Production processes that are closely interwoven with other value chain processes can undermine the stability of the value chain as a whole if they are far removed from the company's home market.

There is one aspect that must not be overlooked: Protection of intellectual property in China has become a major global business challenge. Our colleagues in China have therefore set up a separate study on the issue ("Intellectual property protection in China"), which we will be pleased to send you upon request. The study surveys current practices of multinational manufacturers in China and outlines comprehensive, multi-faceted mechanisms for deterring intellectual piracy.

Most of the items produced in China today, from training shoes to motherboards, meet these requirements, but European companies must examine the manufacturing features of their products very closely. And they must keep in mind that, even if they cannot set up shop in China, their rivals will increasingly do so.

There are, however, alternatives to production in China.

Eastern Europe – a viable geographic alternative

For Western European enterprises, the countries of Central and Eastern Europe remain very attractive as potential production venues. Compared to China, they offer a series of advantages.

Cultural proximity and well-developed language skills among the labor force in Central and Eastern Europe simplify communication and coordination. That makes it easier to base both production and service provision in these countries.

Geographic proximity guarantees short transport paths and fast response times. The recent accession of many former Eastern Bloc states to the EU has simplified the exchange of end products and intermediate products even further, as customs and other duties have now been eliminated. Transportation routes too are well developed.

At the same time, the Central and Eastern European countries are also attractive as target markets and are already further advanced than China.

Operational excellence – a viable strategic alternative

Other ways in which companies can respond to rivals who produce in China are by varying their offerings, adding more value for the customer and cutting their costs.

New products and services: Companies must ramp up their research and development activities and press ahead with technology- and customer-driven innovation.

Added business value: Extra benefits and quality attributes such as speed, reliability and convenience add more value for the customer.

Communication of value-added propositions: Effective pricing and marketing strategies based on thorough market research can positively impact the way customers perceive added value.

Reduced costs: Higher productivity, careful cost controlling and alliances and partnerships can help reduce costs and free up added reserves of value.

This kind of operational excellence is, however, only possible for agile, adaptive and innovative companies that live out effective change management and life-long learning as integral aspects of their corporate culture.

Rethinking efficiency

Companies that want to source in China are well advised to prepare themselves thoroughly. They may find that they are too efficient.

European companies manufacture or purchase in China to save money. They can slash up to 50% off what they would pay to source comparable items on their home markets. Many factors, including lower labor costs, low property prices and government subsidies, contribute to these savings.

Production in China will become more expensive

Companies that are currently wondering whether or not to manufacture in China should ask themselves which factors of production will still yield cost benefits five or ten years from now. In the medium term, only labor costs will meet this criterion. The prices of other significant cost items are already high or will increase in future.

Raw materials: In the past, companies with production or purchasing operations in China reaped the benefit of lower materials costs. That is now rarely the case. Raw materials and supplies are already trading at or above global market prices in China.

Managers: Chinese experts with language and industrial skills are in short supply. The same is true of foreign managers who have a thorough knowledge of both China and their chosen line of business. Competition for these "China experts" and the rising cost of living in Chinese urban centers are making expatriates an increasingly expensive option for foreign firms.

Transportation: The ongoing globalization of production chains drives up international ocean shipping costs. Even within China itself, capacity for land- and water-borne transportation will become scarcer as companies increasingly move away from the expensive coastal regions and settle in the interior.

Payroll costs: Even wage costs are increasing at the rate of around 10% per annum in China, albeit from an extremely low level.

Efficiency, European-style

Low payroll costs currently account for between 25 and 50% of the savings that foreign firms realize by manufacturing in China. However, this implies that, in the years ahead, only those companies that enjoy low labor costs will genuinely benefit from China-based production.

As incredible as it may sound, this presents many European companies with a problem. Their products and processes were developed with high-labor-cost countries in mind, with all that that entails: capital-intensive, heavily automated production; minimal scrap and wastage; complex assemblies that can be put together in a small number of simple steps; just-in-time delivery; largely standardized intermediate products that can be customized in a few easy steps. German companies, for instance, are among the most productive in the world precisely because their products and processes are designed to require as little expensive labor as possible.

When European companies go to China, they must completely rethink their idea of efficiency. The concept of efficiency embodied in their products and processes is exactly the opposite of what makes it worthwhile to manufacture or purchase in China.

Efficiency, Chinese-style

European companies that want to profit from low labor costs and rely on long-term sourcing arrangements in the Middle Kingdom must therefore first redefine what they mean by efficiency. This process involves three steps:

Make or buy simple processes, products and parts in China. This is especially important for products and processes that cannot be automated efficiently however much capital is invested. Examples include packaging, inspection and rework.

Simplify processes, products and parts. To benefit from low labor costs in China, companies must design products that can be manufactured round the clock by a lot of people working with a few machines. Only then can the capital employed be optimized.

Cultivate Chinese partners for more complex processes, products and parts.

In light of what we have said so far, this advice might appear somewhat inconsistent. It is nevertheless important with a view to medium-term developments. Today's cost benefits will decrease in the future. Conversely, cost disadvantages will weigh more heavily. It is these medium-term cost increases that must be offset by more efficient processes.

European managers spend their first few weeks in Shanghai adapting their ideas of such concepts as "lunch" and "evening rush hour" to the reality they find in China. In the same way, European companies must do their homework and redefine what they mean by "efficiency" if they want to manufacture successfully – and save money – in the Middle Kingdom.

Commodities buoyant worldwide

China's voracious appetite for raw materials could negatively impact the global economy in the years ahead. European companies must act now to prepare for commodity prices that will stay high in the long run.

Growing big and strong: China's consumption drives commodity prices

The Chinese economy has been expanding at 8.7% per annum for the past decade. In the process it has naturally developed a keen appetite for labor, capital, energy and raw materials. Demand for the latter in particular has surged consistently. Last year, Chinese firms consumed twice as much steel as in 2000, twice as much copper as in 2002 and three times as much scrap iron as in 2001.

These figures will swell further between now and 2020. Consumption of steel, coal and oil, for example, will increase by 66%, 30% and a whopping 213% respectively.

China produces only a handful of raw materials – such as aluminum, tin and titanium – in sufficient quantities to satisfy its own needs. Accordingly, the bulk of its requirements are sourced on the global markets. Right now, China consumes nearly one-third of all the steel produced in the world and one-third of the planet's coal output. This single huge economy is thus driving global market prices sharply upward. Steel prices alone shot up 50% last year.

The pattern of price hikes is set to continue. Although output volumes are being ramped up, Chinese production capacity will not be able to keep up with consumption in the next few years. The global supply of key raw materials is in a similar situation. Demand from the Middle Kingdom remains well ahead of the capacity expansion curve. Prices for major commodities will therefore rise by as much as 30% in the next four years. Unlike what has happened in recent months, these price increases will be attributable solely to Chinese economic growth.

China's government stands on the brakes

Spiraling commodity prices are threatening to choke off global economic growth. China itself would suffer if this happened. Aware of this, the government in Peking is taking steps to rein in the country's rampant growth and get a handle on its negative side-effects. To engineer a more sustainable level of growth, the authorities are working:

To dampen investment growth by halting major capital spending projects and refusing to issue new licenses for resource-intensive industries such as cement production. The aim is for growth gradually to become driven by final consumer demand.

To stabilize the banking system by stocking up the capital adequacy requirements for banks and making it easier to import capital.

To keep inflation to a minimum by controlling the prices of raw materials, foods and basic necessities.

To make growth more environment-friendly by monitoring water, energy and raw materials consumption in projects that require official approval.

Alternative scenarios

These actions by the Chinese government will determine the extent to which the country's use of commodities affects the global economy.

Crisis scenario: If these actions do not produce the desired effect, i.e. if China's growth outstrips current forecasts while the global build-up of new capacity continues to lag behind, a worldwide shortage of key commodities could ensue. Raw materials prices would then go through the roof. Such a development would increase the probability that China's growth will end abruptly, plunging the global economy into crisis.

Inflation scenario: If the Chinese government's actions do take effect, i.e. if they successfully curb growth and restrict the development of resource-intensive industries, this would contain the impact of rising demand. Higher commodity prices would fuel inflation worldwide, but important raw materials would remain available in sufficient quantities. Stepped up production worldwide would further soften the upward price trend.

Raw materials strategies

As things stand, either scenario is perfectly feasible. Whatever happens, European companies must assume that raw materials prices will stay high for a long time to come. They must respond to this situation intelligently. The "right" strategy depends primarily on a company's position in the value chain.

Raw materials producers can optimize their profits in either scenario. They can boost their investment in sites that would be more expensive to dismantle.

Suppliers of alternative energy and raw materials should invest heavily to develop viable alternatives that can be brought to market in short order. The higher prices go and the more critical the supply situation becomes on the commodities markets, the more these companies can afford to invest in research and development (as their startup losses will be recouped).

Processing plants will suffer most from higher prices. Raw materials are their main cost driver, but they have only limited scope to pass higher costs on to their customers. They will only be able to do this in full if they increase their focus on niche markets. A moratorium on capital investment should be applied in areas where neither specialization nor the use of substitutes is feasible.

Manufacturers can prevent the further erosion of margins by broadening their supplier base and using alternative materials. The more prices rise and the more critical the supply situation becomes, the more customers will insist on technological advances and genuine innovation.

Conclusion

China is not just an emerging market like any other. Its unique characteristics and the Chinese character might explain its current outstanding success, but there is no magic about this. China has to deal with the same problems as any other emerging country. The conclusion for European managers and strategists is: when you think about China, see not just the chances, but also the risks.

As a consequence, any kind of operational or sales strategy must be verified in the same way as in Europe. The main difference is that every company that establishes ties with the Middle Kingdom will need to buy in China-specific knowledge from outside. This is, by definition, a case of trial and error (and potentially very costly) if you do not already have a bridgehead in China. And this in turn means that one should always examine China against the context of other opportunities like CEE, and vice versa.

Even so, it is important not to lose your strategic vision in the current euphoria over China. Sober consideration needs to be made. In any thoughts of relocating to China, there are three strategic tests that must be passed:

- > The first step is to separate the relevant elements from the hype – analyze the opportunities and threats
- > The second step is to understand that there is no single strategy that fits every business
- > And last but not least, we have to admit that despite all the analysis, no-one can be sure where China will be in the near (let alone the distant) future

When this is done, entrepreneurial freedom and the desire for risk can come to the fore. And since we are talking not only of going to China, but also of Chinese companies expanding beyond their own national borders, the words of Sun Tzu ring especially true: "Security against defeat implies defensive tactics; ability to defeat the enemy means taking the offensive."

The project team

Under the leadership of Dr. Stefan Bötzel, an international Roland Berger project team carried out a range of extensive analyses on China strategies for European companies. The key findings are presented in this brochure.

The following contributors worked on this brochure:

Stephane Albernhe, Paris
Florian Huber, Düsseldorf (Project Coordinator)
Dr. Christoph Kleppel, München (Project Coordinator)
Ivo Naumann, Shanghai
Daniel Schellenberg, Berlin (Project Coordinator)
Vincent Rousseau, Brussels
Benoit Hennion, Paris
Matthaeus Rimpler, Berlin
Tanja Wielgoss, Hamburg
Jens Lorkowski, Düsseldorf
Jan Heydolph, Shanghai
Patrick Mueller-Sarmiento, München
Georg Szeless, München
De Jun Luo, Shanghai
Tong Zhu, Beijing
Tao Chen, Beijing

Amsterdam
Barcelona
Beijing
Berlin
Brussels
Bucharest
Budapest
Detroit
Düsseldorf
Frankfurt
Hamburg
Kiev
Lisbon
London
Madrid
Milan
Moscow
Munich
New York
Paris
Prague
Riga
Rome
São Paulo
Shanghai
Stuttgart
Tokyo
Vienna
Warsaw
Zagreb
Zurich