EMPOWER YOUR ORGANIZATION

Balance control and freedom through three phases of growth

Handbook series for medium-sized Danish B2B companies in the Chinese mid-market

Suitable for growth

INDUSTRIENS FOND FREMMER DANSK KONKURRENCEEVNE
The Danish Industry Foundation

KATA FOUNDATION
CATALYZING LEARNING

This guidebook is also available for download at www.suitableforgrowth.dk
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PREFACE BY THE FOUNDATIONS BEHIND SUITABLE FOR GROWTH

The Suitable for Growth (SfG) project is a joint effort by The Danish Industry Foundation and The Kata Foundation.

The starting point of the SfG project is that the real growth in China and other emerging markets is not in the premium segment, where Danish industrial companies operate by default. The mid-market defined by affordable prices and acceptable quality is where you will often find the booming market. By understanding how to tap into this high growth segment through increased competiveness, Danish companies should be able to find new ways of creating value and employment both abroad and in Denmark.

The inspiration for this initiative comes from the local companies in emerging markets, who manage to achieve very high growth rates by an innovative approach to the mid-market segments in China and other emerging markets. Their strategy is to develop affordable products based on in-depth insights into the context, wishes and needs of the local customers. This specific approach, which we have coined “Suitable”, has been the inspiration for developing the Suitable for Growth project.

During almost three years, the SfG project has followed, inspired and studied six medium-sized Danish B2B companies as they tried to expand into the Chinese mid-market. Based on the insights from observing these companies and other successful companies operating in China, the project has developed a strategic framework and related cases, tools and guidelines to support Danish companies wishing to enter the Chinese mid-market. The results are described in seven publications: one overall handbook and a series of six practical guidebooks, covering specific challenges and solutions to succeeding in the Chinese mid-market.

The primary target group for these publications is the medium-sized Danish B2B companies, who are operating in the Chinese market.

It is the ambition and hope of the Danish Industry Foundation and The Kata Foundation that the insights and practical knowledge described in these books can help Danish companies consider and successfully target Chinese mid-market customers, thereby increasing the competitiveness of Danish industry.

Mads Lebech
CEO
The Danish Industry Foundation

Peter Skat-Rørdam
President
The Kata Foundation

PREFACE

This book is part of a series on how Danish companies can grow their business in the Chinese market. The books focus primarily on medium-sized B2B companies that are already established in China and want to target the Chinese mid-market further. However, other kinds of companies in different situations may also find inspiration in the books.

The books contain the key findings from the Suitable for Growth (SfG) project, which intensely supported and closely followed six medium-sized Danish companies over a period of almost three years while they tried to penetrate the Chinese mid-market. (For more information on the SfG project, visit www.suitableforgrowth.dk.) A range of other Danish companies in the Chinese mid-market have also been investigated. The books are based on in-depth understanding of all these companies and provide real and detailed examples (in some cases made anonymous due to confidentiality concerns).

One handbook targets top management and provides a strategic overview of the barriers to success and factors that enable success in the Chinese mid-market.

Another six guidebooks target general managers and business developers and provide operational guidelines and practical tools to support these six imperatives:

- Leverage your core
- Empower your organization
- Lower your costs
- Know your customers
- Adapt your solution
- Scale your distribution

The hand- and guidebooks are not meant to be exhaustive on these topics but rather to supplement other sources with a unique focus on the special working conditions for medium-sized companies and the specific nature of the Chinese mid-market. The books can be read independently and in any order according to the specific interest of the reader. However, the books should be treated as a whole, since they constitute a complete set of elements to be considered when entering the Chinese mid-market.

The content of this book has been prepared with the best effort of the authors and developed to the best of their knowledge. However, the authors cannot provide any kind of warranty and thus cannot be held responsible for the results of any particular application of the provided content.

The project team at Kata Foundation wishes to express gratitude to The Danish Industry Foundation for financial support to the SfG program and to all the companies that have opened their doors to our curious minds. A special thank-you goes to the following persons, who have been very helpful in reviewing the books:

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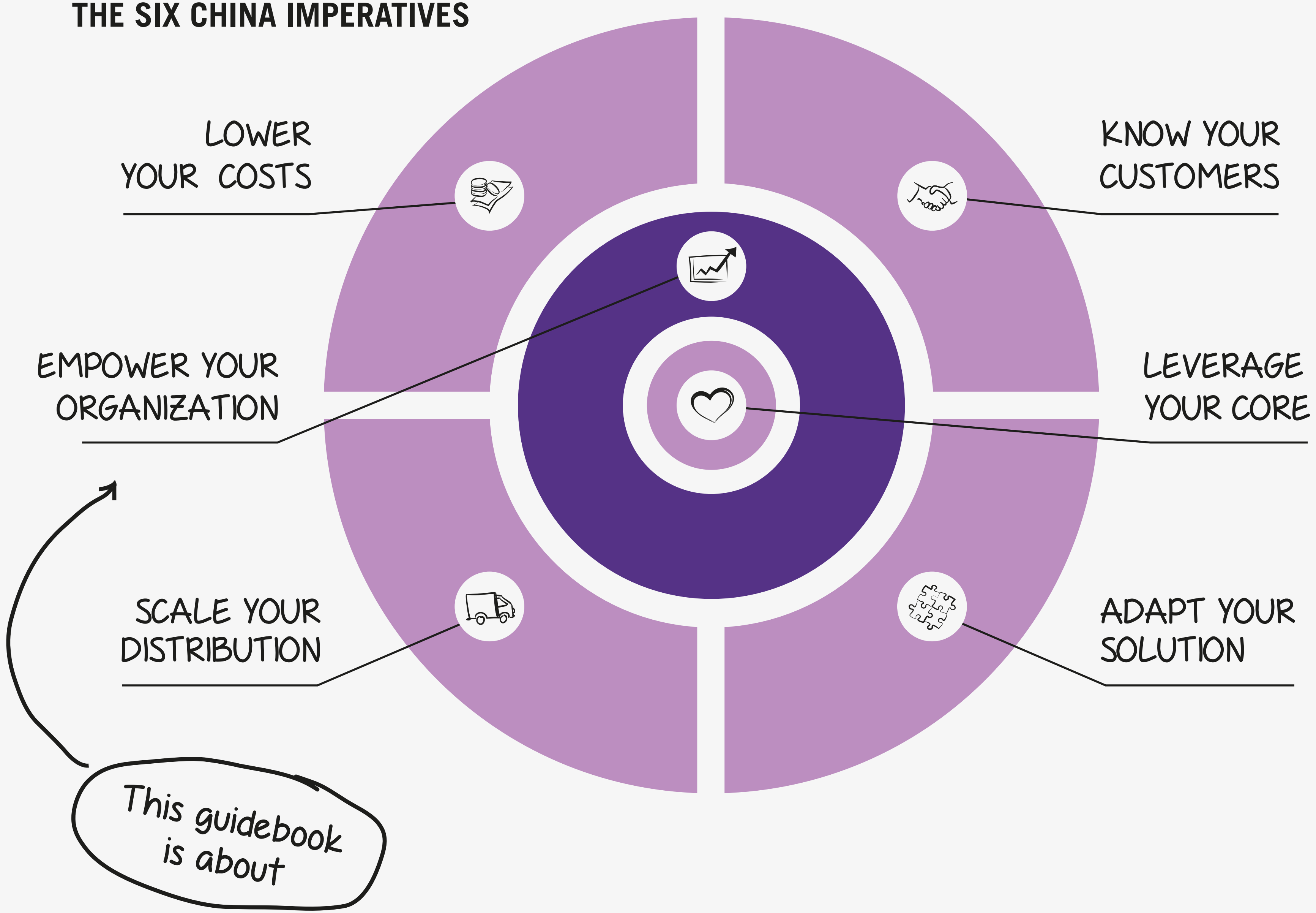
- Tom Behrens-Sørensen, Senior advisor & professional board member

We wish you an insightful experience!

Peter Skat-Rørdam, president
Peter Jyde Andreassen, SfG program director
Thomas Aakjær Jensen, senior innovation specialist

THE SIX CHINA IMPERATIVES



INTRODUCTION

The Chinese culture and language have always been very foreign to Claus. But at the same time, he has been fascinated by the history of China and the incredible development and growth the country has experienced during the last decades—impressive but frightening at the same time.

When Claus started his business career twenty years ago, China was mainly about sourcing and manufacturing. As the "factory of the world," it was the country where foreign MNCs exploited low-cost resources to stay competitive in other parts of the world. However, now that he is responsible for his company's global sales, Claus is aware that a huge new market for goods and services has emerged in China. "If we could get just 1 percent of this market, we would be very well off," his boss has often said to him.

But selling in this market is much more challenging than Claus ever imagined it would be. Most of what he has learned and experienced in other markets just does not fit here. For one thing, he has difficulty understanding the Chinese sales manager, and there is room for improvement in their communication and level of trust. The subsidiary has experienced a high rate of employee turnover, and the present sales manager is the third person in this position within three years. Every time a new sales manager comes on board, it's like the whole organization changes and lots of knowledge disappears, and they almost have to start from scratch. He has to find a better way.

The Chinese mid-market is very different from the more developed markets where most Danish companies have gained their international experience. As a consequence, taking their existing business model and transplanting it to the Chinese market seldom works well. Adaptation is required. The road to success here is a long, hard, sometimes frustrating journey where an open-minded, entrepreneurial growth mind-set that embraces learning and constant development is a prerequisite for survival. In China, more than anywhere else, good communication with and support from headquarters back in Denmark is critical. While providing support, HQ must also give the Chinese subsidiary the freedom to act based on knowledge of the local market. Furthermore, HQ must give its endeavor in the Chinese mid-market the highest strategic priority and be willing to act according to this priority—to "walk the talk." In short, HQ must empower the organization.

In most cases, expansion into the Chinese mid-market is so complex and risky that a medium-sized Danish company can't make this transition in just one step. Based on observations from successful companies operating in China, this guidebook suggests a three-phase transition process—Pilot, Explore, Grow—based on first understanding the organizational challenges for the company. Thus, the guidebook is divided into four chapters, taking you step by step through developing and empowering your China organization.

- Before setting out to enter the mid-market, it's necessary to *understand the specific organizational challenges for the company and how to get the strategy right.*
- *Pilot: Build a beachhead in the high end* by targeting familiar customers to demonstrate commitment to the Chinese market.
- *Explore: Adapt to the Chinese mid-market* by starting to mold the business model to the conditions and context of the local mid-market.
- *Grow: Expand to new segments and regions* through a controlled process of growth based on the established mid-market business model.

DEFINITION

Empower = give power or a mandate to

To empower your organization means to put in place a process whereby the headquarters in Denmark supports, trains, and educates the Chinese subsidiary to be an independent, responsible, and trustworthy local organization that can make autonomous decisions while respecting the overall frames and guidelines of the global corporation.

Content

> Foreign leaders must learn about Chinese culture and how to incorporate the wisdom of the ancient culture into their business practices.
>
> YIN MIN, DIRECTOR OF GLOBAL LEADERSHIP AND ORGANIZATION DEVELOPMENT, LENOVO

UNDERSTAND THE ORGANIZATIONAL CHALLENGES

The key is to overcome the internal barriers

IN BRIEF

Some of the largest challenges facing Danish companies in China have to do not with the market but with aspects of the organization itself. These include

- Corporate resistance to change—the tendency for a company to want to keep doing things in familiar ways and investing in familiar markets
- Human resources—the need to find, train, educate, and keep local talent at the Chinese subsidiary
- Bridging cultures—the need to bridge two cultures with management hires
- Clash between mind-sets—the tendency for a corporate culture built around "the best" to be unable to accept "suitable" quality
- Centralization versus localization—the need to give the local subsidiary sufficient autonomy to operate efficiently but also to be responsible for results
- Management principles—the need to be open to a new approach to organizing and managing the Chinese subsidiary that differs from the model followed in developed markets

The challenges inherent in moving into the mid-market from the high-end market in China result to a large extent from the cultural and administrative differences between Denmark and China, encapsulated in Pankaj Ghemawat's CAGE model (described in more detail in the "Adapt Your Solution" guidebook). These challenges are mainly related to issues and barriers within a company. From our observations, the first key to success in China is to overcome these internal barriers and align the company around a wholehearted China strategy. Let's have a look at the main organizational challenges and how your company can overcome them.

CORPORATE RESISTANCE TO CHANGE

To be clear from the start, your company cannot succeed in China with a halfhearted effort. Competition is so fierce and conditions so different that you must be prepared to go all-in if you want to expand into this market segment. But several factors can get in the way of HQ setting high ambitions and aspirations for the Chinese mid-market and making the necessary commitment to support the local Chinese subsidiary.

- *HQ has a hard time understanding the local opportunities* that constantly emerge for growing, creating, or exploring new businesses, due to the huge differences between China and Denmark.
- *HQ often controls decision making,* slowing down the decision process as they typically ask for more data and documentation.
- *HQ mainly focuses on activities that support the company in exploiting the existing business model and product portfolio* because creation-oriented activities are much more uncertain and may threaten the existing power base in the company.
- *HQ often has a tendency to favor existing markets,* where risk is lower and returns more certain, over new initiatives in China (and especially in the Chinese mid-market), which are seen as high risk and uncertain.

As a consequence, most of the company's attention and resources are invested in developed markets where future growth opportunities are low, as shown in Figure 1.

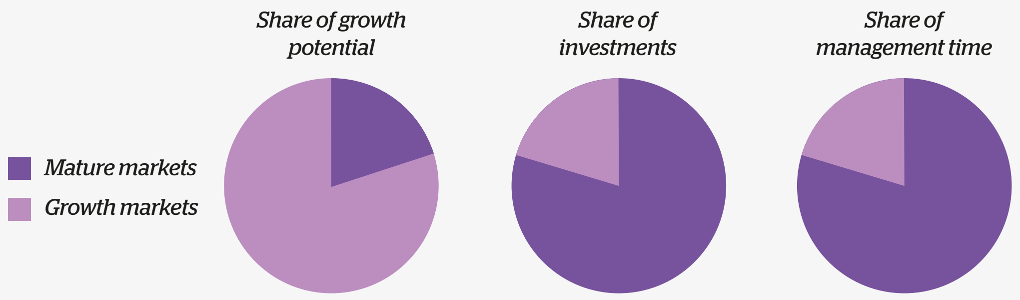


Figure 1. *How Danish companies typically prioritize their markets (illustrative)*

In short, the company does not perceive succeeding in China as a burning platform in the short term, and even though many medium-sized Danish companies say that China is their future market, they act like that future is a long way off.

Seen from China, it can be quite frustrating when the Danish headquarters doesn't seem to understand the circumstances under which the local subsidiary in China is operating. This typically leads to recurring disagreements between headquarters and the Chinese subsidiary over how things should be done. On the other hand, the Chinese subsidiary has to understand that HQ in Denmark must carefully evaluate which of their international initiatives gives the company the most for their money and make rational decisions based on this evaluation.

Often organizational resistance springs from the fact that Danish management's perspective is conditioned by where they come from—and most top management teams in medium-sized Danish companies do not include any Chinese executives! According to a report by Pankaj Ghemawat and Steven Altman, this gap between companies' leaders and their targeted growth markets can pose a serious problem when HQ is deciding the direction and strategy for the China business ("Depth Index of Globalization 2013: And the Big Shift to Emerging Economies," IESE, November 2013).

The result is often that many top management teams dislike the Chinese mid-market segment as it is very different from what they know. Julian Birkinshaw, professor and chair of strategy and entrepreneurship at the London Business School, calls it the "corporate immune system," comparing the way organizations tend to resist change to the way human bodies reject foreign tissue. The body protects itself and pushes back when something alien is happening or introduced. The problem is that it sometimes also rejects things that are beneficial, like a kidney that has been transplanted to save someone's life.

To overcome this resistance from HQ, successful companies include Chinese executives on the top management team, focus intensively on good communication between HQ and the subsidiary, ensure that the CEO visits China frequently, and take other measures further described in the next sections.

CASE

Missing out on a market opportunity due to HQ lack of understanding

The general manager of a Chinese subsidiary identified a new business opportunity and made a proposal to top management in Denmark. The business case was promising, with a rather low investment and risk level. The idea was to include a new product in their assortment and to offer it to their existing customers in China. This new product would be sourced 100 percent from a local supplier and therefore would require only minimal investment and no development of new in-house capabilities. If successful, this new product would generate an increased demand for the company's existing product lines and sales revenue estimated at a two-digit million DKK value.

But HQ did not see this new product as belonging to the core of the company and was concerned about the quality level and quality assurance of the local supplier plus some legal IPR issues. The decision was postponed several times as HQ needed to know more and was uncertain about the potential and how to manage the quality and IPR issues. HQ finally decided to go for the business idea a year and a half after the proposal was originally made, but by this time it was too late—the window of opportunity had closed. Local players had seen the business opportunity and were now occupying the market with products. At this point it would have been costly and difficult for the company to get in and grasp the needed share of the market, so the idea was terminated.

THE HUMAN RESOURCES CHALLENGE

Commitment from HQ is not the only organizational challenge. The need to find, train, educate, and keep local talent at the Chinese subsidiary is also critical. Several researchers and companies we have talked to and investigated point to human resources as one of the largest challenges facing Danish companies in China.

One of the reasons this challenge is so big is that the Chinese business environment for years has been characterized by a higher demand for than supply of skilled people. Workers stand to benefit significantly by changing jobs; many have been able to get very big salary increases within a short period of time this way. The result has been and, to a certain degree, still is an employee turnover rate of 20 to 40 percent annually in most industries.

On top of increasing the salary level, the high employee turnover rate has three other negative effects on Chinese subsidiaries. First, a lot of knowledge inevitably disappears every time an employee leaves the company. Second, the effort to educate and train employees is almost endless. And third, due to their heavy job shopping, many Chinese employees do not have deep knowledge, competence, or experience in a specific function as they do not spend enough time in a job to really become experts. Chinese organizations are learning fast, but they are also forgetting fast due to the rapid turnover of employees!

CASE

Setting up a training academy to provide ongoing education

A Danish company participating in the Suitable for Growth project found that their distributors were very good at selling products to local Chinese customers and end users but not so good at servicing the products and training the customers to use the products correctly. The Danish company discovered that one reason the distributors were more focused on generating sales of new products than after-sales service and training was that high employee turnover at the distributors meant that too many technical service people were not properly trained and educated. Knowledge was simply leaving faster than it was being built up again.

To address this problem, the company established a training academy in China. The academy not only trains the subsidiary's employees and distributors to service products and support customers, but it also trains and educates customers and end users in the correct application and use of their products.

> The Chinese are only disloyal because their opportunities are different than in Denmark. Imagine Boeing, Microsoft, Apple, and General Motors came to Haderslev and offered 30 percent higher salaries.
>
> GENERAL MANAGER KLAUS HANSEN, EJSEN PRECISION PARTS

Besides ongoing training and education activities as described in the case, some foreign companies are implementing concepts like "two in a box," where for critical jobs they hire and train two employees for the same job, leaving the company less vulnerable if one of the employees leaves. Others are implementing rigorous documentation systems so that all work, contacts, decisions, and activities are documented. These solutions may work well, but they also increase complexity and costs, and do not really fix the root cause of the problem, the high employee turnover rate.

Attracting and keeping talented Chinese workers is difficult not only because demand exceeds supply but also because talented Chinese workers favor Chinese companies, large foreign multinational companies (MNCs), or state-owned enterprises (SOEs) over foreign small and medium-sized enterprises (SMEs). There is no doubt that if your company is to attract good people in China, you must make sure that you are more attractive as an employer than the MNC's and the local Chinese companies.

One of the most important keys to attracting and keeping talented Chinese employees is to offer them good career opportunities. The Guideline box on the next page describes some initiatives that have worked well for Danish and other foreign companies in China to find and retain Chinese employees.

Chinese organizations are learning fast, but they are also forgetting fast

WORKING PREFERENCE

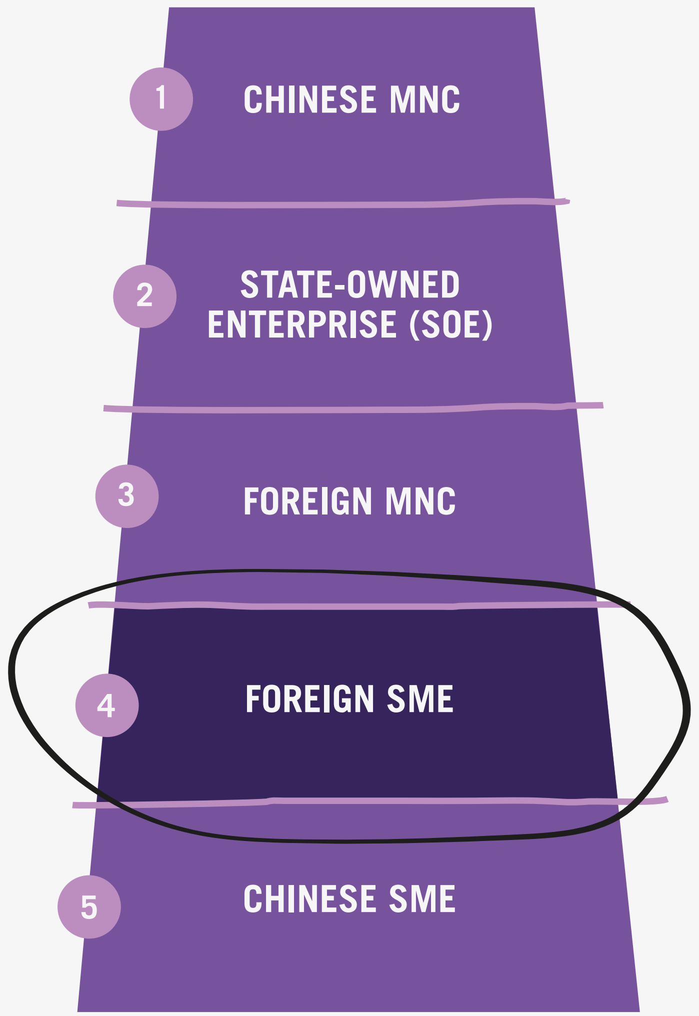


Figure 2. *How Chinese employees prioritize companies to work for (based on input from researcher Yangfeng Cao)*

GUIDELINES

Ways to find and keep good employees in China

- **Offer internships** in the Chinese subsidiary, where students from the local business school or university are employed for a short period, to identify potential new employees. During their stay, the company evaluates the interns' performance and offers the best a job afterward.
- Systematically recruit by **canvassing students** who are taking courses at local universities and business schools on business areas and industries of company interest.
- Build good relationships or "guanxi" by establishing both a professional and a personal **relationship based on trust**. You need to focus on the soft side of knowing people if you want to keep people, as Chinese trust is very personalized. Know each other and invest in the relationship.
- Implement a **visible career ladder** with many smaller steps that makes it possible to advance in the company and link it closely to responsibility and salary. In this way the employee can demonstrate that he or she is successful (keeping face with family and friends).
- **Avoid glass ceilings** that make it impossible for Chinese employees to reach the top.
- Have **frequent one-on-one meetings** with your Chinese leaders and managers to secure alignment and clarity on objectives and strategy. Demonstrate that you care and are interested in their well-being, continued performance, and development.
- Care for their families. Have frequent **company days and social arrangements** where the employees and their families meet after work. The Chinese are very social and group oriented, so creating a culture of belonging to a family, where peace and harmony among the employees are cherished, will create a strong bond to the company. The Chinese put much time and effort into the company, so you must demonstrate taking care of their families.
- Implement a **performance-based salary system**, with a low base salary and a high performance share with the opportunity for bonus payments.
- Help Chinese employees grow by **training and developing** them. Sending good employees to the Danish headquarters for training is also an excellent opportunity to inculcate company culture and values.
- Establish **training academies** or programs to develop Chinese employees and talents.
- Make it possible for your Chinese stars to get **jobs in other parts of the organization** (abroad, at HQ, and so on). Make it part of the career plan in the company for your most talented employees.
- Give the local general manager **direct access to top management** in Denmark. This person is the focal point of the local organization, and the one the Chinese employees look up to. If he leaves the company, a large group of people may follow him, especially the people he has hired.
- Make **more use of female employees**, as they are typically evaluated as more loyal, open, and hard working than male employees.

The general belief is that most Chinese employees are motivated only by money, but this is not true. Relationship (guanxi) is almost as important in motivating employees to stay with a company. Chinese employees like to go to restaurants and coffee shops after work and to engage in activities together on the weekends. Employees and managers call each other "brother" and "sister." Chinese employees see the company they work for as a family where they put in a lot of hard work, and they also expect that the company will take care of them like family. If they see that this is not the case, they will quickly leave your company.

NEED FOR MANAGEMENT THAT BRIDGES TWO DIFFERENT CULTURES

Another critical and challenging task is to find the right general manager for the Chinese subsidiary.

What is needed is a person you can trust who understands the Danish company culture while also having strong local relationships in China. This is hard to find in one person.

Most Danish companies opt for a Danish general manager to head their China operation because they prioritize good communication and trust between HQ and the subsidiary and they find this easier with a Dane who understands the organization, language, and culture back in Denmark. Furthermore, finding a local Chinese manager with the maturity, competencies, and experience to excel in a private international company is extremely difficult. A main reason is that top management positions in medium-sized Danish companies are occupied by native leaders, and this sends a strong signal to Chinese talents that reaching the top in that company is almost impossible.

> It is not mandatory to have a Chinese general manager, as speaking the language is not as important as speaking the culture.
>
> PROFESSOR DANIEL LUND, ALFAISAL UNIVERSITY / FUDAN UNIVERSITY

EXPERT ADVICE

Research by Pankaj Ghemawat and his team on executives who are highly effective in China finds certain interesting patterns:

- They are at least bilingual, and 75 percent speak Chinese; 80 percent speak three or more languages fluently.
- They are highly resilient, positive, and curious.
- They welcome new experiences; most of them actively sought opportunities to go overseas or grew up assuming they would move between countries.
- They have strong family and community ties; 90 percent have marriages over ten years in duration and all participate in social and charitable organizations or contribute time and knowledge individually despite demanding jobs.

Some companies have successfully used a dual leadership model in China where they have a Chinese general manager and a Danish controller (finance or operation director), or a Danish general manager and a Chinese sales or operation director. The Dane is HQ's "man in China" who they can control and rely upon to communicate with them.

CASE

Bridging two cultures via dual leadership

The launch of a participating Suitable for Growth company in China is an example of a successful dual leadership approach. The first employee in China was the current general manager, a native Chinese man who had previously worked for an American company for many years and was familiar with the Western style of doing business. He had a thorough knowledge of the market and was well qualified for building up a sales and service organization. He was supported by a Dane with many years of experience in the company who had an expert knowledge of the company's products and technology.

A trustworthy person that understands the Danish company culture, while having strong local relationships in China is hard to find

CLASH BETWEEN HIGH-END AND MID-MARKET MIND-SETS

A company with a long-term position in the high-end market has, we can hope, built a corporate culture focused on offering "the best" to the market. One of the most prominent examples is the Danish toy company LEGO, whose motto since 1936 has been "Only the best is good enough" (in Danish: "Det bedste er ikke for godt"). It's easy to imagine that employees in such a company strive for "the best" in all aspects. However, it's equally possible to imagine that employees may wrongly equate "the best" with high cost and performance and thus may perceive lowering the cost and performance as inferior to their normal way of operating.

Here are some examples of how this thinking might work against a company's entry into the Chinese mid-market:

- Engineers in R&D, who are driven by developing or exploiting the latest technologies to get the best possible performance, will find it hard to be motivated to purposely lower or change specifications.
- Manufacturing engineers, who over a long period of time have optimized production processes to deliver the best tolerances, surface qualities, and such, will not be happy to step backward in their efforts to achieve the best and instead settle for second-best.
- Sales people, who are comfortable selling to existing customers in the high-end market with high margins, will have to push themselves to make an extra effort to build relationships with new mid-market customers and on top of that will have to settle for lower margins.

Entering the Chinese mid-market requires a different cultural mind-set that focuses on "suitable" offerings with a precise fit between the benefits for the customer and the cost to the customer to acquire these benefits. For this market, the LEGO motto should actually be altered to "It's better to be good enough," since the best offering is characterized by a precise fit between benefits and cost, nothing more and nothing less (although the expression "good enough" has the negative connotation of being inferior to something better).

HIGH-END THINKING:
Only the best is good enough

↓

MID-MARKET THINKING:
It's better to be good enough

Some corporate cultures are flexible enough to span two different mind-sets, "the best" and "suitable." In other cultures, the prevailing mind-set of "the best" will clash with the challenging mind-set of "suitable," and this clash will create resistance to change. Resistance is a natural protective mechanism well known to most companies. However, the cultural change imposed by moving from the high end to the mid-market involves all functional areas of the company, so the resistance may exceed previous experiences with minor cultural changes and manifest itself as a major barrier.

GUIDELINES

Options to avoid the cultural clash: fight or flee

A company basically has only two extreme options to avoid a clash between two radically different cultures:

- Fight, in the sense of integrating the cultures by motivating employees to embrace the "suitable" culture even though it challenges their perception of professionalism. In fact, suitable offerings have a larger degree of complexity and thus potentially can challenge the professional skills of employees. Developing a suitable offering requires multi-objective optimization involving benefits vs. cost, whereas the best solution is a simple single-objective optimization based on benefits alone.
- Flee, in the sense of separating the cultures into two distinct sub-companies– for example, continue with "the best" at HQ in Denmark and isolate the "suitable" culture in the subsidiary in China.

CASE

Clashing with the mind-set of Danish engineers at HQ

Martin Professional has, ever since its founding in 1986, been a pioneer in producing lighting and effect systems for stages, with a market reputation for being the first to introduce the high-est-performance technologies like LED lighting. However, at the beginning of this decade Martin Professional lost market share to lower-priced competitors, and they realized that for some markets their products were actually too good and too expensive.

To protect their premium market position and get some of their old customers back, Martin Professional decided to respond with a lower-priced second brand, Rush by Martin. The company knew that they would not be able to develop and manufacture the product series in Denmark, as their Danish engineers were unwilling to give up the specific routines and guidelines they followed in testing and checking their high-end products. As a consequence, Martin Professional decided to outsource some of the develop-ment and all of the manufacturing of this lower-priced product line to a Chinese partner.

CENTRALIZATION VERSUS LOCALIZATION

When designing the organizational structure to encompass a China operation, Danish companies struggle to find the right balance between centralization and localization. They consider what level of adaptation is needed at the subsidiary, how much of the decision-making authority and mandate should be pushed down to that level, and which standards, procedures, and processes should be aligned with headquarters or adapted to the local conditions. They aim to avoid creating too much complexity and thereby increasing costs and reducing synergies to the other parts of the company's organization. With no fixed formulas for how much slack or autonomy is suitable, it is a desperately difficult balance, and it should be adjusted depending on the organizational stage of development of the subsidiary.

CASE

Focusing on autonomy and accountability

Midea is China's second-largest home appliances maker, based in Shunde near Hong Kong. The company manufactures everything from vacuum cleaners and small water heaters to microwave ovens and air conditioners. Most of the major product lines operate as independent businesses rather than as parts of a larger organization. Each business has a leader responsible for its P&L who has the authority to build a sales force, line up suppliers and retailers, and construct factories where the best incentives are available. The notion of synergies across units has largely been set aside; the focus is on autonomy and accountability.

Source: Harvard Business Review, September 2014

As China is a very different and very dynamic environment, local presence is a must. Good relationships and a deep understanding of customers just can't be built from headquarters or local middlemen (distributors and agents) but must be established via a strong local leadership team in China. Furthermore, the local organization must be capable of experimenting and adapting fast to changing demands and opportunities in the market. This challenges the company to

- shift decision making authority to lower levels so the China head can react quickly to changes in the mid-market,
- give the Chinese subsidiary the needed resources, authority, and responsibility so they are able to take the initiative and improve as the market changes, and
- allow the subsidiary to determine strategy for the product, marketing, and even HR (while financial allocation and branding policy in general continue to be determined by HQ).

Letting go of control and empowering the local subsidiary to make decisions requires a high level of trust. Thus, the relationship between HQ and the Chinese subsidiary is very critical in ensuring the right mix of freedom and support. Good communication is essential, with headquarters learning to listen rather than dictate. The more HQ understands China and the Chinese markets, the more they are in general willing to support the Chinese subsidiary.

NEED FOR NEW MANAGEMENT PRINCIPLES

Danish companies entering China often have a long, successful history of executing a well-proven business model that has been fine-tuned and perfected toward customer segments in the developed Western markets. However, this business model may not be well suited for the Chinese mid-market, where the context and customer preferences are quite different and the market much more uncertain and dynamic. A new approach and mind-set are generally needed.

If we compare the challenges and characteristics of a start-up company with an established company that wants to target the Chinese mid-market, some interesting similarities and patterns appear, as shown in Table 1. As the table illustrates, the entrepreneurial process is more aligned with the situation in the Chinese mid-market than is the planned process of an established company.

Thus, to be successful there, you must be open to a different approach to organizing and managing your local Chinese subsidiary. The Guidelines box suggests some management principles successful Chinese companies follow and highlights some of the issues where Danish companies in general struggle. Successful Chinese companies have designed their organizations to be extremely flexible with a high level of autonomy so that they are able to make fast decisions, and they understand how to deal with the party and state organizations. These are some of the most critical organizational competencies that a company must master to be successful when targeting the Chinese mid-market.

Above all, headquarters must understand that China is about potential. Due to the huge opportunities in China, the competition is immense. China is not an easy win anymore, but a long-term play. HQ should understand this so they do not lose faith in China too early. With that in mind, let's now have a look at the first phase of a three-phase process that medium-sized Danish companies can use to grow successfully into the Chinese mid-market.

GUIDELINES

What we can learn from successful Chinese organizations

China's business leaders are notorious for controlling companies from the top, but what is less known is that

- they decentralize, which helps them respond to market shifts and rapidly add new business lines when needed. Chinese companies create structures that give business units nearly total autonomy.
- They produce more in-house and pay employees less than their Western counterparts, so Chinese enterprises can afford to employ more people.
- They have leaders with as many direct reports as possible, taking the idea of decentralization and flat structures to the extreme.
- They chase topline growth at any cost and believe in structures that support rapid expansion.
- They focus on improvisation and speed, coupled with low costs driven by economies of scale.
- They make decisions in an ad hoc manner and are micromanagers.
- They generally keep engineering and manufacturing close, often co-locating them.
- They keep experimentation and production in-house while they tend to acquire new technologies either through formal licensing deals or by reverse-engineering them.
- They hire more midlevel engineering and manufacturing people, even though they're getting expensive. This gives them bandwidth and the luxury of tinkering, which can solve difficult problems quickly.
- They work to understand the party and state agency organization charts, and the underlying power structures, in every province and city. The trick is in knowing which officials to approach for what and where their interests lie so that mutually beneficial deals can be put together.

Source: Inspiration from Harvard Business Review, September 2014, "A Chinese Approach to Management" by Thomas Hout and David Michael

COMPARISON OF THE CHARACTERISTICS OF A START-UP COMPANY AND AN ESTABLISHED COMPANY ON SELECTED PARAMETERS

Table 1

PARAMETER	START-UP COMPANY (ENTREPRENEURIAL PROCESS)	ESTABLISHED COMPANY (PLANNED PROCESS)
BUSINESS MODEL	Nebulous	Well defined
APPROACH	Customer development	Product management
FOCUS	Speed, learning to do the right things	Quality, improving how things are done
PROCESS	Agile trial-and-error development	Planned sequential development
TEST METHOD	Test hypotheses and assumptions	Test working prototypes
CORE COMPETENCY	Immature, emerging	Mature, strong/incorporated
MANAGEMENT SYSTEM	Loosely structured to process new information quickly	Structured to manage many dimensions
ORGANIZATIONAL STRUCTURE	Independent	Dependent/interdependent
ENVIRONMENT BEST SUITED TO	Suited to a dynamic and uncertain market where knowledge level is low	Suited to a slow-moving and mature market where knowledge level and transparency are high

Relationship building is fundamental to good business in China

PILOT: BUILD A BEACHHEAD IN THE HIGH END

Create the foundation

IN BRIEF

The first phase of expanding into China for companies that don't have the resources to do it all in one step is to establish a beachhead. For medium-sized Danish companies, this means adopting their existing business model at the subsidiary and serving customers in the high-end segment. The main objective of this Pilot phase is to create a strong and independent local unit that can act within given frames, and the challenges are to transfer knowledge and develop relationships. In this phase, the subsidiary has a Danish general manager, a local sourcing team, and heavy support from HQ.

Setting up a local subsidiary in China is critical to the success of any company wanting to create value in the Chinese market on a long-term basis, but most medium-sized companies cannot make this transition in just one step. Even though they may find the mid-market of high strategic importance, they may lack the ability to exploit this market when they first enter China due to the high entry barriers and fierce competition there. As a consequence they often follow a phased-in or beachhead strategy as indicated in Figure 3.

Many Danish companies enter China by following their existing global customers into the market. They establish a beachhead by adopting their existing business model at the subsidiary and serving customers in the high-end segment. We see this as the first phase in a three-phase (Pilot-Explore-Grow) process that makes it possible for such companies to expand into China.

The main objective of this Pilot phase is to demonstrate commitment and build a high-end made-in-China platform from which the company can further develop and grow. The biggest challenges during this phase are building local capabilities at the subsidiary by transferring the needed knowledge, along with establishing strong relationships with headquarters back in Denmark, local suppliers, and the Chinese government.

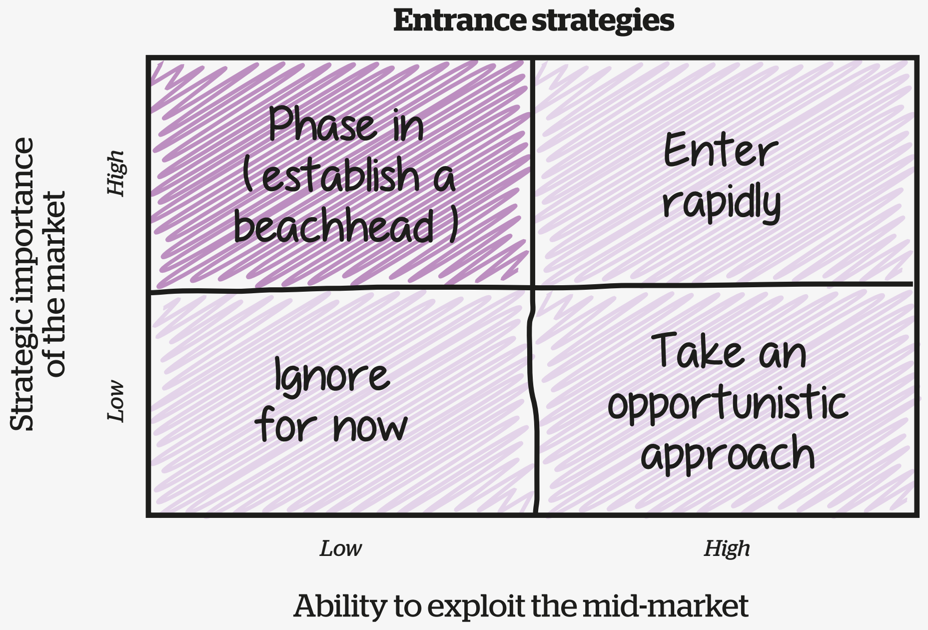


Figure 3. *Entrance strategies for the Chinese mid-market*
Source: Global strategy and organizations, Gupta & Govindarajan.

TRANSFERRING SKILLS, KNOWLEDGE, AND VALUES

Most Danish companies that move to China to supply and service their existing global customers in the Chinese high-end market typically migrate sourcing, sales and service, manufacturing, quality control, and assembly to China. They keep high-value-adding activities like R&D, design, and marketing at HQ in Denmark as these competencies are close to the core of the company and are thus being exploited on a more global scale.

The objective of offshoring to China is to improve local competitiveness and responsiveness by exploiting the closeness to the market and the low-cost manufacturing opportunities. In general, Danish companies just adopt their existing business model at the Chinese subsidiary, which implies that they more or less copy and paste selected activities and capabilities within sourcing, manufacturing, quality control, and sales. This is possible because they are targeting existing high-end customers with the same needs as customers in the Western markets.

At the same time, adopting the existing high-end business model at the Chinese setup has the advantage that this subsidiary can also serve existing customers in markets outside China (giving it a global or regional reach), which can help drive down costs due to economies of scale.

The exercise of migrating parts of the value chain to China calls for heavy support from HQ in training and educating the local subsidiary to transfer and implement the required skills and knowledge in the local organization. Besides transferring skills and knowledge to the subsidiary during the migration process, it is essential that your company build the right values and a deep understanding of the company core in China. Quality control and assurance must have an especially high priority to ensure that products and solutions made in China live up to the company's high-end standards and brand values.

The outcome should be a local subsidiary that understands the value and foundation of the mother company and that has the ability to operate efficiently in the high-end segment within clearly defined frames. HQ remains as the decision maker and responsible "parent" who is raising the "child" to become an independent individual. The subsidiary is still more or less just a messenger, passing on and executing directions from HQ.

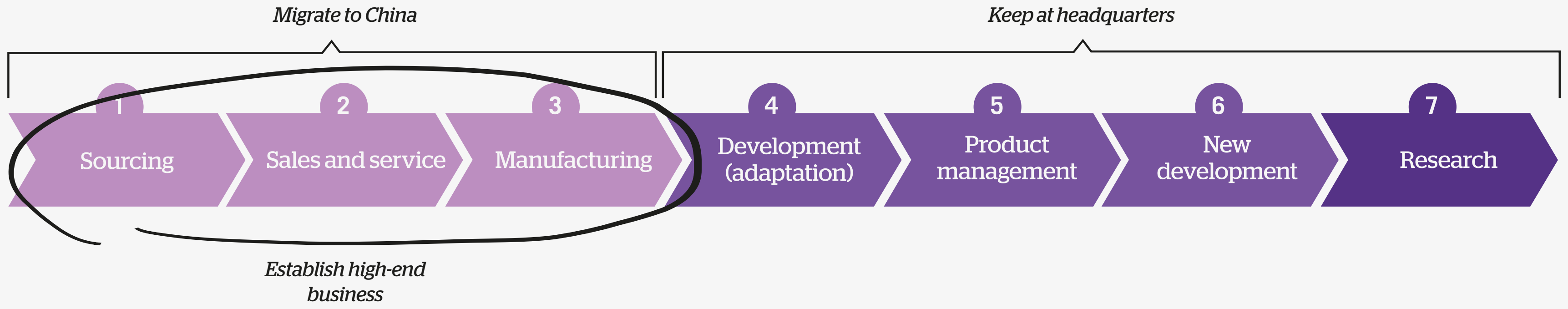


Figure 4. *Typical sequence followed by companies participating in the Suitable for Growth project when migrating value chain activities to China*

CASE

Sourcing global products for the Chinese market

When Danish supplier of veterinary products KRUUSE A/S entered China in 2011, their main strategy was to exploit the Chinese low-cost manufacturing opportunities for products to be distributed on a global scale. As they moved a larger part of their product assortment from European suppliers to Chinese manufacturers, they not only reduced costs dramatically but also opened up the opportunity to supply products to local Chinese customers who were interested in high-quality products and solutions at acceptable price levels. The products that KRUUSE sourced in China were specified according to their high global standards and were produced at such high volumes for the global market that the Chinese sales organization could take advantage of economies of scale to get products to the Chinese market at competitive prices.

KRUUSE

TOOL

Assess your organization's local Chinese capabilities

When building a local beachhead in the high-end segment to improve competitiveness in China, your company should develop and implement superior local capabilities in the following four critical areas:

- Building strong relations with global customers, industry associations and government
- Speeding up lead time by improving process flows in manufacturing
- Delivering consistent cost and quality by making continuous improvements
- Reducing costs by working with suppliers

Assess your organization's capabilities to manage these tasks by asking if you have people

- with the needed experience
- who know how to source locally
- who can run a supply chain that extends worldwide
- with the needed technological skills and experience
- who can implement the company culture and values

THE IMPORTANCE IN CHINA OF RELATIONSHIPS AND TRUST

According to Copenhagen Business School professor Peter Ping Li, Western companies and their HQ tend to rely on formal relationships (law, contracts, and the like) in doing business and to neglect the informal, soft side of knowing people. Danes have an "impersonal" trust, where trust is based in society as a whole. In contrast, Chinese trust is very personalized; in business you need to know each other and invest in the relationship. The Chinese will not honor the formal relationship and follow a contract if no informal relationship exists. This is not intuitive for Westerners.

Relationship building is fundamental to good business in China and must be managed carefully at three levels, as shown in Figure 5. Management in Denmark must understand that doing business in China is often more about relationships than skills, meaning that who you are and who you know is often more important than what you know.

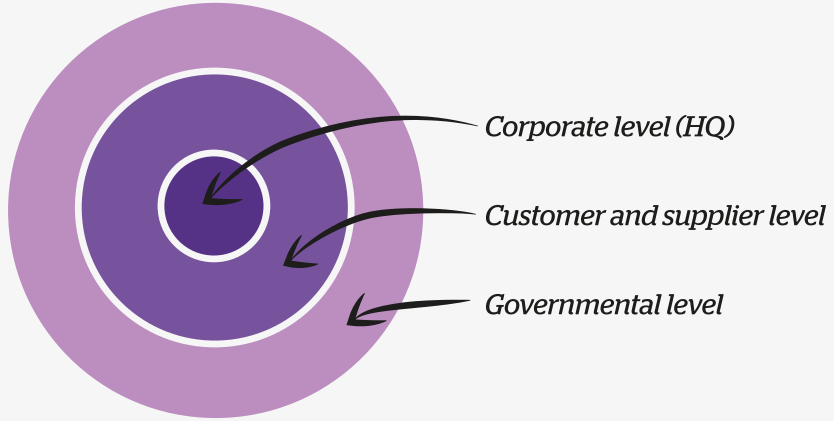


Figure 5. *Relationship building at three levels*

> China is a low-trust society and people cut corners if they can get away with it. When HQ chooses to loosen control and empower the subsidiary, you really have to work on the relationships at the same time.
>
> PROFESSOR KLAUS MEYER, CEIBS SHANGHAI

BUILDING RELATIONSHIPS TO HEADQUARTERS

As the Chinese culture is very different from the Danish culture, companies typically struggle with a lack of trust in the relationship between the Danish headquarters and the local Chinese subsidiary. This may lead to unproductive conflicts and misunderstandings, thereby slowing down the decision process. The best way to cultivate trust is by building strong personal relationships through frequent communication and face-to-face meetings, by implementing tough sanctions for untrustworthy behavior, and by linking rewards to team performance instead of personal performance.

To improve the relationship between HQ and the subsidiary you have to work hard on creating a common understanding of, commitment to, and focus on China. It is a two-way process that relies on close dialogue and information sharing. The Chinese subsidiary must understand that they need to sell China to HQ, and HQ needs to be open about how to integrate China into the organization.

> The leadership team in China faces two challenging sales: selling your company to China and selling China to your company.
>
> STEVE SCHNEIDER, GE CHINA

CASE

Building trust and credibility between HQ and the subsidiary

The general manager of one of the companies participating in the Suitable for Growth project initiated a number of activities to improve communication and understanding between HQ and the subsidiary.

- He spent half of his time educating colleagues in Denmark about the conditions and opportunities in China.
- He hired a consultant to assess a new business opportunity and make recommendations to HQ, adding credibility to his own similar ideas.
- He took top management on field trips to more remote areas in China to help them understand how uneven the development of China has been and that China does not all look like Shanghai.
- He built a very good personal relationship with the Danish boss at HQ.
- He gave high priority to making the numbers and/or exceeding the sales performance of the existing business.

The outcome of these initiatives was an increased level of trust from the Danish top management. More decision authority was transferred to the subsidiary, and the interaction between HQ and the subsidiary was improved significantly, speeding up the decision and approval process.

Still, the general manager believes the subsidiary does not yet have the ideal level of authority and empowerment to decide how to meet their goals.

GUIDELINES

Initiatives to improve the efficiency of the interaction between HQ and the subsidiary

Successful Danish companies are implementing one or more of the following initiatives:

- Members of top management visit the China subsidiary frequently and go on field trips to understand what life is like in the new markets.
- A Chinese executive is placed on the top management team to ensure diversity.
- A Danish senior manager who wants to live in China is hired as general manager of the subsidiary, thereby ensuring that the company values are transferred. Alternatively, a Chinese general manager who understands Western values (culture translator) is hired in combination with a Danish controller (company translator) to bridge relations to headquarters.
- Chinese employees are sent to training and education sessions at HQ.
- Danish experts are sent to China to transfer knowledge to the local Chinese employees at the subsidiary.
- Procedures are implemented to ensure that information is flowing adequately and frequently between HQ and the subsidiary.
- Managers from HQ stay at least two or three weeks when they visit the Chinese subsidiary and avoid flying in and out.

BUILDING RELATIONSHIPS WITH CHINESE PARTNERS

Good relationships are also the ticket to doing business with customers and suppliers in China, but they are not the only requirement. A thorough due diligence is much more important to do in China than in any other market, even when you feel very good about a relationship and your experience tells you that this is a good business partner.

Trust and good communication are key factors in building strong relationships. As China is very different from Western markets in terms of culture, language, mind-set, and business orientation, building strong relationships to Chinese partners is more difficult. Developing mutual trust requires that you spend a lot of time with your partners and customers to really get to know and understand them.

You have to look upon your Chinese partnerships as a marriage where you each work hard to understand the true needs and wants of the other in order to ensure that you have the same dreams (vision and targets) and share the same mind-set (agreed ethics and standards). You must be able to see the partnership through the eyes of your partner—and this takes time and may require help and support from local experts or advisors.

Developing a good partnership is about understanding (and matching) the value that the partner adds to your business and the benefits the partner gets from the relationship. Be careful to evaluate not only the assets your company can leverage from the relationship but also your Chinese partner's capacity to learn and develop skills, as these capabilities are critical in a dynamic market. How to manage partnerships (distributors) is described in more detail in the guidebook "Scale Your Distribution."

BUILDING RELATIONSHIPS WITH THE CHINESE GOVERNMENT

In China the government sees the performance of the economy and of society as a whole as an extension of the government itself and its image. This means that you can't separate government from business and that your business success depends heavily on the government. Understanding the Chinese government system and finding ways to reach the right decision makers and gate keepers is critical if you are to get needed approvals and support, and is best managed by local Chinese talent with the necessary knowledge and insights.

There is a Chinese adage that "no man can approve a project, but any man can veto it." Thus, lobbying the right people is essential. There are three levels of government to deal with—central, provincial and local—and relations need to be built with at least two levels (often local and provincial). Building these government relations requires a substantial investment of time and attention, not only from executives at the local subsidiary but also from HQ.

The Chinese government is cautious and sometime acts in a protectionist manner, making the process of getting approvals difficult for foreign companies. However, companies have to understand that the Chinese government is also in a learning process, developing and improving rules and laws based on their experience with these companies. Understanding this can help you when working with the government system.

It is difficult to deal directly with the Chinese government, and it may take a long time to build the necessary relationships. Because the Chinese market has grown in size and importance in the last decade and thus has attracted a lot of new local and international players, getting the attention of and time with the government can be hard. An alternative and often faster way to reach the government may be through industry associations, as they in general already have very good relations with the Chinese government as well as the needed power and influence. Industry associations may also be able to provide your company with detailed market and industry information that can otherwise be quite difficult to obtain.

GUIDELINES

Six fundamentals of a government relations strategy in China

- Map the bureaucratic arena (ranks, reporting lines, influence, and the like). Which vice mayors/vice governors/vice ministers and heads of lower-ranking units can help or hinder businesses? Identify a set of targets for corporate efforts to develop relationships, information, and influence.
- Put in face time. Prioritize informal meetings over formal dinners.
- Know the political phrases and slogans, and cast proposals in this language.
- Never have only one key personal relationship.
- Provide training and technical advice if appropriate. China has a consensus-building policy process, so take time to ascertain policies in the making and put forward suggestions and proposals regarding key regulations.
- Have your CEO visit officials to discuss key issues, and prepare well for these meetings.

Source: Jimmy Hexter and Jonathan Woetzel, Operation China: From Strategy to Execution

CASE

Getting approvals as a moving target

A Danish company decided to establish their own local manufacturing facility in China as a way to get into the Chinese market of governmental bids, which required locally manufactured products. The company planned to set up an exact copy of their Danish assembly and testing line to ensure quality. Setting up the production facilities and getting the manufacturing license was time consuming and hard work but was manageable with the right use of local Chinese people and authorities. However, the company discovered that getting local government approval of the product was more or less a moving target. The local government was constantly asking them for new information, and more than two years later they still had not gotten their products approved for local production.

When they started out, the law said that they needed to have a manufacturing license and manufacturing people hired and in place before they could apply for product approval, making the product approval the last hurdle to complete. Then the law was changed several times, and now companies in the industry can actually apply for product approval even before getting a manufacturing license or putting manufacturing people in place—and even before the R&D of the product is finished. So the process has been improved, but unfortunately it's some years too late for the Danish company to benefit.

The government in China sees the performance of the economy and the society as an extension of the government itself and its image

Danish companies underestimates the impact of the differences between their Western markets and the Chinese mid-market

EXPLORE: ADAPT TO THE CHINESE MID-MARKET

Establish a local business model

IN BRIEF

The second phase of expanding into China for medium-sized Danish companies is to adapt to the mid-market. The main objective of this Explore phase is to move toward a made-for-China business model. How and what strategies to use depend on the capabilities of the company and the size of the gap between the present high-end customer segment and the new mid-market segment.

But regardless of strategy, Danish companies pursuing the mid-market opportunity must develop an independent local organization that is flexible and entrepreneurial in its approach to the market and is given the needed autonomy to improve and make its own decisions based on local insights. It is a delicate balance as adaptation always increases complexity and cost, so companies must find ways to limit the variations and improve their organizational adaptability by exploiting synergies with their existing business where possible.

In this phase, the subsidiary has a Chinese general manager and a Danish CFO, local product development and quality control, and an autonomous/independent setup for decision making.

When your company has entered China successfully in the high-end segment and established a local supply chain platform that can serve existing customers, you may be ready to take your Chinese business to the mid-market. This market segment is characterized by mainly local competitors who are delivering products and solutions at half price and operating and adapting at the speed of light, and by local customers who are difficult to understand, who have different needs, and who are not experienced with your products/solutions. It is a very different game, and the gap between your existing market segment and the mid-market may be uncomfortably wide.

You have to learn how to move from your existing business model where your company is managing well-known products, solutions, and customers to a more exploratory business model where you can adjust and adapt your offerings and your way of doing business to a new type of customer. You also have to be prepared to give the subsidiary the freedom to make decisions. The companies that succeed in the Chinese mid-market are those with subsidiaries that show lots of initiative, that are able to improve, and that have the autonomy and resources to develop new and different solutions. In short, these subsidiaries have latitude—room for maneuvering.

ARE YOU READY TO COMPETE IN THE MID-MARKET?

Before deciding to enter the Chinese mid-market, you should evaluate whether your organization is ready, and if so, how you should enter. The answers to these questions depend on your company´s capabilities and how they match the requirements or characteristics of the mid-market customer segment you want to target. They also depend on the aspirations of headquarters.

A more explorative business model is needed to adapt your offerings to a new type of customers

Evaluate your readiness to compete in the Chinese mid-market

1. Start by evaluating what customers in the mid-market want in terms of

- product performance,
- product quality,
- cost structure and level,
- sales, distribution, and service, and
- speed and flexibility.

Compare these specs to what your existing customers want and see how wide the gap is.

2. Next evaluate your organization's capabilities in the areas of

- research and development,
- production setup,
- go-to-market model,
- sales and trade incentives,
- organizational skills and mind-set, and
- legal or IP trends.

See how well they match the requirements of the mid-market. From this analysis you should be able to identify which strategy to follow.

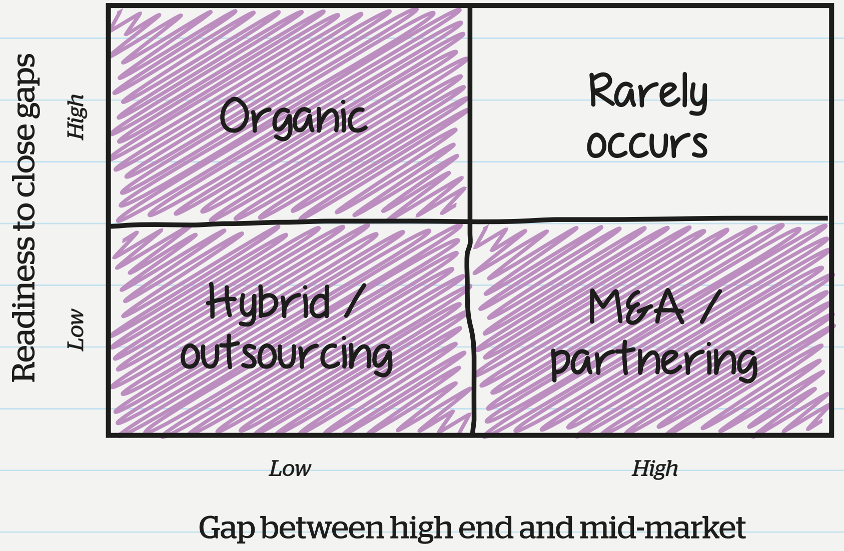
3. Finally, top management at headquarters should ask themselves these questions:

- Are our best and brightest employees deployed in China?
- Are our aspirations bold enough? Are our growth ambitions high enough?
- Have we created a profitable business model that delivers growth?
- Do we and our senior team spend enough time on the ground?
- Are our initial investments big enough?

Inspired by Bain & Company, "How to win on China's good enough battlefield" (2014), and Boston Consulting Group, "How companies in emerging markets are winning at home"

Strategies for entering the mid-market

Figure 6.



TOOL

Entering the Chinese mid-market: Strategies used by Danish companies

Organic

- FOSS built a separate organization for their SINO Foss (Labtec) mid-market line
- ALFA Laval developed a "low entry" product line called i-series

Hybrid / outsourcing

- Martin Professional (now Harman) outsourced the manufacturing of the RUSH by Martin product line to a Chinese OEM

Merger & acquisition

- Danfoss Drives acquired the local Chinese company HOLIP
- Nilfisk Advance acquired the local Chinese company VIPER
- Grundfos acquired the local Chinese company EMERCO

CASE

It isn't the fittest that survive; it's the most flexible

ADAPTING YOUR BUSINESS MODEL TO THE MID-MARKET

Chinese mid-market customers are different. Their buying criteria and how they value the specific parameters in your product's value proposition are often quite different from your Western or global customers. You must adjust or adapt your value proposition—and thus your products/solutions—to their needs to be successful, as indicated in Figure 7. This comes at a cost even as it increases the customer's willingness to pay.

Managing adaptation includes finding ways to limit the need for and/or the cost of variation—to reduce the impact of differences. Our case studies indicate that management in medium-sized Danish companies often underestimates the impact of the differences between their Western markets and the Chinese mid-market, and therefore they tend to underadapt their products and services or underestimate the time and resources required to penetrate this market segment.

From existing to new customers

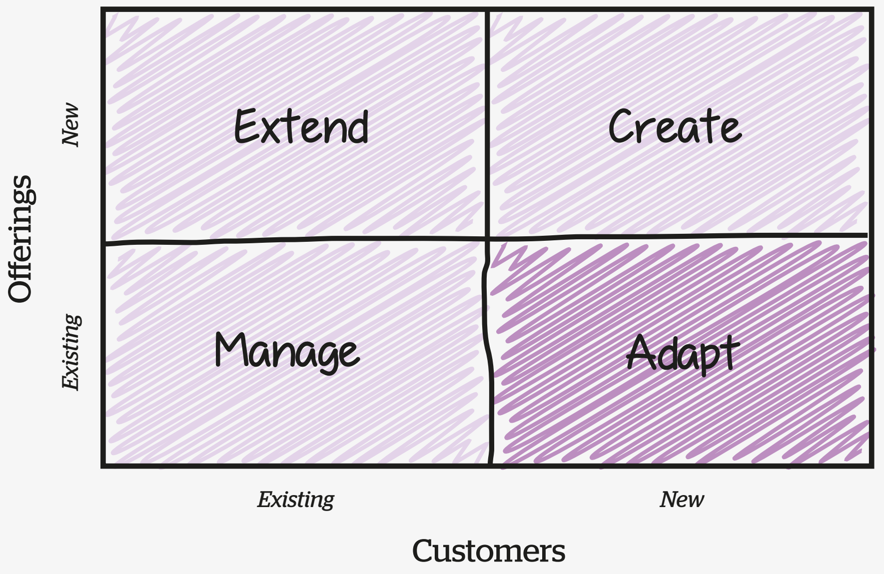


Figure 7. *The move from existing offerings and customers to new customers*

Based on the experience of larger Danish corporations operating in the Chinese mid-market, the local subsidiary should implement two critical elements to improve their ability to adapt:

- *Integrate local market research and design* to improve the chance of developing products and solutions that are suitable for local needs.
- *Integrate design and manufacturing* to reduce the design-to-order lead time significantly and make the company much more responsive to the dynamic mid-market situation.

Medium-sized companies should carefully consider establishing a local design and development function in China, and integrate this function with a local market research function and manufacturing platform, as shown in Figure 8.

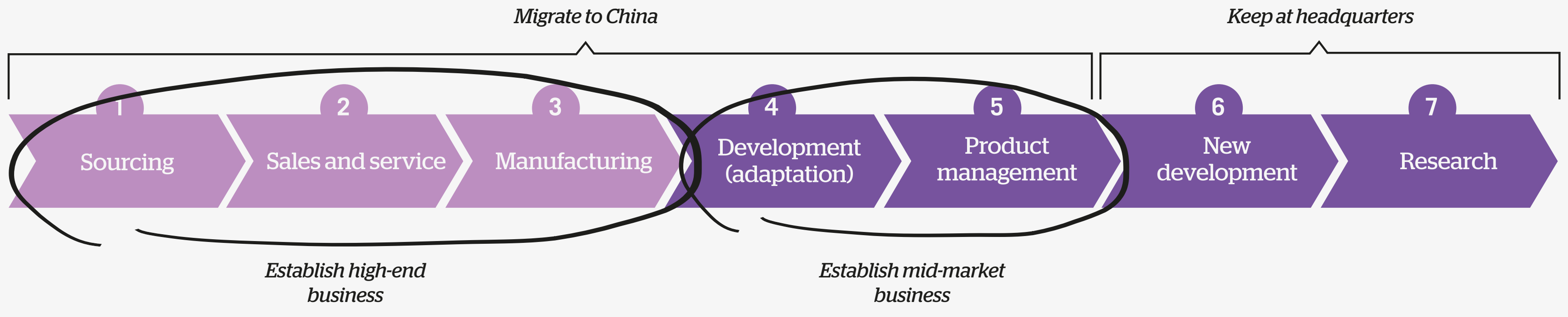


Figure 8 *Sequence followed by Danish companies as they adapt to the Chinese mid-market*

Most companies see this as an extra cost and a double function as they already have these activities at HQ. But what they often forget is that the need for adaptation changes over time, so local presence and monitoring is critical to make the change when needed. There are some other significant benefits to consider:

- The cost of a local designer in China is still lower than in Denmark.
- Inspiration for designs based on customer needs is found locally in the Chinese factories and on the streets in China (and not in Denmark).
- Designers in China are more open to selecting materials and parts already available in China, which can reduce costs significantly. They are typically in a better position to translate local needs into better design and product specification decisions.
- Having designers close to the suppliers and manufacturers enables a much more efficient working relationship that can shorten the product development lead time and increase the speed of testing and approving samples and products.
- Having local market research and development competencies opens up opportunities for reverse innovation, where the company develops local products of high value at affordable prices that can be sold in other markets

The local Chinese mid-market setup will have a different product development focus than HQ as their objective is to meet local Chinese customer needs. Where HQ in general focuses on making the best global products and making them more cheaply, the mind-set of the local subsidiary should be making local products cheaper and better—that is, creating suitable solutions.

> What you learn in your home market about a particular industry may have very little to do with what you'll need to succeed in a new market where the context is different.
>
> TARUN KHANNA AND JAN W. RIVKIN

GUIDELINES

Focus areas to develop suitable solutions for the mid-market

- Do on-the-ground research to understand the market and its needs, functions, problems.
- Set the right price point to tap the market.
- Use technology and knowledge to reduce costs and prices, not to improve products.
- Provide local product developers with the authority to respond and make fast decisions based on market understanding without waiting for approval and response from HQ, which is too slow in most companies.
- Build a local development team with foreign and Chinese engineers and designers.
- Integrate product development with market research.
- Be patient, as change takes time.

CASE

Growing a subsidiary as a two-way process

The way Gabriel has changed its organization in China is an excellent illustration of how a subsidiary matures from a phase of dependency on the Danish HQ to a phase in which it becomes much more competent and able to act independently. Like a good parent, Gabriel has consciously transferred knowledge and responsibilities in parallel to its Chinese subsidiary.

Gabriel initially opened an office in China to source textiles for its European customers. Gradually the division started to sell to Chinese customers in greater numbers and to Western furniture companies that were manufacturing in China. Over time, the Chinese market grew in sales and as the future potential became clearer, HQ decided to let the Chinese subsidiary operate with the same extensive autonomy that has worked well for the other business units in the Gabriel group. Today, Gabriel Asia Pacific is a 100-percent independent unit. It has its own design and development, sales, logistics, and quality control functions.

Making the transition to an independent local unit required a lot of communication and top management visits to China in order to clarify the practical consequences of the change. For example, the Chinese organization continued to have the quality control department at HQ approve tests, even though they had the capabilities and tools themselves. When the Danish organization had to change procedures, they double-checked the Chinese organization's quality test to make sure they were OK. When the Chinese subsidiary got ISO certified, it created more confidence and trust because they are regularly audited in order to maintain the ISO certification.

Gabriel®

IMPROVING THE ORGANIZATION'S CAPACITY TO ADAPT

If activities like product development, market research, sourcing, and production are established in China, the Chinese team and subsidiary must be highly qualified and skilled, as they need to be able to react to the shifting demands locally but also to possess a global mind-set and understanding of how to balance China-specific issues and needs with the global business and corporate strategies and requirements.

GUIDELINES

Skills and competencies of a local Chinese A++ team

- For designers and/or engineers from Denmark: Can work well with local Chinese employees and can transfer their knowledge, values, and experiences.
- Can work with complex government structures where extensive cultivation of officials is a critical part of their job description. This requires cultural sensitivity and a feeling for government and public relations, which is beyond the skills of many Danish managers.
- Can work with suppliers to reduce costs.
- Are capable of making continuous improvements to deliver consistent cost and quality.
- Are trained in global standards, norms, values, and ethics that are nonnegotiable.

Improvisation is a matter of the individual employee's ability to act, but it also depends on whether a company will allow its employees to improvise

From research, we know that operating in ways that are congruent with the organization's cultural context can improve business performance. Therefore, operating in the Chinese mid-market will require some variation and adaptation of the company's operating procedures. The mix of products that need to be supported, the scale and complexity of the market, and the unique challenges around developing and managing local talent create a need for the subsidiary to have decision rights and for structures and processes supporting these rights.

However, simply varying all practices and pushing all decision-making authority down to the Chinese subsidiary is also problematic, as the result is likely to be a costly increase in complexity and a low level of synergy.

If a company has a strong brand and sells the same high-quality products globally, it's important to ensure that all subsidiaries conform to company standards. There are very good reasons why companies insist on quality control and ISO standards. But the further toward the local mid-market the company wants to move, the less productive this centralized model becomes. When every little local change of specifications has to be approved by HQ, it dramatically reduces the ability of the local manager to respond to shifts in market demands.

Of course there are certain issues where you cannot be flexible, such as labor laws and corruption, and you must be aware that Danish companies are under close scrutiny by the Chinese government, which sometimes strikes very hard against any irregularities in foreign companies. But transferring decision-making power to the Chinese subsidiary enables much more efficient management of the local operation as time does not have to be spent discussing decisions.

The dynamic market situation in China makes it crucial that the general manager and the employees in China have a high degree of initiative so that they can spot the changing demands of customers and react quickly when they see new opportunities. Initiative taking and the ability to improvise are critical requirements for a subsidiary in China. The local employees must have the personal motivation and drive to explore new opportunities—and also enough slack time and resources to do some experimentation.

In part, improvisation is a matter of the individual employee's ability to act, but it also depends on whether a company will allow its employees to improvise. There is a difference between what you can do and what you are allowed to do. According to research done by Yangfeng Cao, PhD, of the Copenhagen Business School, the local managers in Danish subsidiaries in China have lots of ideas for new ways of creating value for customers, but HQ often doesn't give them the resources or freedom to convert the ideas into action. The main reason is that it is risky. But if you want to go into the Chinese mid-market, where opportunities are huge, you have to take some risks.

> In the Chinese mid-market it's not about being able to deliver perfect solutions in six months - rather, customers expect fast adjustments so they can have a solution which fulfills their needs within a couple of weeks.
>
> PROF. CLAUS MEYER, CEIBS

Aside from finding the right level of decision-making authority for the subsidiary and giving its employees room to improvise, companies can also improve their capacity to adapt by limiting the need for and/or the cost of variation and by following the suggestions in the Guidelines box.

OPINION

Boy scout or maverick?

Several of the managers at Suitable for Growth participant companies have complained of frustrating episodes when they identified very promising new business opportunities but were unable to pursue them because they couldn't convince HQ to approve the idea—in the general managers' view because the management in Denmark did not fully understand the situation in China. As Professor Julian Birkinshaw of the London Business School points out, this leaves the general manager with two options: "You can stay within the rules, and be a boy scout who does things slowly and gradually, following the instructions of the head office. Or you can become a maverick and deliberately push the rules by doing something without having official resources or approval."

Particularly in a dynamic market like the Chinese mid-market, being a good corporate foot soldier, waiting for instructions, will likely not be sufficient to get anything done—and probably no one at the Danish head office will know enough about the situation in China to really be of help anyway. So to some extent, a company needs its local manager to be a maverick. On the other hand, the head office needs to be careful that the local manager doesn't become a loose cannon, damaging the company or even ending up on the wrong side of the law. As Birkinshaw puts it: "It's a desperately difficult balance—which is why Western-trained Chinese are such a scarce resource because they have the dual skill set."

GUIDELINES

Ideas for improving the organization's capacity to adapt

- Hire for adaptability and bring in people who are good at thinking across cultures, strong in innovation, and knowledgeable about the local market.
- Invest in cross-cultural training.
- Consider team opportunities where it's possible to bring together people from China and Denmark.
- When flying in executives from Denmark to learn about China, it's nice to meet in Shanghai, but often it would make more sense to have meetings in a county-level city.
- Avoid bringing people in for just one or two weeks to develop new products; allow a minimum of three months to gain sufficient depth. Longer is advantageous.
- Use expatriate assignments to improve the capacity to adapt. It's hard to entice people to go from Shanghai to a tier-3 city, but it can be important.
- Strive for more representation of Chinese people at the top.
- Cultivate a strong company culture, which can help to create an integrated company across a variety of culturally different locations.
- Keep the company open to outside ideas from partners and other relationships.
- Participate in industry associations in countries where you want to be more adaptive.

Source: Input from Steven Altman, IESE Business School, Barcelona, Spain

TAKING AN EXPLORATORY APPROACH

When a Danish company enters the Chinese mid-market, a key activity is to discover and validate new local customers to understand their different needs and requirements. Hence, management can't expect to have the right solution from the start but instead must explore and experiment to test their assumptions.

A useful approach in such a situation is to act more entrepreneurial by following a discovery-driven process. The objective is to search for new insights that can be used to make better decisions by focusing relentlessly on testing assumptions and hypotheses and turning them into facts. To succeed, Danish companies need to improve their organization's ability to move quickly from thinking and planning to knowing and doing. Speed is everything, and entrepreneurial methods may be the right way forward.

Hence, following standard procedures is often not the way forward when you move into the mid-market in China. Instead you should focus on people management, trusting them and following them closely. Learn from what they do, how they fail and succeed. Mentoring and coaching the employees may be the right way to escape underperformance and resource reallocation.

If you have an open mind and are willing to let go of what you think is the right thing to do, you may be closer to success. Unlearning what you know from other markets may be just as important as learning what you don't know. Because it's a learning process, companies should focus on measuring learning just as much as they measure results as this will help them readjust their plans and strategies frequently and quickly.

TOOL

Discovery driven planning

In a new business as in the mid-market, little is often known and much is assumed. The discovery driven planning (DDP) framework makes assumptions explicit and converts them into knowledge as the business progresses and unfolds. The framework imposes a strict discipline on the planning process that is different from that used in conventional planning. DDP is about how to plan under uncertainty.

The six key disciplines are

- framing a worthwhile challenge,
- recognizing competitive market and industry matrices and knowledge,
- specifying required operations,
- identifying and documenting assumptions,
- identifying major milestones, and
- testing assumptions at each milestone ahead of investment.

Source: Rita McGrath and Ian MacMillan, "Discovery Driven Planning"

Find a way to balance synergies and conflicts between your high-end and your mid-market business models

GROW: EXPAND TO NEW SEGMENTS AND REGIONS

Scale the China mid-market business

IN BRIEF

The third phase of expanding into China is to scale the mid-market business that you have established. The objective of this Grow phase is to exploit opportunities of scale while creating a more integrated and efficient operation. This often implies taking advantage of the company's global outreach and moving into similar customer segments in other emerging markets. In this phase the subsidiary has a Chinese general manager and is interdependent with the parent organization.

A challenge often encountered in this phase is how to balance the synergies with the conflicts that exist between the high-end and mid-market business models. Scaling the business and its organization is not easy as the strength of many Danish companies is in applying their core knowledge, which makes finding and developing talented employees a key issue. To really grow the business in China, companies should start to treat China as their second home, giving it the needed attention and support.

Most of the Danish companies we have talked to and followed are not experienced with the Growth phase, so this section is not detailed. Nevertheless, we know mainly from the experience of larger multinational corporations that the main challenges include deciding to what extent your new mid-market business and your existing high-end business should be integrated or separated to improve efficiency, scaling the organizational structure to include a middle management layer, and making the commitment to build a second home market in China.

BALANCING SYNERGIES AND CONFLICTS BETWEEN BUSINESS MODELS

When growing your business in the Chinese mid-market, a fundamental challenge will be to decide to what extent your new mid-market business and your existing high-end business should be integrated or separated to improve efficiency. This is not to say that integration versus separation is only an issue when growing. However, when you are growing the business the impact of not having decided how to integrate or split activities and functions between the two business models can be quite damaging.

Your company needs to find a way to balance synergies and conflicts between your high-end and mid-market business models. Whether to integrate or separate the two business models depends on the similarities and differences between the market segments. The level of similarity between the high-end and mid-market business models will determine synergies and how resources can be exploited across the two markets, whereas the level of difference between the two businesses and their ways of competing in the market will determine conflicts that must be managed to minimize impact in the market-place.

Deciding the right strategy is not easy, as it must balance staying flexible in the mid-market with implementing common standards and systems to exploit synergies (economies of scale) and reduce costs. The difficult question that you should ask yourself is: Which activities in your value chain should be separated (or kept separate) and which activities should be integrated (or kept integrated)? Whichever strategy you choose, the Guidelines box offers some suggestions on how to successfully manage the strategy, gleaned from case studies and research.

TOOL

Strategies for managing dual business models in China

First estimate the level of strategic similarity between your high-end and mid-market businesses by evaluating these factors:

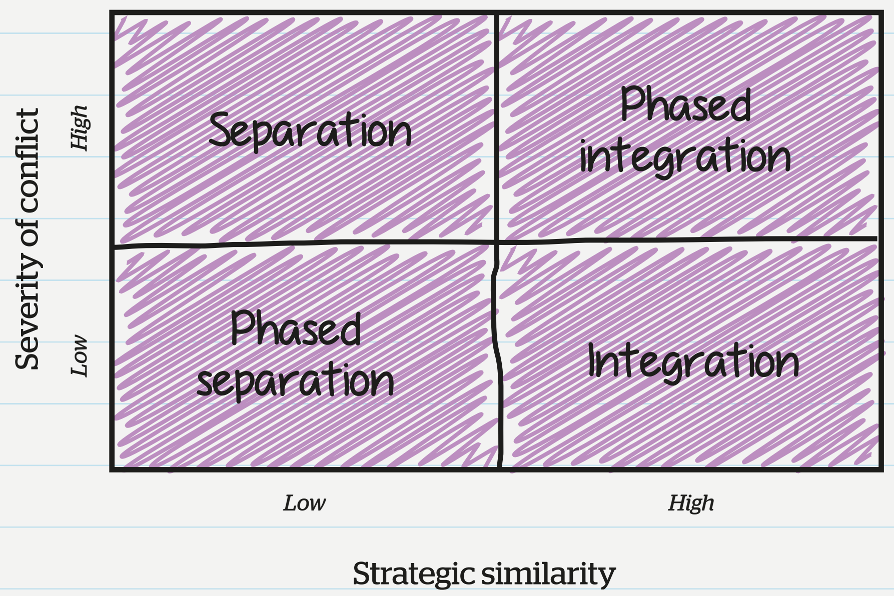
- extent of the need for personal/technical service
- degree of customization
- level of marketing expenditure
- level of labor skill and competence required
- need for low-cost staff

Next estimate the level of conflict between the two businesses by evaluating these factors:

- risk of cannibalization
- risk of compromising quality
- risk of undermining brand image and destroying the culture
- risk of defocusing the organization or shifting customers

Based on these evaluations, use the matrix to decide what strategy (separation or integration) would be most appropriate to follow when managing the two business models.

Figure 9.



Source: Inspired by Constantinos Markides and Constantinos D. Charitou, "Competing with dual business models: A contingency approach," The Academy of Management Executive, August 2004

GUIDELINES

HOW TO SUCCESSFULLY MANAGE A SEPARATION OR INTEGRATION STRATEGY

Table 2

SEPARATION	INTEGRATION
Give operational and financial autonomy to the mid-market business unit.	Treat the mid-market business as a great opportunity.
Encourage cooperation between the two businesses.	Leverage the strength of the high-end business to differentiate yourself.
Maintain a close watch from HQ over strategy in the mid-market business.	Approach tasks in a proactive, strategic manner.
Allow the mid-market business to develop its own culture and budgetary system.	Be careful not to suffocate the mid-market business with existing high-end policies.
Give the mid-market business its own CEO who is transferred from inside the organization.	

Source: Inspired by Constantinos Markides and Constantinos D. Charitou, "Competing with dual business models: A contingency approach," The Academy of Management Executive, August 2004

CASE

Working toward a phased integration

When Danfoss Drives (today called Danfoss Power Electronics) acquired the Chinese mid-market company Holip, the general manager at that time was aware of the high level of conflict between their existing high-end and mid-market businesses. However, a lot of similarities between the two businesses were also obvious.

As a consequence, the Danfoss management decided to keep the two companies separate at first ("Holip stays Holip") and then slowly work toward phased integration within all the areas where they could see synergies. A critical element in this strategy was maintaining a balance between treating Holip as a great new opportunity that could leverage the strength of the high-end business and taking care not to implement too many rigid Danfoss policies and systems that would increase costs and/or reduce the local flexibility of Holip.

CASE

Starting with separate distribution channels and then integrating

FOSS established a representative office in China in 1997 and started importing products to the Chinese market. In 2008 they established the FOSS Scino company (later changed to Labtec) to get closer to the Chinese market and to broaden their product portfolio with a second brand targeting the mid-market. Products with the original FOSS brand have a high degree of automation of the measuring process, while products with the FOSS Scino brand have a semi-automatic process. The products have the same precision in their measurement; only the automation level differs, since the lower cost of labor in China favors a semi-automatic process and some Chinese laboratories have a smaller number of samples per day.

Initially FOSS was concerned about cannibalization between the two brands, so they started with two separate sales channels. The first years were not a success since the new salespeople for the FOSS Scino brand didn't have any guanxi in the market and the distributors didn't like talking with different salespeople for the different brands. Cannibalization did not turn out to be a major issue since customers didn't jump from the high-end brand to the mid-market brand. Therefore, the regional sales managers of the FOSS products are now also selling the FOSS Scino products. They judge which customer should have which brand on a case-by-case basis.

SCALING THE ORGANIZATIONAL STRUCTURE

Many medium-sized Danish companies are niche players, focusing on a narrow niche in the B2B market. They excel due to their high level of application knowledge and their ability to deliver solutions that solve specific customer problems and meet customer needs. This gives them a competitive advantage that is difficult for local Chinese competitors to copy. But the challenge of this business model is that it is difficult to scale, as the companies are dependent on having very skilled people in the organization that can access and understand Chinese customers and help them solve their problems.

Scaling such a business model requires a lot of training and education of the local sales and technical service staff, which is both time consuming and expensive. Especially in a Chinese market where employee turnover rates are high, it can be an endless effort to keep the organization's capability at the required level. As a consequence, some Danish companies use a two-string distribution and sales platform. In this approach, they use a network of local distributors to achieve broader reach and access in selling products to specific customer segments and/or regions. Parallel to this they establish their own direct sales force with technical service staff who can support local customers and develop solutions tailored to the customer's specific needs.

Other companies choose to find local Chinese partners who are reliable and have industry insights and networks to the required customer segments, and use them to expand and scale their business.

CASE

Employing a two-string sales and distribution setup

When DESMI Pumping Technology followed the shipbuilding industry into the Chinese market, they partnered with a local Chinese distributor who had good relationships with the large shipbuilders and experience with the bidding process in China. From their activities in other international markets, DESMI had already developed good relations with and knowledge about the global ship owners, so it was a good match.

Some years later, when DESMI decided to target the Chinese industrial market segment, they realized that this segment required a different sales approach and much closer dialogue with local customers as most of the solutions needed to be customized or engineered to order. As a consequence they decided to build their own sales force and technical service staff.

As DESMI has become more and more visible and established in China over the years, the natural step for all sales segments is to rely on at least a couple of sales channels and to prioritize the investment in their own direct sales to grow the business further.

DESMI

A key challenge for most companies that start to grow in China is to scale their organization beyond being a small local company whose activities can be coordinated and supervised by top management. At some point, companies need to change from a two-tier to a three-tier organizational structure, with a competent middle management level, as shown in Figure 10.

This middle management level plays a key role in translating ideas, strategies, and business model adjustments directed by top management. They must excel at leading the actual operation as it is executed by bottom-tier employees. Talent for this level can be hard to find, so it is critical that your company pay close attention to developing, training, and keeping these middle managers as your business grows.

MAKING CHINA YOUR SECOND HOME MARKET

If your company wants to grow and leverage the opportunities in the Chinese mid-market, you must start focusing on China as much as you focus on your existing Western markets. You have to treat China as your second home and give it the needed support and commitment. This implies understanding the diversity and complexity of the Chinese mid-market, defining clear and bold objectives, and translating these into metrics just as you would in any other important market. You may, for example, need to shift from measuring growth in revenue to measuring market share as an important metric to better understand how you are performing against local competitors.

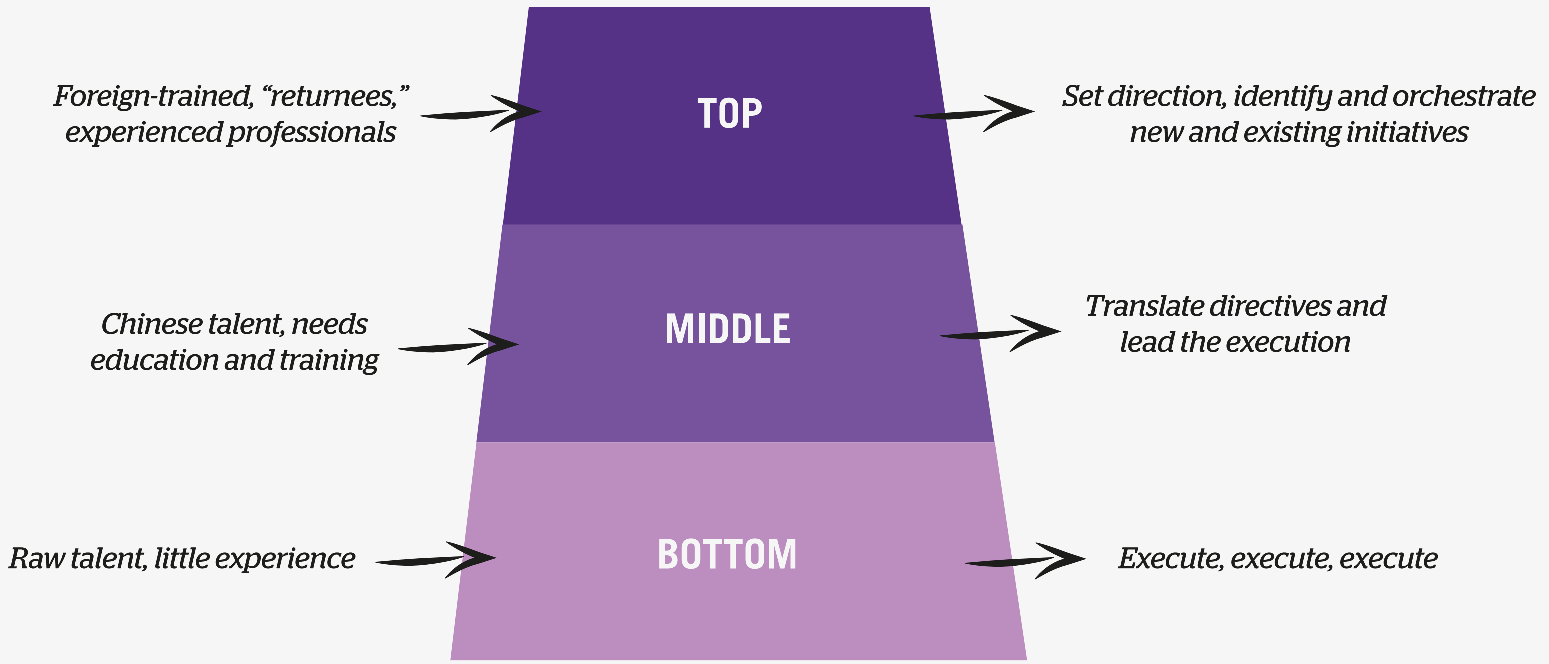


Figure 10. *Three-tier organizational structure (inspired by Ming Gu and Edison Tse)*

CASE

Aspiring to a larger market share in China

Around 2004 the CEO of Danfoss, Jørgen Mads Clausen, read an article about a European company in China that was happy about their 40 percent growth there until they discovered that their product category was actually growing by 80 percent, meaning they were losing market share. On a trip later that year he personally experienced that China was far more developed that he had imagined, giving him a feeling that there were huge opportunities in the market. This made him wonder whether his company was doing enough in the Chinese market even though they were making good money.

Based on his experiences, Danfoss decided to make an exploratory review of all their markets and discovered that they were just skimming the surface of the Chinese market and only capturing a few percentage points share in most of their categories. As a consequence, they made a shift to define their aspirations in China by market share rather than by growth rates. In the end this led Danfoss to the concept of China as their second home market after Europe, where they had most of their revenues but where economic growth was slow.

Source: William E. Hoover Jr., "Making China your second home market: An interview with the CEO of Danfoss," McKinsey Quarterly 2006, number 1

CASE

Designing the organization for international expansion

Hempel's organizational design connects the various parts of the organization to facilitate international expansion in the future.

- The top management group is international—four out of six members are non-Danish or have spent most of their career outside Denmark.
- Employees are exchanged across the international organization.
- Three R&D Centers of Excellence around the world, including one in China, report to HQ. R&D projects of strategic importance report to DK, and other projects are governed by a regional decision board.
- The Danish HQ facilitates cross-company collaboration initiatives.
- The Chinese general manager acts as a bridge between local employees and HQ but is Chinese speaking to be able to link properly with local authorities.
- Decision making is done with an international perspective. Resources are allocated internationally based upon best business cases. For example, CTO Dave Deters says, "As a global supplier, we carefully consider where investments are made to ensure they bring most benefit to our customers. For instance, in China we have factories in Guangzhou, Shanghai and Yantai, and opened a new R&D Centre near Shanghai in April 2015. These complement our global expertise with knowledge of local customer requirements - in this case in China."

GUIDELINES

Questions to ask if you want to make China your second home

TECHNOLOGY AND PRODUCT STRATEGY	○ Have your products been designed for China, based on Chinese customers' needs and requirements? ○ Are your price points adjusted to the Chinese local market?
MARKETING	○ Have you invested in a Chinese market intelligence unit, to really understand Chinese customers? ○ Is your customer segmentation based on local knowledge or just applied from another market?
OPERATIONS	○ Are your customer service centers adjusted to local needs? ○ Have you invested the required resources in building, maintaining, and refining your Chinese supply chain operation?
HUMAN RESOURCES	○ Do you invest just as much in training and development programs in China as in your home markets? ○ Do you offer local Chinese talents and executives the same opportunities for a global career that you offer your people in Denmark?
GOVERNMENT RELATIONS	○ Do you have a capable government relations staff? ○ Are you helping shape regulations as you do in other markets?

Source: Inspired by Jeff Galvin, Jimmy Hexter, and Martin Hirt, "Building a second home in China," McKinsey Quarterly, June 2010

SUMMARY

THE IMPORTANCE OF EMPOWERING YOUR ORGANIZATION

In a huge and fast-changing market like China, your traditional high-end business model will only take you so far as you service your familiar international and global customers. If your company really wants to exploit the opportunities in the Chinese market, you must be willing to go for local Chinese customers and start treating China as your second home market.

The main organizational challenges in developing and growing your business in China are internal. It is critical for HQ to understand, support, and commit to China by empowering the local Chinese subsidiary to take responsibility and make their own decisions based on local insights. A highly skilled and capable Chinese organization is required in order to establish a local value chain setup adapted to the Chinese context. This implies an organization that is able to understand the market and to design, develop, and manufacture products adapted to Chinese customers.

Based on our knowledge from observing Danish companies expanding into the Chinese mid-market, we have suggested the following three steps for getting there:

1. **Pilot:** First build a beachhead in the high-end segment where your company normally operates. Focus on transferring knowledge based on your existing business model and building relationships. Establish a local supply chain and build local capabilities by reducing your cost level and improving your responsiveness through close cooperation with local suppliers. Work closely with local authorities and demonstrate that you are committed to China and the local market.

2. **Explore:** Adapt your business model to the Chinese mid-market. Doing so requires you to empower the Chinese subsidiary and give them the freedom, mandate, and responsibility to make decisions based on their local insights. The subsidiary must operate like an entrepreneur, learning about new customers and how to adapt the business model to the different needs of these customers. This probably requires that you integrate design and development with your local manufacturing in China.

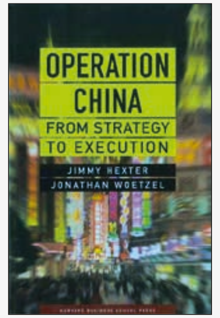
3. **Grow:** Scaling your business in China requires that you carefully balance the synergies of global standardization with the need for local flexibility and adaptation without increasing costs. China is different, and growing the business there requires that you start measuring and investing in the market as if it were your second home.

FURTHER READING

This guidebook isn't meant to be a complete and exhaustive discussion of how to empower your organization. We recommend that you also consult the following sources:

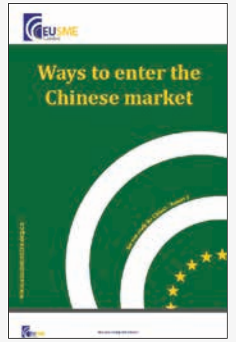
Chao, Stanley. 2012. Selling to China: A guide to doing business in China for small- and medium-sized companies. iUniverse.

In this book the author helps SMEs learn effective ways to deal with Chinese business people and private and state-owned companies, to analyze whether a product or service is viable for the Chinese market, to understand the psyche of the "Mao Generation" Chinese, and to develop low-cost market-entry strategies.



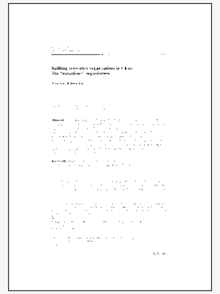
Hexter, Jimmy, and Jonathan Woetzel. 2007. Operation China: From strategy to execution. Cambridge, MA: Harvard Business Review Press.

The authors survey the most recent changes in China and outline best practices for key functional areas. The key point is that success in China depends on execution, drawing from global best practices that are adapted to the Chinese context. It is not easy or common, but if companies succeed they may in turn be able to leverage the China advantage into a global one.



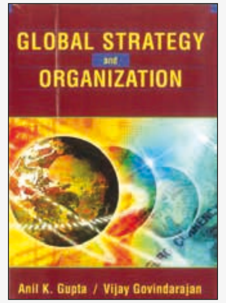
EU SME Centre. November 2013. Ways to enter the Chinese market.

This report focuses on the different options open to European SMEs considering entering the Chinese market and gives pointers as to which strategy is most suitable for your business. It spans the whole spectrum of possibilities, from indirect modes of entry like licensing, franchising, and online selling to exporting with or without the help of local partners and investment in the form of representative offices, partnerships, joint ventures, and wholly foreign-owned enterprises. Every approach has its advantages, depending on the goals and specific circumstances of individual companies.



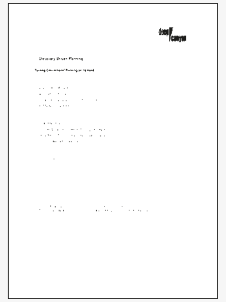
Gu, Ming, and Edison Tse. March 2008. Building innovative organizations in China: The "execution+" organization. Asia Pacific Journal of Management.

This paper explores how to build innovative organizations in China focusing in ICT industries. Their conclusion is that a competent middle management level must be built to create what they call an " execution+" organization.



Gupta, Anil K., and Vijay Govindarajan. 2004. Global strategy and organization. New York: Wiley.

This book describes four essential tasks for transforming a company into a global success: 1) identifying market opportunities worldwide, 2) converting global presence into global advantage, 3) cultivating a global mind-set, and 4) striving to invent the rules of the global game. Contains several small reports on the activities of real MNCs that provide insights into the challenges associated with globalization.



McGrath, Rita, and Ian C. MacMillan. August 1999. Discovery driven planning: Turning conventional planning on its head. DeepCanyon, an HP e-publishing service.

The article, expanding on one that appeared in the July-August 1995 issue of the Harvard Business Review, describes a framework for companies to use when operating in a very uncertain business environment.

Hout, Thomas and David Michael. A Chinese Approach to Management. Harvard Business Review, September 2014

Through several case studies of successful Chinese companies the article describes their characteristics and management abilities and how this have given them an edge; responsiveness, flexibility, improvisation and speed.

Ghemawat, Pankaj and Steven A. Altman. Depth Index of Globalization 2013: And the Big Shift to Emerging Economies, IESE, November 2013.

The report documents the potential in regards to globalization and the problems actually encountered in achieving that potential. It provides the readers with a comprehensive and timely source of hard data and analysis depicting the actual extent of globalization around the world.

Markides, Constantinos, and Constantinos D. Charitou. August 2004. Competing with dual business models: A contingency approach. The Academy of Management Executive.

The article describes how companies can embrace new business models without destroying their existing models. Based on cases, it describes the challenges for companies to balance the benefits of keeping the models separate and at the same time integrating them to exploit synergies. Finally it describes possible strategies companies can use to achieve balance.

TOOL BOX

These tools and guidelines support you in empowering your organization:

PAGE 14

Ways to find and keep good employees in China

Ways to find and keep good employees in China

- **Offer internships** in the Chinese subsidiary, where students from the local business school or university are employed for a short period, to identify potential new employees. During their stay, the company evaluates the interns' performance and offers the best a job afterward.
- Systematically recruit by **canvassing students** who are taking courses at local universities and business schools on business areas and industries of company interest.
- Build good relationships or "guanxi" by establishing both a professional and a personal **relationship based on trust**. You need to focus on the soft side of knowing people if you want to keep people, as Chinese trust is very personalized. Know each other and invest in the relationship.
- Implement a **visible career ladder** with many smaller steps that makes it possible to advance in the company and link it closely to responsibility and salary. In this way the employee can demonstrate that he or she is successful (keeping face with family and friends).
- **Avoid glass ceilings** that make it impossible for Chinese employees to reach the top.
- Have **frequent one-on-one meetings** with your Chinese leaders and managers to secure alignment and clarity on objectives and strategy. Demonstrate that you care and are interested in their well-being, continued performance, and development.
- Care for their families. Have frequent **company days and social arrangements** where the employees and their families meet after work. The Chinese are very social and group oriented, so creating a culture of belonging to a family, where peace and harmony among the employees are cherished, will create a strong bond to the company. The Chinese put much time and effort into the company, so you must demonstrate taking care of their families.
- Implement a **performance-based salary system**, with a low base salary and a high performance share with the opportunity for bonus payments.
- Help Chinese employees grow by **training and developing** them. Sending good employees to the Danish headquarters for training is also an excellent opportunity to inculcate company culture and values.
- Establish **training academies** or programs to develop Chinese employees and talents.
- Make it possible for your Chinese stars to get **jobs in other parts of the organization** (abroad, at HQ, and so on). Make it part of the career plan in the company for your most talented employees.
- Give the local general manager **direct access to top management** in Denmark. This person is the focal point of the local organization, and the one the Chinese employees look up to. If he leaves the company, a large group of people may follow him, especially the people he has hired.
- Make **more use of female employees**, as they are typically evaluated as more loyal, open, and hard working than male employees.

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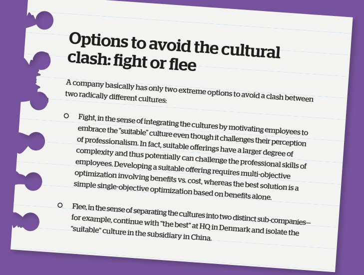
Options to avoid the cultural clash: fight or flee



Options to avoid the cultural clash: fight or flee

A company basically has only two extreme options to avoid a clash between two radically different cultures:

- Fight, in the sense of integrating the cultures by motivating employees to embrace the "suitable" culture even though it challenges their perception of professionalism. In fact, suitable offerings have a larger degree of complexity and thus potentially can challenge the professional skills of employees. Developing a suitable offering requires multi-objective optimization involving benefits vs. cost, whereas the best solution is a simple single-objective optimization based on benefits alone.
- Flee, in the sense of separating the cultures into two distinct sub-companies—for example, continue with "the best" at HQ in Denmark and isolate the "suitable" culture in the subsidiary in China.

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What we can learn from successful Chinese organizations

What we can learn from successful Chinese organizations

China's business leaders are notorious for controlling companies from the top, but what is less known is that

- they decentralize, which helps them respond to market shifts and rapidly add new business lines when needed. Chinese companies create structures that give business units nearly total autonomy.
- They produce more in-house and pay employees less than their Western counterparts, so Chinese enterprises can afford to employ more people.
- They have leaders with as many direct reports as possible, taking the idea of decentralization and flat structures to the extreme.
- They chase topline growth at any cost and believe in structures that support rapid expansion.
- They focus on improvisation and speed, coupled with low costs driven by economies of scale.
- They make decisions in an ad hoc manner and are micromanagers.
- They generally keep engineering and manufacturing close, often co-locating them.
- They keep experimentation and production in-house while they tend to acquire new technologies either through formal licensing deals or by reverse-engineering them.
- They hire more midlevel engineering and manufacturing people, even though they're getting expensive. This gives them bandwidth and the luxury of tinkering, which can solve difficult problems quickly.
- They work to understand the party and state agency organization charts, and the underlying power structures, in every province and city. The trick is in knowing which officials to approach for what and where their interests lie so that mutually beneficial deals can be put together.

Source: Inspiration from Harvard Business Review, September 2014, "A Chinese Approach to Management" by Thomas Hout and David Michael

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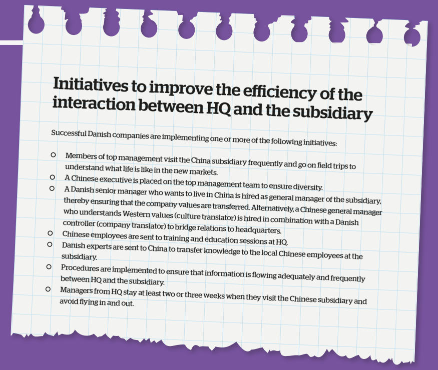
Initiatives to improve the efficiency of the interaction between HQ and the subsidiary



Initiatives to improve the efficiency of the interaction between HQ and the subsidiary

Successful Danish companies are implementing one or more of the following initiatives:

- Members of top management visit the China subsidiary frequently and go on field trips to understand what life is like in the new markets.
- A Chinese executive is placed on the top management team to ensure diversity.
- A Danish senior manager who wants to live in China is hired as general manager of the subsidiary, thereby ensuring that the company values are transferred. Alternatively, a Chinese general manager who understands Western values (culture translator) is hired in combination with a Danish controller (company translator) to bridge relations to headquarters.
- Chinese employees are sent to training and education sessions at HQ.
- Danish experts are sent to China to transfer knowledge to the local Chinese employees at the subsidiary.
- Procedures are implemented to ensure that information is flowing adequately and frequently between HQ and the subsidiary.
- Managers from HQ stay at least two or three weeks when they visit the Chinese subsidiary and avoid flying in and out.

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Six fundamentals of a government relations strategy in China

Six fundamentals of a government relations strategy in China

- Map the bureaucratic arena (ranks, reporting lines, influence, and the like). Which vice mayors/vice governors/vice ministers and heads of lower-ranking units can help or hinder businesses? Identify a set of targets for corporate efforts to develop relationships, information, and influence.
- Put in face time. Prioritize informal meetings over formal dinners.
- Know the political phrases and slogans, and cast proposals in this language.
- Never have only one key personal relationship.
- Provide training and technical advice if appropriate. China has a consensus-building policy process, so take time to ascertain policies in the making and put forward suggestions and proposals regarding key regulations.
- Have your CEO visit officials to discuss key issues, and prepare well for these meetings.

Source: Jimmy Hexter and Jonathan Woetzel, Operation China: From Strategy to Execution

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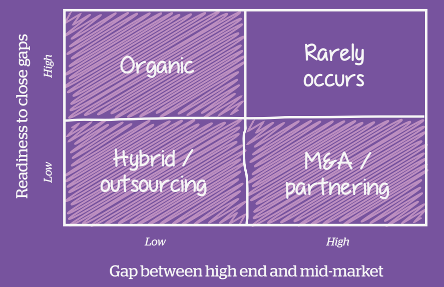
Evaluate your readiness to compete in the Chinese mid-market

Strategies for entering the mid-market



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Focus areas to develop suitable solutions for the mid-market

Focus areas to develop suitable solutions for the mid-market

- Do on-the-ground research to understand the market and its needs, functions, problems.
- Set the right price point to tap the market.
- Use technology and knowledge to reduce costs and prices, not to improve products.
- Provide local product developers with the authority to respond and make fast decisions based on market understanding without waiting for approval and response from HQ, which is too slow in most companies.
- Build a local development team with foreign and Chinese engineers and designers.
- Integrate product development with market research.

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Skills and competencies of a local Chinese A++ team

Skills and competencies of a local Chinese A++ team

- For designers and/or engineers from Denmark: Can work well with local Chinese employees and can transfer their knowledge, values, and experiences.
- Can work with complex government structures where extensive cultivation of officials is a critical part of their job description. This requires cultural sensitivity and a feeling for government and public relations, which is beyond the skills of many Danish managers.
- Can work with suppliers to reduce costs.
- Are capable of making continuous improvements to deliver consistent cost and quality.
- Are trained in global standards, norms, values, and ethics that are nonnegotiable.

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Ideas for improving the organization's capacity to adapt

Ideas for improving the organization's capacity to adapt

- Hire for adaptability and bring in people who are good at thinking across cultures, strong in innovation, and knowledgeable about the local market.
- Invest in cross-cultural training.
- Consider team opportunities where it's possible to bring together people from China and Denmark.
- When flying in executives from Denmark to learn about China, it's nice to meet in Shanghai, but often it would make more sense to have meetings in a county-level city.
- Avoid bringing people in for just one or two weeks to develop new products; allow a minimum of three months to gain sufficient depth. Longer is advantageous.
- Use expatriate assignments to improve the capacity to adapt. It's hard to entice people to go from Shanghai to a tier-3 city, but it can be important.
- Strive for more representation of Chinese people at the top.
- Cultivate a strong company culture, which can help to create an integrated company across a variety of culturally different locations.
- Keep the company open to outside ideas from partners and other relationships.
- Participate in industry associations in countries where you want to be more adaptive.

Source: Input from Steven Altman, IESE Business School, Barcelona, Spain

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Discovery driven planning

Discovery driven planning

In a new business as in the mid-market, little is often known and much is assumed. The discovery driven planning (DDP) framework makes assumptions explicit and converts them into knowledge as the business progresses and unfolds. The framework imposes a strict discipline on the planning process that is different from that used in conventional planning. DDP is about how to plan under uncertainty.

The six key disciplines are

- framing a worthwhile challenge,
- recognizing competitive market and industry matrices and knowledge,
- specifying required operations,
- identifying and documenting assumptions,
- identifying major milestones, and
- testing assumptions at each milestone ahead of investment.

Source: Rita McGrath and Ian MacMillan, "Discovery Driven Planning"

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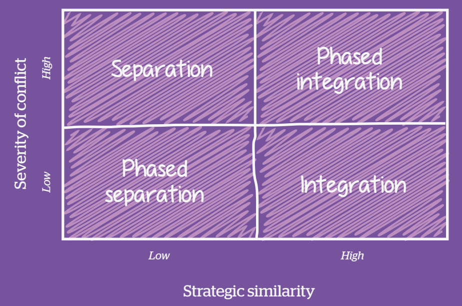
Strategies for managing dual business models in China



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How to successfully manage a separation or integration strategy

HOW TO SUCCESSFULLY MANAGE A SEPARATION OR INTEGRATION STRATEGY

Table 2

SEPARATION	INTEGRATION
Give operational and financial autonomy to the mid-market business unit.	Treat the mid-market business as a great opportunity.
Encourage cooperation between the two businesses.	Leverage the strength of the high-end business to differentiate yourself.
Maintain a close watch from HQ over strategy in the mid-market business.	Approach tasks in a proactive, strategic manner.
Allow the mid-market business to develop its own culture and budgetary system.	Be careful not to suffocate the mid-market business with existing high-end policies.
Give the mid-market business its own CEO who is transferred from inside the organization.	

Source: Inspired by Constantinos Markides and Constantinos D. Charitou, "Competing with dual business models: A contingency approach," The Academy of Management Executive, August 2004

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Questions to ask if you want to make China your second home

Questions to ask if you want to make China your second home

TECHNOLOGY AND PRODUCT STRATEGY	Have your products been designed for China, based on Chinese customers' needs and requirements? Are your price points adjusted to the Chinese local market?
MARKETING	Have you invested in a Chinese market intelligence unit, to really understand Chinese customers? Is your customer segmentation based on local knowledge or just applied from another market?
OPERATIONS	Are your customer service centers adjusted to local needs? Have you invested the required resources in building, maintaining, and refining your Chinese supply chain operation?
HUMAN RESOURCES	Do you invest just as much in training and development programs in China as in your home markets? Do you offer local Chinese talents and executives the same opportunities for a global career that you offer your people in Denmark?
GOVERNMENT RELATIONS	Do you have a capable government relations staff? Are you helping shape regulations as you do in other markets?

Source: Inspired by Jeff Galvin, Jimmy Hexter, and Martin Hirt, "Building a second home in China," McKinsey Quarterly, June 2010

Suitable for growth

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