The Globe

John Jullens is a Shanghai-based partner at Booz & Company, where he coleads the firm's engineered products and services practice. He blogs at **www.johnjullens.com**.

How Emerging Giants Can Take on the World

The trick is to learn to innovate and manage quality while remaining nimble.

by John Jullens

ABOVE The Great Wall car dealership in Brighton, a suburb of Melbourne, Australia, in 2011.

PHOTOGRAPHY: GETTY IMAGES

Many of today's emerging giants face an existential threat they didn't see coming: The headlong growth that put them on the map isn't enough to sustain them when their industries mature or their geographic markets experience the kind of cooldown that's occurring right now in China and India.

Companies in developing countries are often so focused on chasing growth that they fail to invest in improving their capabilities in areas such as innovation, operations, and brand management. So even if they have enormous reach and revenues in the billions, they're unprepared when growth slows and competition from increasingly savvy developed-world multinationals intensifies. They lack the tools—and the structure—to remain profitable in a slower economic environment by becoming efficient and gaining competitive advantage in new markets. Some, including the once high-flying Chinese automakers BYD and Chery, have landed hard.

It's critical that the next generation of emerging-market corporations heed this lesson and develop enterprise capabilities from the very beginning—even as they battle for early advantage by seizing nascent business opportunities. Great Wall, which has seemingly emerged from nowhere to become one of China's most successful automakers, and the appliance maker Haier, which in 30 years trans-

How One Chinese Car Company Came Up Short

Founded in 1995 by Wang Chuanfu, BYD was originally a low-cost manufacturer of rechargeable lithium ion batteries for cell phones. Wang had considerable expertise in batteries but virtually none in automotive technology. That didn't stop him from buying a state-owned automobile maker in 2002 and envisioning a central role for battery technologies in the rise of electric vehicles.

Although the company borrowed ideas from Japanese manufacturing (and reverse-engineered popular Japanese car designs), it shunned Japan's reliance on intensive automation and employed thousands of workers to produce not only cars but most of the needed parts, from braking systems to CD players. To boost sales, it rapidly expanded dealerships in China, set aggressive sales targets, and pushed inventory to dealers in pursuit of those targets.

In 2008 Warren Buffett bought 10% of the company, dramatically enhancing its brand value and increasing BYD's sales in the United States. In 2009 its F3 model was the best-selling sedan in China, with more than 250,000 cars sold. The company's sales hit a peak of about 500,000 units in 2010.

But soon after, BYD began to falter. Consumer demand for electric vehicles was weak, and China Central Television questioned the company's quality standards. Indeed, BYD ranks below the industry average in a number of J.D. Power studies, including initial quality and dependability.

BYD did a few things right, from adopting a bold vision to establishing a position as a technology leader. But that vision

formed itself from a local manufacturer of poor-quality refrigerators into a world-class competitor, have achieved this ambidexterity. Unless emerging-market companies can become capabilities-driven, they're doomed to follow BYD and Chery—and may eventually fall victim to a shake-out in their industries.

Playing Catch-up

Companies in emerging markets embody a contradiction: They are both first movers and latecomers. They're among the first to have made cars, appliances, or computers in their home countries, but they're way behind multinationals that have been honing their capabilities, technologies, and brands for decades.

As first movers, they have typically pursued rapid top-line growth at all costs, acquired technologies by all means legal and sometimes illegal, and simply copied the products and processes of developed-market companies. They have mastered the local business landscape and learned to cater to customers who are just joining the consumer economy. Their speed and agility have served them well—indeed, some scholars have argued that opportunism, tenacity, ingenuity, and connections with local power brokers are the only capabilities emerging giants need.

But in their eagerness to get ahead, many of these companies have neglected to lay the foundation for profitability in any environment other than a rapidly expanding market. They often don't know how to compete on quality, for example, or on the strength of design ideas, or on innovative branding. As they expand, they lose managerial control and begin suffering operational problems—poor product quality, poor inventory management, low employee satisfaction levels—that become worse over time.

It's easy to see how emerging-market corporations get themselves into this position of weakness. Copying established companies' products and processes can seem like a great strategy when markets are young and growing by double digits. Moreover, many of these emerging giants are still run by their founders—industry veterans with powerful connections to key government officials—who tend to make decisions on the basis of their own experiences. They fail to realize that their organizations have outgrown their management structures or are overextended, with too many employees, too many facilities, and too many commitments to volume levels. They don't notice until too late that a changing business climate poses challenges the company isn't prepared to face.

Over the past decade China's leaders have been pushing its economy toward greater reliance on domestic consumption as a driver of growth. That uneasy transition is partly responsible for lower revenue increases at many Chinese companies. Maintaining profitability in this environment requires companies to become more productive and to shift their marketing efforts from enticing wide-eyed new consumers to winning over competitors' customers.

Meanwhile, developed-world multinationals have learned a thing or two about emerging markets, and some have become formidable players there. So emerging giants must now compete against one another and against foreign multinationals on efficiency, marketing, branding, service, quality, innovation, and, in many cases, managing acquisitions. In other words, they need enterprise capabilities that create value, are difficult to copy, and can be translated into profits.

Companies in emerging markets embody a contradiction: They are both first movers and latecomers.

BYD lacked a wide range of those. After dominating in the global battery market, it chased a grandiose vision of becoming the world leader in electric vehicles. The wasn't rooted in reality: Widespread consumer adoption of battery-powered passenger vehicles is still far in the future (if it occurs at all). And the company's emphasis on technology made a good start in establishing a strong competitive position, but a vehicle maker must be known as reliable, too. BYD's stumbles resulted from a failure to develop sophisticated capabilities such as new-product development, demand forecasting, capacity planning, inventory management, and customer insight. The company may have to accept being a niche player, selling electric passenger cars and buses.

A recently shuttered BYD showroom in Shanghai, 2012

company expanded rapidly and tried to diversify in order to preempt competitors. But it never mastered the notoriously complex process of automobile product development; it overestimated how quickly its markets would grow; and it fell short on product quality.

As better-made vehicles from competing manufacturers eroded its market share, BYD's unit sales fell by 15% in 2011 and stayed flat in 2012. Only now is the company beginning to appreciate the importance of the capabilities it lacked, including product development, quality management, and network management. Although BYD has had some recent success in selling electric buses to the city of Los Angeles and the Amsterdam airport, its passenger car business continues to struggle. (See the sidebar "How One Chinese Car Company Came Up Short.")

Chery, too, lacked a number of capabilities, most noticeably for managing multiple brands and models. Its strategy for China was to develop car models for practically every taste and income level. In 2009, when its lineup already included nine passenger vehicles, one commercial vehicle, and one minivan, the automaker added 15 new and redesigned models. By 2012 it was producing more than 30 models, and it couldn't generate enough sales per model to cover its investments in product development, plant capacity, and tooling.

Instead of slowing down and adopting a more balanced approach to growth, Chery aggressively expanded its dealer network. But the sales volume couldn't support all those dealerships. Many dealers got fed up and quit. After reaching a sales peak of about 600,000 units in 2010, Chery's sales numbers dropped steeply. Its chairman, Yin Tongyue, has acknowledged that Chery needs to improve its portfolio and sales management. The company has reduced the number of brands and models and cut personnel by more than a quarter. Nevertheless, sales have continued to decline. In the first half of 2013 they were down by 18%.

The Right Capabilities at the Right Time

It takes a long time to acquire capabilities—even longer in China and other developing countries, where companies face a lack of competent suppliers, distribution networks, and qualified candidates to fill managerial positions. In deciding when and how to do so, the best approach is to develop capabilities in four stages:

1. Seize the moment. Business opportunities—such as industry privatization or the emergence of a new customer segment with money to spend—are fleeting, so it's critical that companies move quickly and be tenacious. In this early stage they typically don't have the time or inclination to invest in anything more than rudimentary capabilities in payroll, finance, factory operations, and employee management.

2. Build strength. Once the company is up and running, its strategic focus should shift to getting the business model right and becoming profitable. It's at this stage that many companies neglect to develop the basic capabilities they'll need when the industry matures, such as innovative product design and engineering and quality management—not just in manufacturing but in other activities. Every company needs specific competencies that are aligned with its strategy.

A good way to attain them is to learn—through licensing or contract manufacturing, for example—from companies that already have advanced capabilities. Galanz, a Chinese company that started as a duck feather dealer, became a respected maker of microwave ovens and other appliances after working as a contract manufacturer for Toshiba and other global players.

3. Scale and consolidate. Next companies must focus on scaling up to become leading players in the domestic market and on consolidating their positions, often by acquiring competitors. But they must not overstretch management resources or become an ill-functioning collection of poorly integrated business units: They should keep product lines and markets relatively narrow and fill capability gaps through greater investment in, for example, R&D, acquisitions, and partnerships.

The Chinese automotive supplier Wanxiang took this approach, building capabilities step-by-step. The company initially focused exclusively on improving quality performance and lowering its costs for just

PHOTOGRAPHY: GETTY IMAGES

Great Wall: First Stronger, Then Bigger

Great Wall began in 1984 as a vehicle-repair collective and grew by focusing on the manufacture of pickup trucks and SUVs for the Chinese market. Its approach all along has been "Be stronger and then be bigger," in the words of its low-key chairman, Wei Jianjun.

As part of its effort to improve R&D, the company invested in a world-class testing facility that includes a 250-meter crash-test track. Although it is largely vertically integrated, Great Wall outsources noncore parts to outside suppliers. To maintain high quality standards, it has formed alliances with global suppliers such as Bosch, BorgWarner, Delphi, and ZF for core parts. It cooperates with these suppliers to develop technologies, an approach that has enhanced its R&D strength.

Great Wall also expanded its dealer network carefully, assessing the local market before opening new dealerships and then refraining from overstocking them. The company trains dealers to improve their service capabilities, resulting in greater satisfaction and loyalty among dealers as well as customers.

Not until 2008 did the company start making sedans. When it moved into the sedan market, it built on its existing platform and released just a few models. Instead of trying furiously to grow the top line, it concentrated its resources on developing and improving those models in a market segment where it could compete successfully. Great Wall's early sedans were unpopular, but it was able to pivot quickly to make improvements.

Having established itself in sedans, the company intends to manufacture SUVs that can rival vehicles produced by joint ventures in China. It recently announced its intention of becoming the first Chinese automaker to enter the highly competitive U.S. market by 2015. But Great Wall's president, Wang Fengying, says the company values product and operational quality above export scale.

Wang Fengying, Great Wall's president and CEO

PHOTOGRAPHY: AP IMAGES

one product line: universal joints. It was able to win lucrative contracts with world-class multinationals such as Bosch and Delphi, and gradually it developed from a domestic tier-three supplier into a global tier-one supplier by expanding into other parts. In the process Wanxiang acquired, merged with, or established 30 companies around the world.

4. Move up and out. At this stage companies are typically expanding into higher-value customer segments and international markets. This kind of breakout growth requires that they have a portfolio of strong brands to compete across multiple price points, innovation capabilities and advanced technology to develop premium products, sophisticated marketing and sales capabilities, and a means of integrating them all into a complete system that confers a distinct competitive advantage.

Back in the 1990s, China International Marine Containers (CIMC), recognizing that China would soon play an important role in world trade, expanded its presence in the country's coastal regions. During the scale-and-consolidate stage it focused exclusively on low-tech dry-goods containers and then used an IPO to grow and acquire its local competitors, becoming the largest dry-goods container manufacturer in China. Ultimately, it expanded into refrigerated containers through acquisitions and a licensing agreement with a German competitor, Graaff, and invested heavily in its own technology. Only after its global market share exceeded 50% did CIMC start to move into new areas of growth—and always with an eye to making use of its capabilities in low-cost manufacturing.

Great Wall, too, followed the right pattern in acquiring capabilities. From the very beginning it has focused on becoming proficient at automaking rather than trying to achieve rapid top-line growth. During its start-up stage it found opportunity as a niche player, making pickup trucks and low-end SUVs, and began building its know-how in product development, safety technology, sheet-metal stamping, and total quality management. During its growth stage it improved its R&D, honed product quality, and adopted foreign standards for safety as well as emissions. During its scaling-up stage it prioritized its original products but moved judiciously into making sedans.

Great Wall's cautious expansion of its product line didn't limit its growth: Sales rose sharply from just over 100,000 vehicles in 2008 to well over 500,000 in 2012. During the first six months of 2013 Great Wall's sales grew by 43%. The company has recently pulled ahead of BYD and Chery in both sales and profits. In 2012 its gross margin stood at a healthy 27%, in comparison with about 12% for BYD. (See the sidebar "Great Wall: First Stronger, Then Bigger.")

Haier changed its pyramidal, hierarchical, and siloed structure into a project-based network.

A New Structure for Staying Nimble?

Emerging-market companies that have moved into the fourth phase of development have typically outgrown the top-down management style of their early days. They must organize themselves to simultaneously coordinate their global operations and remain agile.

The matrix structure used by virtually all established multinationals is too rigid, but a good alternative is not yet clear. Managers at a few emerging-market corporations that have reached this stage are experimenting with new structures—for example, breaking up into nimble, globally dispersed, semiautonomous units held together by governance organizations that provide services and disseminate best practices. The units may be empowered to enter and exit partnerships quickly in order to pursue opportunities.

Haier is one such corporation. In the early years its business model was based on its executives' belief that the company must differentiate itself by improving product quality and building a valued brand. Haier entered into a joint venture with Germany's Liebherr to strengthen its manufacturing skills, make higher-quality products, and become a leading local Chinese manufacturer of refrigerators. After years of growth and development that included acquisitions and a strategic push to become more customer-oriented, Haier changed its pyramidal, hierarchical, and siloed structure into a project-based network.

This radical new structure is aimed at reducing bureaucratic distance from customers. The company has been broken up into more than 2,000 semiautonomous teams of 10 to 30 employees with their own P&Ls. One team might focus on a given air conditioner model, another on a refrigerator. Below the teams are two tiers of units that oversee functions such as marketing, supply chain management, sales, product development, and manufacturing of all Haier products. The units in those tiers provide services to the semiautonomous teams; indeed, formal service contracts govern their interactions.

Is this the emerging giant of the future? It's difficult to say. But Haier has become the world's leading manufacturer of household appliances. It has succeeded not only in defending its home market against stronger, better-endowed foreign competitors, but also in opening up new markets for itself in the United States and Europe. Other companies will no doubt join Haier in experimenting with organizational structures aimed at allowing them to grow while retaining speed and agility.

ALTHOUGH EMERGING-MARKET companies can learn much from the capabilities of established multinationals, this article isn't intended to advocate that they imitate the conventional management and planning styles of those organizations. Most developed-world multinationals are too slow and inflexible to seize dynamic opportunities in developing countries, and they lack local companies' ties with government and knowledge of markets and customers. Emerging-market companies thus have an advantage on their home turf and in countries with similar business environments. Their problem for the long term is sustaining that advantage as they grow larger and significantly more complex and as their markets mature.

HBR Reprint R1312J

"This economy has been especially hard on sidekicks."

CARTOON: KAAMRAN HAFEEZ