leading IDEAS

strategy+business

China's Multinational Quandary

by William J. Holstein

05/26/2009

a strategy+business exclusive

booz&co.

China's Multinational Quandary

Lenovo's ill-fated ambitions reveal the difficulties China faces in developing and managing innovative global corporations.

by William J. Holstein

When China's Lenovo Group bought the personal computer division of IBM in May 2005 for US$1.25 billion, the company launched a bold experiment: Founder and chairman Yang Yuanqing attempted to create one of the first truly multinational Chinese corporations. He retained Stephen Ward, who had been head of IBM's PC division, as chief executive officer, designated English as the company's official language, and laid plans to market Lenovo computers in virtually all major world markets. As a result, Lenovo, the world's fourth-largest PC maker, became a symbol of the Chinese government's stated aim to build a "national team" of multinationals that would occupy 50 positions in the Fortune 500.

By December 2005, Ward was out, a victim of infighting during the postmerger integration. But Yang continued to pursue his internationalist strategy, naming American high-tech veteran Bill Amelio, who had run Dell Inc.'s Asian operations, as CEO.

Amelio, however, encountered friction between Western and Chinese management styles. He was frustrated by his Chinese colleagues' reluctance to speak their minds and their preference to follow orders. "You don't want everyone saying, 'yes, yes, yes' all the time," Amelio told the *Wall Street Journal* in late 2008. His decision in 2006 to remove a popular Chinese executive who was head of the company's supply chain triggered a backlash from other Chinese executives. Under fire, Amelio left in early 2009 after Lenovo reported big losses for the fourth quarter of 2008, as well as declining global PC market share. Yang returned as CEO, and the company retreated at least temporarily from its multinational ambitions, deciding instead to concentrate on the Chinese market, where it is dominant.

The Lenovo story has led many Chinese experts to a troubling conclusion: Despite its significant gains as a manufacturer during the past few years, China will have much greater difficulty than its leaders anticipated in creating true multinational corporations.

Amelio's departure reflects Lenovo's and China's "extremely limited international capabilities," says Oded Shenkar, a professor of global business management at Ohio State University and author of *The Chinese Century: The Rising Chinese Economy and Its Impact on the Global Economy, the Balance of Power, and Your Job* (Wharton School Publishing, 2006). Lenovo relied on a U.S. consulting firm to help integrate the IBM PC acquisition, but neither management nor the outside consultants fully understood the cross-cultural challenges, Shenkar adds. "Culture was a major part of what went wrong."

The fundamental differences between Chinese

William J. Holstein
(bholstein2001@yahoo.com) is the author of *Why GM Matters: Inside the Race to Transform an American Icon* (Walker, 2009). For more on his work, see www.williamjholstein.com.

companies and typical multinationals lie in the roles that top executives and rank-and-file workers play. Unlike more decentralized Western corporations, Chinese organizations are generally run by a powerful CEO who gives orders to a hierarchy of workers, who typically follow them to the letter without raising questions. In addition, the Chinese have little trust in impartial Western systems of performance measurement or executive development, and frown on lower-level employees proposing ideas to their superiors. Chinese companies "have a very severe handicap in empowering their workforce in order to generate creativity," says Gordon Redding, adjunct professor of Asian business and comparative management at INSEAD and coauthor of *The Future of Chinese Capitalism: Choices and Chances* (Oxford University Press, 2008). "These organizations have an absolutely dominant *laoban* — a father figure — who usually created the company."

Lenovo isn't the only Chinese company that has attempted to gain a foothold as a global player, and others, arguably, have had more success. For example, Haier Group is among the world's largest appliance manufacturers and now assembles some products in the United States. Huawei Technologies Company and ZTE Corporation are going head to head against Cisco Systems Inc. in marketing routers and other telecommunications networking equipment, particularly in developing markets. And China International Marine Containers Group (shipping materials), Galanz Group (microwave ovens), and the Midea Group (household appliances) are also making waves globally.

The reasons these companies have had an easier go of it than Lenovo also show why China's plans to quickly create multinational giants may be unrealistic. In comparison to Lenovo's grand plans, for example, Haier's approach to international expansion was more incremental. It began by exporting a limited number of private-label products and then slowly extending the reach of its manufacturing operations. "They didn't jump from being a domestic company to acquiring a very complex operation like Lenovo did," says Shenkar.

Moreover, Haier's products are low tech, and the company is not known for being particularly innovative. Indeed, China relies on foreign companies for the vast majority of the advanced technology it deploys, and, to some observers, Lenovo's failure underscores China's lack of homegrown R&D. "If you cannot innovate technically and organizationally, you cannot stay in the global game," Redding says. "Making refrigerated containers and air conditioners is the kind of technology the Chinese can handle."

China's automakers have been generating headlines about their global intentions, but they face some of the same limitations that afflict other aspiring Chinese multinationals. Chery Automobile Company, China's largest vehicle manufacturer, tried to cut a deal with the Chrysler Corporation to distribute its A1 compact sedan in the United States. But even before Chrysler's bankruptcy put the effort on hold, few automobile experts were optimistic that Chery could ever successfully meet Western safety and emissions standards and sell cars in the United States. In January 2009, BYD Company promoted its lithium ion battery electric cars at the Detroit auto show, and Shanghai Automotive Industrial Corporation has used joint ventures with the General Motors Corporation and Volkswagen AG to develop its engineering and design capabilities. However, neither of these companies has yet been able to achieve U.S. quality levels or develop global distribution and branding strategies that a multinational requires.

Facing such obstacles, many Chinese companies may instead pursue strategic joint ventures, similar to what some Chinese companies in Hong Kong and Southeast Asia have done. For example, such organizations as Hutchison Wampoa Limited, Cheung Kong Holdings, and Henderson Land Development Company tend to forgo R&D in favor of developing telecommunications networks and market products by licensing technologies and distribution rights from companies like IBM and Cisco. "When they need a certain kind of technology or political backing or sales network or manufacturing capability, they create an alliance to make it work," Redding says. "The mainlanders will probably do the same thing."

Of course, the Chinese may surprise Western experts, as they have many times before. Companies such as Lenovo could still regroup from Chinese-style hierarchical control and transform themselves into nimble international competitors. "I wouldn't write off Lenovo as a global player yet," says Peter Williamson, coauthor of *Dragons at Your Door: How Chinese Cost Innovation Is Disrupting Global Competition* (Harvard Business School Press, 2007).

But if that occurs, Lenovo and similar companies will likely remain islands of success that won't reflect broadly on the majority of Chinese enterprises. For one thing, the only companies that could hope to succeed as multinationals anytime soon will have to come from China's private sector. The country's many state-owned or state-subsidized banks, petroleum, chemical, and mining enterprises, for example, are far less sophisticated in international business affairs than even the most insular private companies.

Which means that it could take the Chinese many years before they can claim their 50 spots on the Fortune 500. +

Resources

William J. Holstein, "China's Long Road to Innovation," *s+b Leading Ideas Online*, 11/18/2008: Chinese companies are facing difficulties in creating technological innovation. www.strategy-business.com/li/leadingideas/li00102

Gordon Redding and Michael A. Witt, *The Future of Chinese Capitalism: Choices and Chances* (Oxford University Press, 2008): A definitive examination of the challenges that China faces in its effort to emerge as an economic superpower. www.amazon.com/dp/0199218137/

Dexter Roberts, "China's Chery Gets Closer to Being a World Player," *Business Week*, December 12, 2008: An update on the aspirations of the Chinese car manufacturer. www.businessweek.com/globalbiz/content/dec2008/gb20081212_144409.htm

Oded Shenkar, *The Chinese Century: The Rising Chinese Economy and Its Impact on the Global Economy, the Balance of Power, and Your Job* (Wharton School Publishing, 2006): Chinese enterprises and companies will force a radical restructuring of the global business system. www.amazon.com/dp/0131877313

Jane Spencer and Loretta Chao, "Lenovo Goes Global, but Not Without Strife," *Wall Street Journal*, November 4, 2008: An exploration of the internal cultural challenges at Lenovo. (Subscription required.) http://online.wsj.com/article/SB122575905072195339.html

Ming Zeng and Peter J. Williamson, *Dragons at Your Door: How Chinese Cost Innovation Is Disrupting Global Competition* (Harvard Business School Press, 2007): How Chinese enterprises and companies can rapidly target high-end industries that rely on engineering, design, and research and development. www.amazon.com/dp/1422102084/

strategy+business magazine
is published by Booz & Company Inc.
To subscribe, visit www.strategy-business.com
or call 1-877-829-9108.

booz&co.