



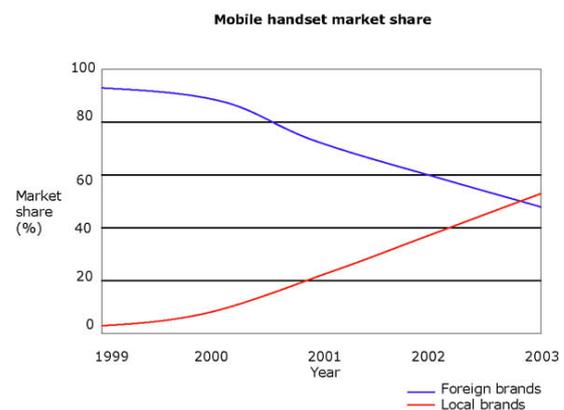
## The China market: Windows of opportunity

**Foreign firms have been eyeing the Chinese market ever since the country began opening up in the 1980s. And given that China has a population of about 1.2 billion people, it's a market that has plenty of promise. However, former INSEAD Assistant Professor of Asian Business and Comparative Management, Steven White, believes that foreign firms may find it difficult to compete with their Chinese counterparts. He points to the way mainland mobile phone companies quickly overtook multinationals such as Motorola, Nokia and Ericsson within just a few years.**

In 1999, foreign brands dominated the China mobile phone market with a 92 per cent share but within just four years, that figure had been cut to 45 per cent, with the local brands holding 54 per cent of the market.

White says a “confluence of events” worked against the likes of Nokia. While living standards rose in China, the handset industry saw structural changes, with foreign companies bringing their suppliers to China -- suppliers who would find a “willing market in the local firms wanting to assemble their own products.”

Government policy changes also helped. Not in terms of direct subsidies, but rather through the government issuing licences to emerging local players, firms who were already established players in home appliances, consumer electronics and other sectors.



Source: Chinese government

The mobile phone companies then set their sights on markets not targeted by the multinationals which were focusing their attention on major cities such as Beijing, Shanghai and Guangzhou. Instead, local firms such as Ningbo Bird concentrated on rural areas and smaller cities. “You have to remember there are 171 cities in China with more than one million people. These are not small markets and as a group can be a huge market to get going, get

economy of scale, go down the learning curve. The important thing is that some of things in those markets, things that sold well, became strengths even when they moved into the cities.”

TCL, Haier and others also had something the multinationals lacked in the countryside: brand recognition. “The domestic handset companies came from other industries where the name was familiar even though they weren’t known for handsets,” White says. “So they had a lot more brand awareness than even these multinationals, Nokia, Motorola, etc.”

### Lenovo takes on the world

While the multinationals maintained their global models serving every market, the mainland Chinese focused on the local market and the strategy paid off.

White draws parallels with the personal computer sector. Mainland company Lenovo has already started to switch to a global focus, with its acquisition of IBM’s PC ops clearly demonstrating its ambition. “You’ve just have to look at the Koreans to see Samsung and LG, what an impact they’ve had on the global markets in handsets, as well as other consumer electronics. So just imagine if you had two or three of these handset makers making a similar impact being able to compete as effectively as the Koreans, maybe 5 years from now, maybe less. That could have a huge impact on the global market.”

Chinese companies are likely to avoid head-on competition with established players by selling their phones at the bottom end of the market globally. White argues they may be ‘underestimated’ by the multinationals again, even in their home markets in Europe or North America as they wouldn’t be interested in trying to capture the low-end market.

### Danger signs?

“I think that’s a dangerous strategy because that’s exactly what the Japanese did with many of their manufacturing industries, autos, cameras, consumer electronics. (They) started at the low end but then worked their way up and basically we saw the disappearance of those industries for all practical purposes in Europe and the US.”

The signs are already plain to see. Chinese handset manufacturers only had a 2.3 per cent share of global production in 1999 but by 2003 that figure had risen to 35 per cent. Ningbo Bird, for instance, is emerging as a major exporter, accounting for more than 50 per cent of Chinese handset exports, shipping 3 million in 2004 compared with just 500,000 a year earlier.

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White believes there are lessons to be learnt from the experience of foreign firms who were once dominant in China’s mobile phone market to make sure that “similar mistakes aren’t made.”

In terms of internet services, he says, Sohu.com is one of three dominant search engines. “Where’s Yahoo! in China and Google? They’re essentially not that important.” The reason is that these mainland search engines which offer email and other services captured the market early on. “So they’re not too worried about inroads from the foreign firms in those industries.”

### Targeting low-end markets

The automobile industry is going to be ‘the big one’, White says, as “we see signs of Chinese auto exports increasing 60 pct in 2006 over 2005, 60 per cent of a small number – granted – but that shows ambition and willingness to export, yes mainly to the Middle East and developing countries.” Again, the strategy is to target the low end of the market with cars costing as little as 3,000 euros. “If I were buying a car for my children and it’s safe enough, 3,000 euros sounds a lot better than the 5,000 euro car Renault is starting to introduce in Europe or the 7,000-12,000 (euro cars) that other manufacturers are offering.”

“So I think that the potential to have a dramatic impact on the competitive landscape through pricing and then quality for dramatically lower price, I think that’s where the Chinese are going to be upsetting a lot of established players in a lot of industries, and not just in China but outside.”



Foreign banks have been eyeing China for some time and are looking to tap the growing amount of wealth there. However, White says financial services may also prove to be a difficult sector to penetrate: “I think many of these foreign banks are going to be targeting private banking. It sounds very sexy and they have the resource capabilities to deal with that. But I think maybe the domestic banks – not all of

them – will be starting at a lower price point. You don't have to be as wealthy to get the same types of services (as from the foreign banks) ... and they'll have captured the growing bulk of increasingly rich and (be) catering to them in ways that those customers prefer.”

The hotel industry could also see similar developments, he says. As more and more Chinese tourists choose to travel around the world, mainland hotel firms which have the necessary 'learning capabilities' will be well positioned to tap that market to “achieve a much better fit with their customers than most of the foreign firms would be willing to adapt to the same degree.”

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