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# Cost innovation and the dragons



**‘Cost innovation’ sounds like an oxymoron. Most of us associate innovation with greater functionality and sophistication. Mainland Chinese companies, however, are turning conventional business models on their heads and these ‘dragons’ are making inroads into markets in ways that would have been unimaginable just a few years ago.**

Former INSEAD Affiliate Professor of Asian Business and International Management Peter Williamson says Chinese companies are tapping niche markets and customising products, but instead of looking at premium pricing they’re choosing to go mass market with ‘everyday low prices on steroids.’ Yet, they’re still offering advanced technology and are not skimping on research and development.



Williamson, who has just brought out a new book called '*Dragons at Your Door: How Chinese Cost Innovation is Disrupting Global Competition*' with co-author Ming Zeng, says mainland companies are also using their cost advantage to offer speciality products at low prices.

Take for example Haier. It grabbed a 60 per cent share of the market for wine-storage fridges which had earlier been regarded as a niche, premium product.

The authors argue we must all learn to cope with a world that will soon see a cost revolution, whether we're ready or not.

The dragons are successfully building their bases in China and are then looking to expand globally. The implication is that Western companies that decide not to fight the emerging dragons on their home turf will leave themselves exposed in the long run.

## **Exploiting loose bricks**

According to the book, the dragons look for 'loose bricks' in the defences of their competitors and then seek to exploit these. And there's no escape by moving upmarket either. Instead, the authors say 'new and creative strategies' are needed in response.

"If it were just the threat of low costs and low prices, the standard answer would be to go upmarket," Williamson says. "But what we see the Chinese doing is taking a niche market and making a mass market by cutting prices by 50 per cent."

The authors say that although moving upmarket may be 'little more than a retreat into oblivion', they're not arguing that these mainland Chinese firms will simply take over the world.

"In the book, we try to give a wake-up call for companies that basically think these people are going to stay at the bottom of the market and that the easy answer is to go to the sunlit uplands in the top segments, you'll be fine," Williamson says. "What we're saying is that Western companies, established companies need to rethink how they're going to approach this new threat."

## **'The game's not up'**

"We say there are some things you can do, so it's not the game is up, we should pack up and go home," he adds.



First, Western companies should learn to play the same cost innovation game. Williamson says GE runs its medical scanning business system out of China where it now develops products and sets the positioning. Another good example is Nokia, which by aggressively expanding its distribution and product range, now dominates the bottom of the market as well as the top, Williamson says. “So they’re interestingly squeezing the Chinese companies by playing this cost innovation game.”

“We also think that companies need to look more seriously at penetrating the mass market in China,” and that includes the rural areas where around 800-900 million people live – a significant portion of the population which so far has been ignored by the multinationals.

Williamson says that if Western companies can’t beat them, they should look at joining them, in the form of alliances. “We’re recommending there should be more partnerships between established multinationals and these dragons, but not just to penetrate Chinese markets, but to say if we combine these complimentary capabilities the resulting venture should be more competitive in the global market.” For example, 3Com and Huawei have formed an alliance in the telecoms equipment business. “Neither company can compete with Cisco which dominates that business globally, but together they’ve

been pretty successful,” Williamson says.

## **Change your mindset**

“It is possible for multinationals to (compete with the dragons) but it’s not something you can learn to do overnight. So part of our message is take the threat seriously and get on with your process of coming up with a strategy to counter it,” Williamson says.

Williamson says it’s important that multinationals realise that the game is no longer played by the same rules and this requires a change of mindset. “I think that’s a key point in the book, that if you come up against a competitor who uses a very traditional strategy you know how to counter it (and) make some moves to keep you in a strong position. But the Chinese are coming from left field and they’re undermining the existing business models.”

“We say that companies that understand that the Chinese have something to teach us and if we combine that with our existing strengths, we can continue to be global winners, are the ones that are going to prosper,” Williamson says.

“Those that for various reasons resist that thinking or don’t believe the Chinese have anything to teach us about how to use costs in an innovative way will really find the going tough.”

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