

“As trade between China and the United States has exploded, the gap has widened between companies taking full advantage of this opportunity and those left behind. Hexter and Woetzel have put their finger on what every executive must focus on to succeed.”

—Ambassador Charlene Barshefsky
former U.S. Trade Representative and
Senior International Partner, WilmerHale

A seismic shift is underway in China as it transforms from an emerging economy to a maturing one where the barometer of business success is rapidly rising.

With 460 of the *Fortune* 500 companies currently operating in China, McKinsey partners Jimmy Hexter and Jonathan Woetzel reveal the changes companies must make to win in China today—if they hope to win globally tomorrow. In their new book, *Operation China: From Strategy to Execution* (Harvard Business School Press, December 18, 2007, hardcover), they carefully examine the fluid business environment and the urgent need for companies to dramatically boost performance and set new standards for flawless execution.

Operation China brings together solid research and the authors’ forty years of collective experience in China to provide a glimpse into the Chinese business landscape in a way no one else has done. Hexter and Woetzel look keenly at the evolution of management practices, competition, cost, business-to-business opportunities, and distribution issues with a practiced eye. And with real life examples from companies like Johnson & Johnson, Procter & Gamble, Coca-Cola, and a host of others, they prescribe a clear, four-part plan:

- set uncomfortably high aspirations
- make readjustments frequently and quickly
- be tighter on people and looser on controls
- measure learning as much as results

Together, these four components are the key to moving from just managing in China to being measurably great.

Operation China is a definitive guidebook for companies ready to move from mere presence in China to operational excellence—it brings execution to the forefront and lays out a cogent plan for executing in business in Asia at the highest level.

New from



**HARVARD
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a conversation with **JIMMY HEXTER** *and* **JONATHAN WOETZEL**

What changes in China have brought execution to the forefront?

The massive middle class that has started to emerge in China's cities, large and small, has a buying profile different from the segment of consumers to which multinational companies (MNCs) have been selling during the last five years. The same is true for the corporate market where small and medium companies are emerging as major players. The number of companies—domestic and global—competing for share of wallet in nearly every consumer and business-to-business category is skyrocketing. For many years, companies thought of execution in China as something fairly basic and certainly China-specific, with little relevance to global operation standards, recognized best practices, or top-level capabilities. But creating unique processes and systems on the fly no longer works in China. Companies intent on improving how they execute in China need not be daunted by the differences they find in the business landscape here versus what the landscape looks like in more developed markets, but rather should strive to bring and adapt global practices to China. This would apply to areas from talent management to sales to procurement and all key functions.

In China, regional differences in products, marketing, and distribution costs count. How can companies address this dimension?

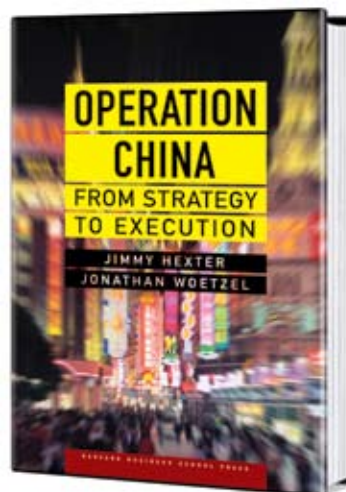
The process begins with figuring out the right product-market mix in this complex, fragmented, and continuously evolving environment. Once companies figure out who to serve with what, they need to develop these new products with feature sets for customers who don't always know what they want, while under increasing pressure to keep the cost of products (and development) low to meet the world's most competitive pricing targets. Companies such as Danfoss and P&G, have a clear lead in their efforts to expand to a broader number of cities, where the volumes are. In our experience, too many MNCs aren't doing enough at this critical first step—designing the right map for success—to better their odds of designing, making, and distributing competitive products to growing markets.

How important is talent in this equation?

Fifteen years ago MNCs were willing to make compromises concerning the management and staff they had in place in their operation in China because the opportunity was minor. Today, the situation is very different. Companies with the best talent are winning. The pool of stars is growing, but not as fast as demand. MNCs can win more than their fair share of star recruits by introducing world class recruiting, development, and career management to attract and retain the best people. It is the MNCs' experience, professionalism, and internationalism that give them an edge.

How do mergers and acquisitions play a role in operations in China?

We think mergers and acquisitions activity will spike upward over the next decade, potentially reshaping many industries here. Deals have unique characteristics in China with regards to due diligence, and building the capability is key. Operational capabilities give companies an advantage in assessing whether they can truly manage and/or turn around their acquisition target. Those that can execute well stand a better chance than lackluster operators at succeeding in what we think will become a volatile buying and selling atmosphere. Success in M&A deals in this environment favors those companies that already have their operations in world-class shape.



excerpt from **OPERATION CHINA**

For Jorgen Clausen, CEO of Danfoss, a global manufacturing company headquartered in Denmark, the realization came in 2004. He and his wife traveled the old Silk Road from Almaty, in Kazakhstan, to Urumqi, in China's western province of Xinjiang. As soon as he crossed into China he noticed how the condition of the roads improved; the roadway was newly paved and modern like a good stretch of road in Europe. He noticed that many of the buildings in this remote province of China were new, as well. A factory he looked at was highly automated, and, at a department store in a fourth-tier city, the offerings included expensive dresses and \$100 ties.

"Something that particularly caught my eye was a refrigerator with inverters that control the speed of the motor and thus save energy," he recalled recently. "That was a luxury category one couldn't find even in a large Danish town."¹

Clausen came away from his visit to Greater China with the nagging feeling that Danfoss wasn't doing enough here. Danfoss, which makes valves, compressors, motion control devices and the like, had net sales of over \$3 billion in 2006, has factories in twenty countries, including China, and sells products in eighty countries. At the time Clausen was returning from his Silk Road journey, Danfoss was growing its business in China by around 35 percent a year, primarily by making (at the company's factory near Beijing) and selling European-designed components and devices to Chinese manufacturers. The nagging feeling he had was this: Years earlier, Danfoss moved too slowly in markets such as the United States, Japan, and South Korea, and lost market leadership to domestic rivals. His company's inverters were not in the refrigerator he saw in Xinjiang province. Was Danfoss losing out in markets that matter?

At Clausen's instigation, the company launched a review of all their product markets in China. The conclusions of the review shocked him.

"We found that we were just skimming the surface," Clausen said. "We were capturing only a few percentage points' share in most of our product markets. Our products addressed the high end of the market and some of the middle, but not the low end, which in many cases we hadn't even known existed." The analysis opened his eyes to the shortcomings on their ventures in China. While there was a growing pool of customers for Danfoss's global components,

sales were constrained by the cost and functionality of products designed for other markets than China. One motor-speed control used in commercial refrigerators (engineered by Danfoss to meet European standards) was over-engineered and too costly for many Chinese makers' of commercial refrigerators. These companies were primarily interested in getting energy-saving functionality at the lowest possible price—and having it designed to better withstand dust, a need local to China but not to Europe.

"What stunned us was the size of the low-end market," he continued. "We concluded that if we could offer the right products, there was a potential to increase our coverage by a factor of ten and our profits by a factor of thirty in one segment of industrial-control devices—somewhat less in other segments, but still a very substantial amount. Collectively, this could give us a market share of from 15 to 20 percent, roughly equal to our share in Europe."

As Clausen noted, growing sales at rates even Silicon Valley chieftains would admire but losing market share was ultimately a ticket to nowhere. European or American companies that could not compete in broader Chinese markets like the one he visited in Xinjiang province—in the smaller cities, with lower-priced products, and with features appealing to Chinese buyers—could soon become eclipsed by companies that can, whether those companies are domestic or international rivals.

"We want to be a market share leader here," he said. "Maybe we cannot be number one in China, but maybe we can be number two or three. We certainly don't want to become number seventeen, because then we will be in trouble later on when the industry consolidates here, and we don't have the volume to compete with local Chinese incumbents."

Under Clausen's leadership, Danfoss re-set aspirations in China. Today the company is aiming higher, much higher, and a sense of urgency drives his management staff's efforts here. Danfoss now views China as its "second home market" after Europe. Clausen changed the metric the company focused on, from sales growth to market share. To pursue market leadership, Danfoss has begun to design products in China for broader, low-cost segments, has acquired other companies in China to expand its set of offerings, and is overhauling its R&D, manufacturing, marketing, sales, and distribution functions.

¹ Notes from a Fall 2005 discussion between Clausen and our McKinsey colleague, William Hoover. For an edited version of the discussion see, "Making China your second home market: An interview with the CEO of Danfoss," by William Hoover, *McKinsey Quarterly*, 2006 #1.

about the **AUTHORS**



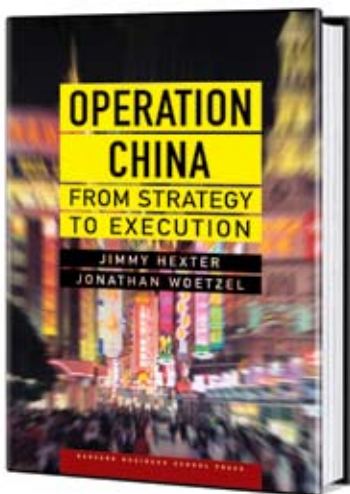
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Jimmy Hexter and Jonathan Woetzel

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