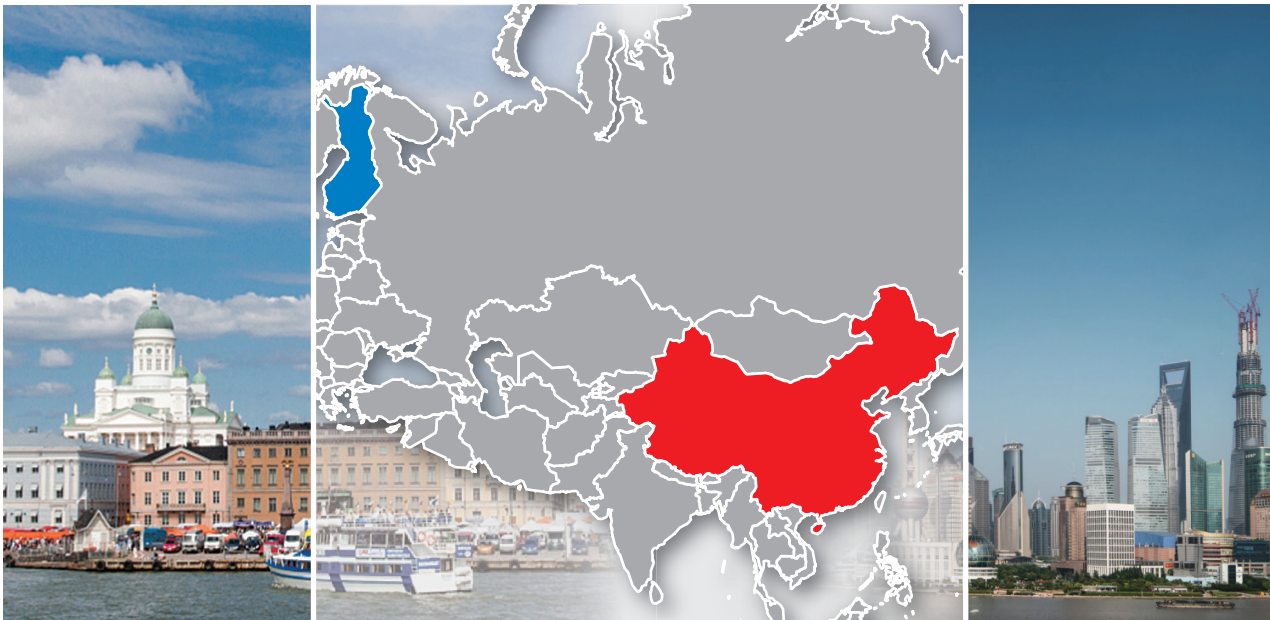


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Sino-Finnish Paths to International Competitive Advantage

Contact Information

Booz & Company

John Jullens

Partner

Suite 2511, One Corporate Avenue

No. 222 Hu Bin Road

Shanghai 200021, P.R. China

Tel: +86 21 2327 9800

Fax: +86 21 2327 9833

Blog: www.johnjullens.com

john.jullens@booz.com

Booz & Company Oy

Hannu Suonio

Partner

Mikonkatu 15B, 7th floor

Helsinki 00100, Finland

Tel: +358-9-6154 6614

Mobile: +358-40-511 9324

hannu.suonio@booz.com

EXECUTIVE SUMMARY

It may seem ironic that China's future depends increasingly on the country's ability to forge new paths for growth through international expansion. Over the last 30 years, China has grown at a breakneck pace, largely because of the West's insatiable appetite for goods that China produced with its near-limitless supply of low-cost labor. But success breeds its own challenges. Rising wages are gradually eroding China's low-cost advantage, and the country's continued progress now increasingly hinges on its ability to transform itself from a low-cost to a high-value economy.

Some of China's best opportunities for developing the capabilities and acquiring the technology needed to make that transition are to be found abroad and can be captured only through partnerships with foreign entities.

Finland also needs its companies to expand internationally to drive overall economic growth. But many Finnish companies lack the capabilities to expand in emerging markets, where their growth prospects are greatest, because of their limited experience operating in these countries. And many lack the capabilities and capital to commercialize innovation, even when they are strong in R&D.

We believe win-win opportunities abound for international partnerships between Chinese and Finnish companies because they possess many complementary tangible and intangible assets. Chinese companies have deep experience operating in emerging markets, and they can provide access to China's vast home market. They can also supply the capital and low-cost resources that many Finnish companies need in order to bring innovation to market. Finnish companies have world-class technology and possess many of the capabilities—including experience navigating developed markets—that Chinese companies need to move up the value chain and tap new markets for growth.

The best opportunities for Sino-Finnish partnerships fall into four categories, depending on whether the target market is already developed or still emerging and whether the

target sector is in a “sunrise” or globally mature industry. These criteria serve as the basis for our Market Opportunity Matrix, which characterizes four broad opportunity sets for Finnish and Chinese companies seeking international partnerships.

The first part of this report explains why Finnish and Chinese companies need to pursue international expansion to secure their futures. We start with the Finnish case, but we dedicate most of this section to explaining the complex historical circumstances that make internationalization critical for China.

In the second part of the report, we introduce our Market Opportunity Matrix and provide details about the four opportunities the matrix highlights: good enough, latent demand, breakthrough, and leapfrog. We describe multiple real-world partnerships between Western and Chinese companies that have been established to pursue these opportunities. And we offer guidance on the types of Finnish and Chinese companies that would make good partners.

No country has ever advanced so far in such a short time as China has. But the strategies that brought it to where it is today won't take it where it wants to be in the future. Finnish companies face different but often daunting challenges, in part because many have not been sufficiently prepared for the rise of emerging economies. Together, Chinese and Finnish enterprises have an opportunity to gain tremendous ground and even to take the lead in some markets.

PART I: THE CASE FOR INTERNATIONAL- IZATION

To achieve their growth potential, companies in both Finland and China must increase their efforts to expand abroad. We explain why in the following two subsections. We start with Finland, whose needs in this regard are similar to the needs of many other developed economies, particularly those with relatively small home markets. We then discuss China, giving more space to explaining China's situation because the nation's urgent present-day needs are best understood when put in historical context.

Finland's Internationalization Imperative

Finnish companies began to pursue international expansion on a large scale in the 1980s, and many have built strong global positions in their own segments. The trend was led by large companies that had the resources to finance international efforts, and most of those companies pursued growth through acquisitions that provided them with access to new markets in developed economies.

Yet Finland's international business presence lags behind that of other small, open economies, such as Holland, Sweden, and Switzerland. In particular, it does not have a strong presence in emerging markets. Large Finnish companies in industries such as forestry, telecommunications, and industrial equipment have made important forays into emerging markets, but most Finnish companies are not prepared for the shift in the world's center of economic gravity from West to East.

Finland cannot afford to sit out the emerging market revolution that has already proved to be such a powerful engine of growth for companies across the developed world. Emerging markets will continue to be a source of disproportionate demand as their standards of living rise and their consumers increasingly require midmarket goods and services. Demand for infrastructure

development will also continue to grow rapidly in emerging markets, including in the area of information and communications technology.

International growth is particularly important for companies in small countries like Finland because domestic demand often is not sufficient to justify the large capital investments required to bring innovation to market. This is a matter not only of finding new markets for proven products but also of accessing a sufficiently large customer base to cover the cost of launching the new products that will enable Finland to maintain and extend its competitive advantages.

To expand their reach and compete with multinational corporations (MNCs), large Finnish companies must further extend their efforts from developed to emerging economies. They will often need help from local enterprises to bring their products to market in countries where regulations may be much looser, consumer needs may be unfamiliar, and ultra-low-cost products may be a prerequisite for success. Finnish small and medium enterprises (SMEs) may also be eager to focus on emerging markets to gain access to rising consumers and tap financing from local companies that can help them commercialize innovation both at home and abroad.

China's Internationalization Imperative

China's rise over the last 30 years has been astonishing by any measure. China became the world's second-largest economy in 2010, up from ninth largest in 1980, bringing its share of world GDP to 17 percent based on purchasing power parity. (See *Exhibit 1, page 3.*) In the process, it lifted 680 million people out of misery: economic development reduced China's extreme-poverty rate from 84 percent to 10 percent. Deng Xiaoping, who succeeded Mao

after his death in 1976, finally opened the path to economic growth in the late 1970s, when he began introducing market reforms that paved the way for modernization. To do so, Deng struck what some have characterized as a Faustian bargain with the West, allowing foreign companies to access China's vast supply of surplus labor and potential demand from its billion-plus consumers in exchange for foreign direct investment (FDI) and transfer of advanced technology and know-how.

In fact, the bargain had the potential to be Faustian for both sides. In giving Western companies access to its market before most of its domestic businesses were ready to compete, China risked losing entire industries to

advanced MNCs. But in cooperating with Chinese companies, which they knew sought to acquire technology and capabilities from their partners, Western companies risked surrendering their competitive advantages.

Deng's bargain was particularly painful because many in China felt humiliated by the historical record and were reluctant to embrace any solution that would seem to involve turning to foreigners for help. The feeling persists even today. China had been one of the most powerful countries in the premodern world, from at least 600 to the early 1800s; it became one of the poorest seemingly overnight. A period of chaos and immense suffering lasted for almost 150 years, until the end of the Mao

era. Many Chinese people still experience a deep sense of shame about this period and would prefer a remedy based on national self-sufficiency.

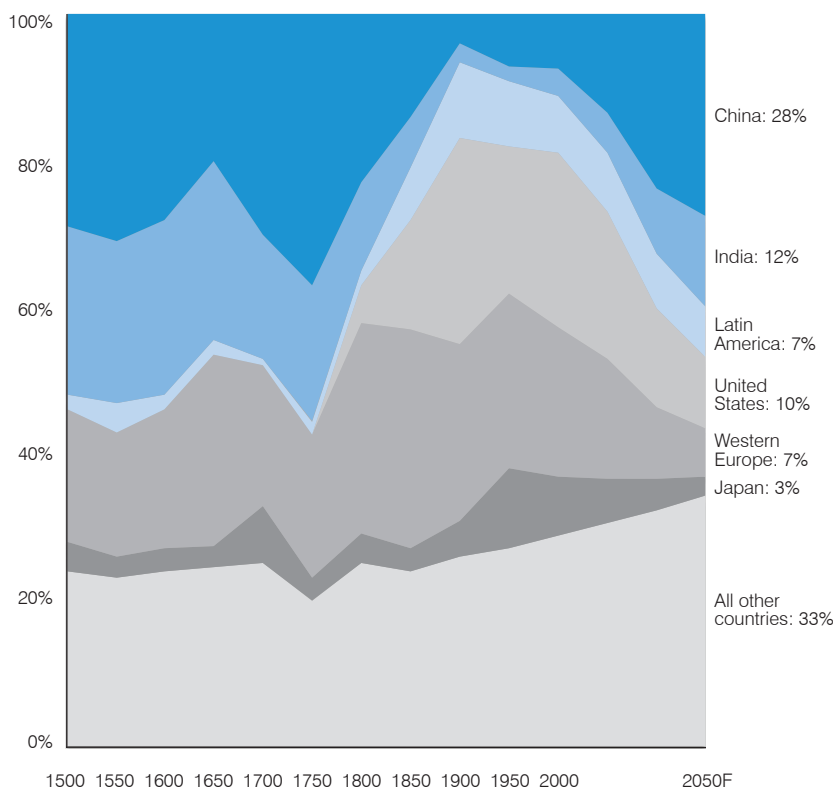
Those familiar with Chinese history understand that the bargain was always about survival and modernization for China, not Westernization or democratization. It ultimately enabled China to emerge from the decades of near-autarky and economic mismanagement that threatened its survival and rendered it virtually irrelevant to foreign businesses.

China's tremendous growth over the next 30 years was concentrated in three spurts that each persisted at high levels of intensity for five to six years. The first arose as a result of an unleashing of Chinese entrepreneurship in the early 1980s and was not export-oriented. The second came in the 1990s and was propelled by the labor-intensive, low-price export model that is familiar to most readers. The third resulted from the combination of China's accession to the World Trade Organization (WTO) in 2001 and the credit-enabled consumer-spending binge that drove demand from U.S. and other Western markets until the 2008 global financial crisis.¹

The surge in FDI fueled massive domestic expansion, and Chinese demand for various metals and other natural resources drove commodity prices to all-time highs. Indeed, China's rapid rate of growth continued even in the wake of the 2008 economic crash. In the four years ending in 2011, China doubled its GDP per capita.

Though Deng's bargain could still prove to be Faustian in coming years, it's difficult at present to see it as anything less than the animating spirit behind China's astonishing 30-year rise from poverty and irrelevance to prosperity and power.

Exhibit 1
China: Reclaiming Global Economic Leadership



Source: EIU, Nexis, World Bank, CEPIL, literature research, Booz & Company analysis

Turning Point

China is now approaching a critical stretch along a path that has so far delivered transformative growth. This is no surprise. Economic theory predicts that China could experience slower growth as it reaches the end of an initial catch-up phase fueled primarily by low-cost advantages. Indeed, the Chinese government set a growth target of 7.5 percent for 2013, down from the 10 percent annual growth rate it averaged during most of the previous 30 years.

Until recently, growth was fueled by high rates of investment, a growing labor force (resulting from the migration of workers from subsistence farming to industry in coastal cities), and technological progress. For decades, the supply of labor greatly exceeded demand and costs remained low. But wages began to rise as the remainder of China's surplus labor, mostly from the agricultural sector, was redeployed in modern industrial sectors. The point in the development of an emerging economy when further capital accumulation begins to increase wages is known as the "Lewis turning point," named after the Nobel Prize-winning economist Sir William Arthur Lewis, who first described the phenomenon.

China has now neared—if not reached—the Lewis turning point. Margins are shrinking as costs rise, and export-led demand is falling as foreign companies explore alternative options, including moving operations to other countries, such as Vietnam, where labor is cheaper.

Of course, Chinese companies could tap rising domestic demand to make up the growth shortfall, but MNCs chasing Chinese consumers have brought intense competition to many industry sectors since China's 2001 accession to the WTO. Other factors could partially mitigate the effects of rising costs,

such as the fact that most Chinese companies have many opportunities to improve the productivity of their existing operations so as to increase productivity and suppress costs.²

Nevertheless, if China doesn't find new avenues for growth, it will eventually fall prey to the "middle-income trap." This happens when a country's surplus labor runs out and wages begin to rise (that is, when its economy reaches the Lewis turning point), rendering it increasingly less competitive in the labor-intensive, low-value-added industries that enabled it to achieve high rates of growth in the past. Indeed, history is replete with examples of emerging economies—including South Africa, Jordan, Turkey, the Philippines, Thailand, Malaysia, and many countries in South America—that have

fallen into decades of stagnation as a consequence of their inability to sustain growth in the face of rising costs.

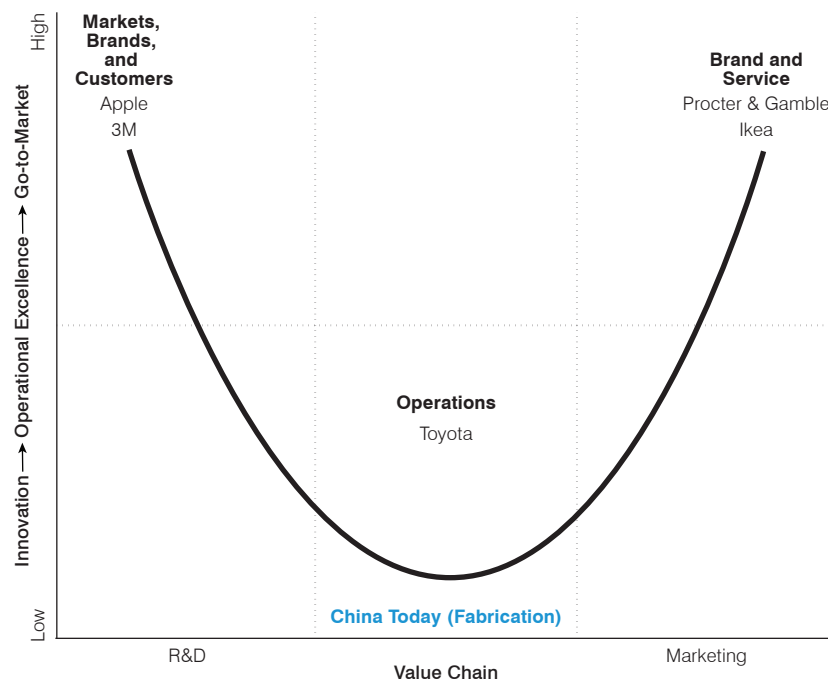
From Low-Cost to High-Value

To avoid the middle-income trap, China must transition from a low-cost to a high-value economy. The challenge is neatly summarized in the "smiling curve" proposed by Acer founder Stan Shih to describe how companies can avoid stagnation as their low-cost advantages erode. (See Exhibit 2.)

Most Chinese companies still operate near the nadir of Shih's smiling curve—they compete primarily in labor-intensive industries to manufacture low-value items such as textiles or to assemble electronics. They must climb the smile's right or left side to migrate up the value chain. This

Exhibit 2
Ways Around the Middle-Income Trap: Innovation, Go-to-Market, and Operational Excellence

STAN SHIH'S "SMILING" CURVE



Source: Literature research, Wikipedia (graph), Booz & Company analysis

would involve investing in R&D to become real innovators such as Apple and 3M or investing in marketing to develop iconic brands such as Procter & Gamble and Ikea.

A third option involves rising straight up the center of the chart to achieve distinction through operational excellence, as Toyota did via its famous production system.

All of this is easier said than done. Deng set his sights on technology and knowledge transfer as well as FDI when he struck his bargain with the West more than a quarter century ago, and China has made no secret of its motivation to develop high-value capabilities and acquire technology through partnerships with foreign companies. It has had many successes, including working with

China has had mixed success upgrading its technology and capabilities through acquisitions of foreign companies.

Siemens and Kawasaki to acquire the technology to build its high-speed-train network.

But Chinese companies have had mixed results in other areas such as the automotive industry. Although China recently became the world's largest automotive market, it is dominated by foreign brands that operate through mandatory joint ventures, and China has yet to produce a globally competitive car company. Moreover, while China has more entries than any country except the

United States on *Fortune* magazine's 2012 list of the world's largest companies, there are no Chinese companies on Interbrand's 2012 list of the world's "best global brands."

International Gambits

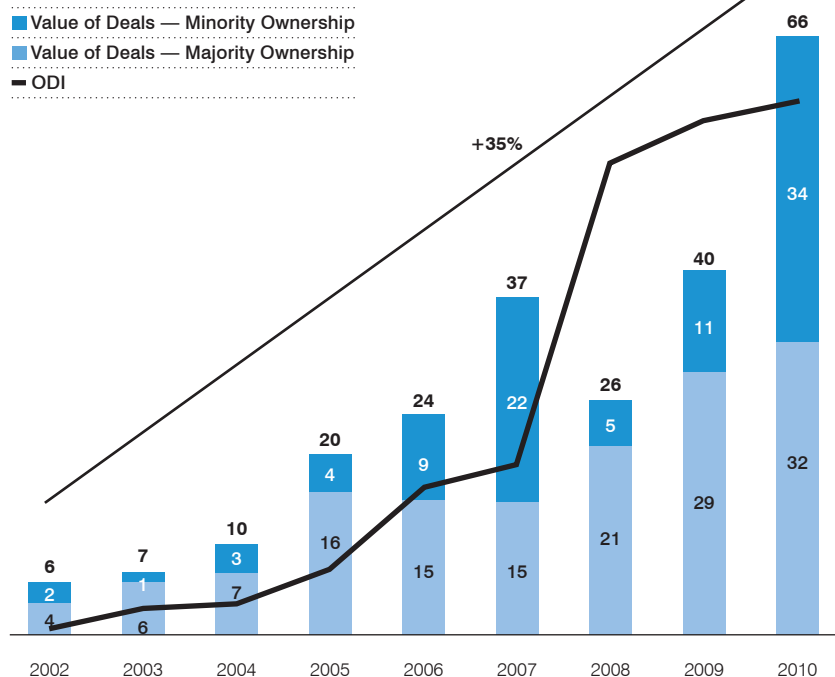
Competition at home has become increasingly intense since China's accession to the WTO in 2001, and China has had mixed success upgrading its technology and capabilities through domestic partnerships with foreign companies. As a result, Chinese companies have increasingly pursued international expansion, often through M&A, to acquire technology and develop high-value capabilities. Indeed, China's outbound M&A grew at a compound annual growth rate of 35 percent from 2002 through 2010. (See Exhibit 3.)

This is unusual. Companies from countries such as Japan and South Korea at the time of their emergence initially pursued international growth by introducing in foreign markets products that they had already launched successfully at home. And they usually started in countries that weren't too far away. But because technology and skills acquisition are a primary motivation for many Chinese companies, developed countries far from home have received an increasing share of China's outbound direct investment. (See Exhibit 4, page 6.)

But Chinese companies have had an exceptionally high failure rate when it comes to foreign expansion. Only 47 percent of announced Chinese overseas

Exhibit 3
China Invests Abroad to Become More Competitive at Home

CHINA OUTBOUND DIRECT INVESTMENT AND OUTBOUND M&A / 2002-10, IN \$BN



Source: Global Insight, Booz & Company analysis

deals are completed, compared with 67 percent for Indian companies. And of the overseas M&A deals by Chinese companies that are completed, more than 60 percent don't achieve their expected outcomes.³

This can be attributed, in part, to Chinese companies' tendency to take an overly aggressive approach to expansion. Under pressure to achieve rapid successes, they often try to do too much at once. More importantly, most lack capabilities to execute deals successfully. They have little experience integrating enterprises or managing turn-arounds, and they lack the language and other skills required to navigate other cultures. Talent is often underdeveloped, and many Chinese companies lag behind MNCs when it comes to governance, managerial, and systems standards. A survey we conducted with more than 100 MNCs revealed that they perceive Chinese companies to be weakest in the areas of HR management, branding and marketing management, and management of cultural differences. MNCs are particularly concerned that Chinese companies lack the people skills to navigate multicultural environments. (See Exhibit 5, page 7.)

But MNCs perceive Chinese companies as having strengths in several areas as well, including low-cost manufacturing. They believe Chinese companies are good at developing products to meet local market needs, and they recognize that Chinese players often have extensive experience navigating markets that are less regulated than Western markets. (See Exhibit 6, page 7.)

MNCs see these strengths as the basis for win-win partnerships. Many say they expect to cooperate with Chinese partners internationally in the future, particularly on

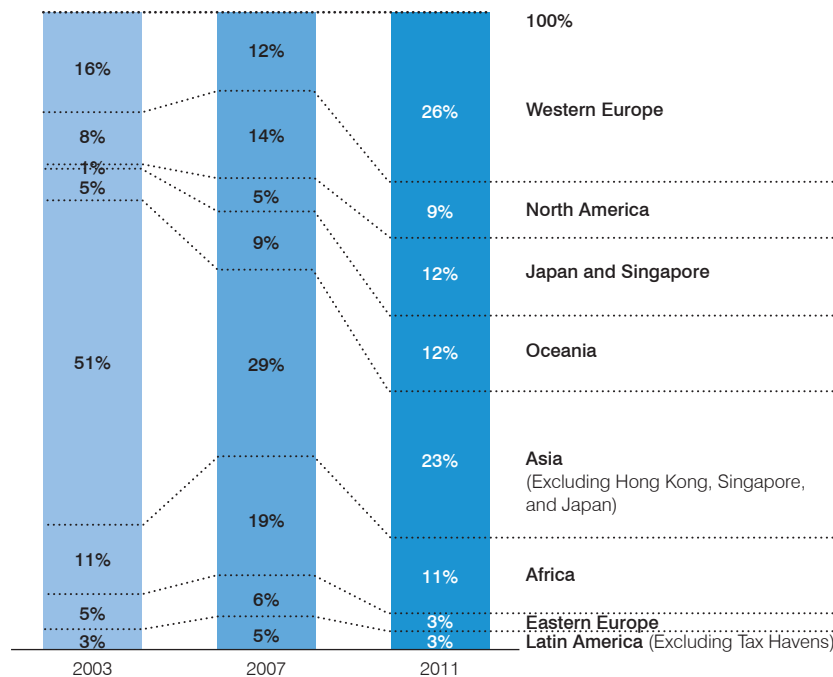
R&D. The top reason they cite for partnerships is to develop low-cost products for the Chinese market, but a number want to leverage their low-cost know-how to enter other emerging markets, and some want to do so to boost performance in or enter mature markets.

In fact, despite the high failure rate noted previously, Chinese companies do not internationalize solely from a position of weakness. Industrial companies and companies from sectors where branding and blue-sky innovation are less critical often do well abroad. These companies frequently excel at reducing complexity, re-designing products and processes to lower costs, and navigating markets whose institutional environments are not as developed as they are in Western economies.⁴

Moreover, Chinese midmarket innovators have shown that they can sometimes leverage their unique factor conditions to become global category killers. Like other successful Chinese companies, midmarket innovators focus relentlessly on cost, but they also innovate to improve their products, processes, and business models, and they strive to achieve standards of reliability and performance comparable to those of Western MNCs. Their goods are lower in cost but better attuned to Chinese needs than goods from MNCs. Chinese players such as Lenovo, Haier, Mindray, and Sany are using their dominant position in China's massive midmarket to build a global leadership position and challenge established multinationals from developed countries.⁵

Exhibit 4
Developed Countries Get an Increasing Share of China's ODI

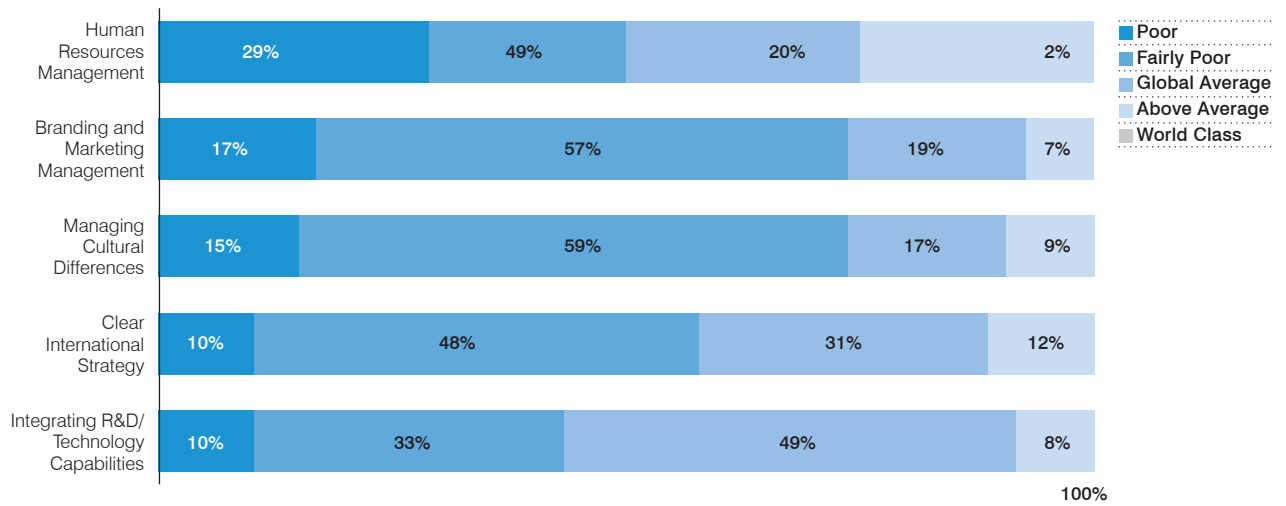
GEOGRAPHIC DISTRIBUTION OF CHINA ODI FLOW, 2003-11¹



¹ Tax havens are excluded.
Note: Sums may not total 100 because of rounding.
Source: Oxford Handbook of International Business, Booz & Company analysis

Exhibit 5
Chinese Firms Are Weakest in HR and Branding, Say MNCs

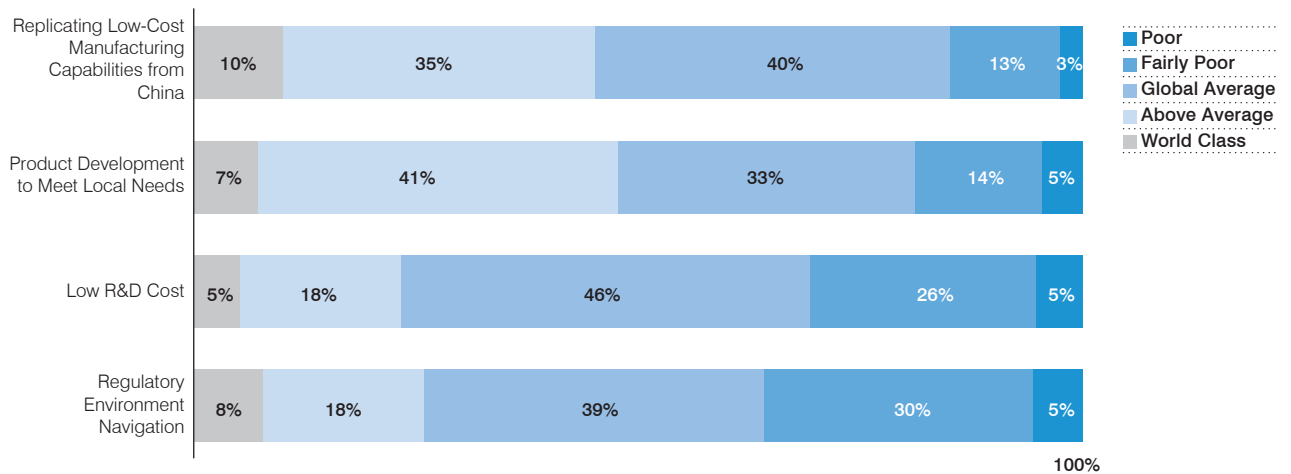
MNCs' PERCEPTION OF CHINESE COMPANIES' CAPABILITIES¹



¹ Based on survey of more than 100 MNCs with a 30% response rate
 Note: Sums may not total 100 because of rounding.
 Source: Survey data; Booz & Company analysis

Exhibit 6
Chinese Firms Know Low-Cost and Emerging Markets, Say MNCs

MNCs' PERCEPTION OF CHINESE COMPANIES' CAPABILITIES¹



¹ Based on survey of more than 100 MNCs with a 30% response rate
 Note: Sums may not total 100 because of rounding.
 Source: Survey data; Booz & Company analysis

PART II: THE CASE FOR SINO-FINNISH PARTNERSHIPS

Finnish and Chinese companies have the potential to strike win-win partnerships that would enable both to expand beyond their borders and capture growth opportunities that will lay the foundations for future competitive advantages.

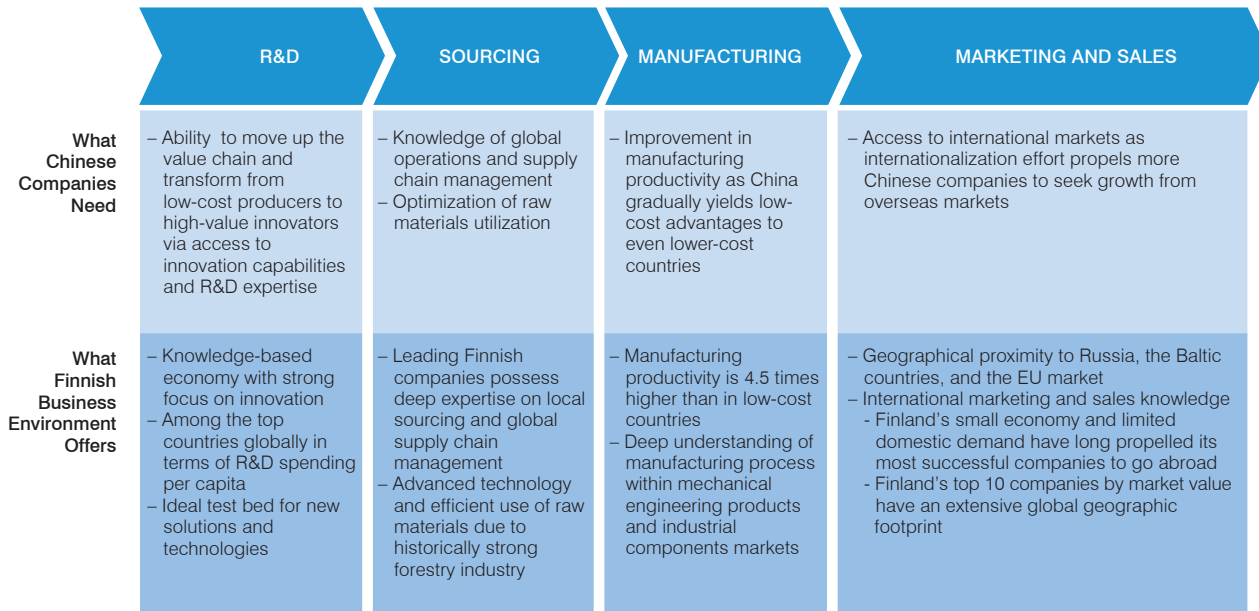
Chinese companies can help Finnish partners reach consumers in emerging markets, including in China. They can provide managerial talent with experience navigating economies with less-developed institutional environments than is standard in developed countries. They can also contribute capital to help Finns commercialize innovation, provide the necessary insight for adapting Finnish products and services to suit consumers in emerging markets, and supply low-cost manufacturing resources to help Finnish companies reduce their costs and bolster margins.

Through partnerships with Finns, Chinese companies can gain access

to advanced technology and learn to develop more effective R&D programs. They can advance their marketing and branding skills by working with Finnish partners to bring products to market across the developing world. (See Exhibit 7.) They can also gain operating experience in developed economies that are governed by tighter regulatory requirements than they are used to, and they can advance their managerial and governance capabilities through collaboration with Finnish companies that hew to Western standards.

The following sections provide details about how Finnish and Chinese companies can develop successful partnerships. The first section introduces the Market Opportunity Matrix, a framework that highlights four broad strategic options that Finnish and Chinese companies can pursue to expand internationally. The second section outlines important

Exhibit 7
Finland Can Help China Move Up the Value Chain



Source: Booz & Company analysis

considerations for selecting Finnish or Chinese partners. The third section highlights three basic questions that companies should ask themselves when they are just beginning to consider international partnerships.

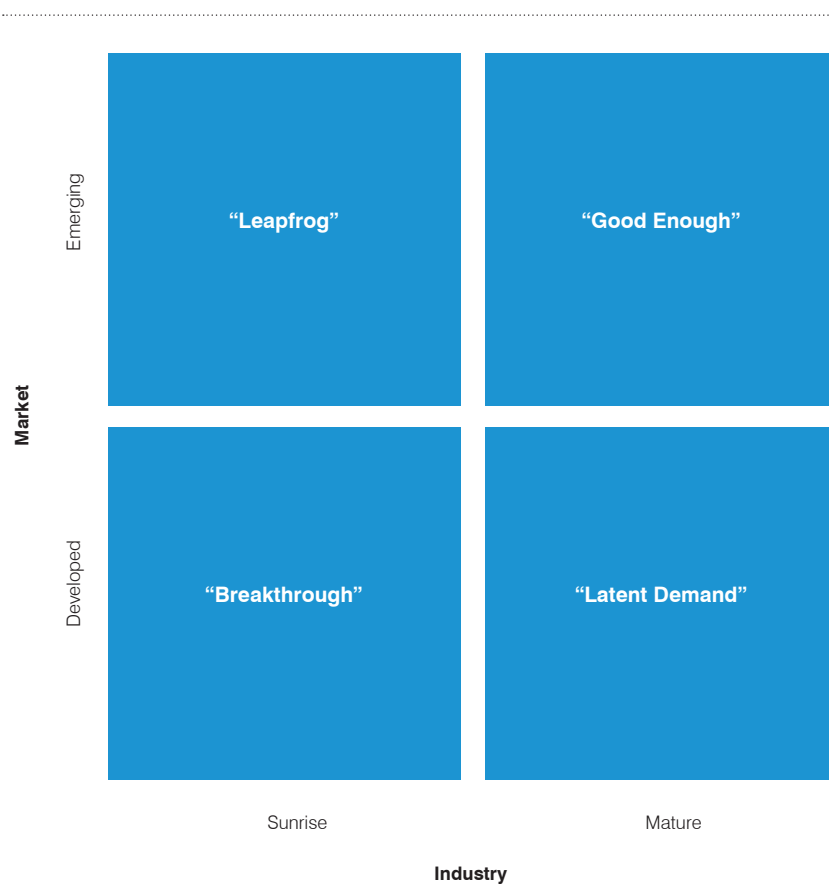
The Market Opportunity Matrix

We created a Market Opportunity Matrix to help companies identify win-win opportunities accounting for two critical factors: phase of market development (mature or developing), and phase of industry development (sunrise or mature). Based on these factors, the Matrix highlights four main strategies for successful partnerships between Finnish and Chinese enterprises. (See Exhibit 8.)

- *Good Enough*: Emerging markets, mature industries. Jointly develop low-end or midmarket versions of existing products for emerging markets.
- *Latent Demand*: Developed markets, mature industries. Join forces to activate latent demand for low-end or midmarket products for developed markets.
- *Leapfrog*: Emerging markets, sunrise industries. Capitalize on latecomer advantages to develop new products and technologies that will be more readily adopted in emerging markets that lack an installed base for an existing product or technology.
- *Breakthrough*: Developed markets, sunrise industries. Create truly cutting-edge products for developed markets (for example, by combining high-end and low-cost capabilities).

It is also critical to note that plays focusing on opportunities in one quadrant open opportunities for plays in other quadrants. It is

Exhibit 8
The Market Opportunity Matrix



Source: Booz & Company analysis

particularly likely that companies adapting efforts targeting “good enough” opportunities in emerging markets will pursue “latent demand” opportunities in developed markets. Similarly, there may be potential to adapt “breakthrough” plays launched in developed markets to launch “leapfrog” plays in emerging markets. In some cases, partners may be able to launch initiatives in pursuit of opportunities in multiple quadrants simultaneously.

The following sections provide detail about each of these opportunities, including what is needed from Finnish and Chinese partners and examples of partnerships involving

Western and Chinese companies that successfully pursued them in markets around the world.

It is worth noting that we looked for examples of Sino-Finnish partnerships in the course of doing our research. We identified a number that are currently in development, and we found that interest in pursuing partnerships is high among both Finnish and Chinese companies. No partnerships have progressed far enough to be useful as case examples, however, which is why we don’t discuss any particular Sino-Finnish partnerships. We see this as further evidence that Finland has fallen behind when it comes to pursuing opportunities in

emerging markets, but we are encouraged to see that partnerships between Finnish and Chinese companies are beginning to emerge.

Good Enough

Finnish and Chinese companies can cooperate to capture new growth opportunities in emerging markets by creating low-cost versions of successful products that are already available in mature industries. (See Exhibit 9.) This often involves stripping costs from products available in developed markets—for example, removing “nice to have” features while preserving the product’s essential benefits—to make them more affordable for consumers in emerging markets.

Alternatively, companies could add features to bare-bones products to make them attractive to midmarket consumers, or they could combine forces to design entirely new low-priced products from the ground up. The strategy is most attractive in cases when Finnish companies can contribute technology that is already proven and accepted in other markets. Industries where Finns have advantages include information and communication technology, industrial manufacturing, mining, construction equipment, and forestry. Finnish companies can also contribute strong international operations experience as well as brand and marketing know-how.

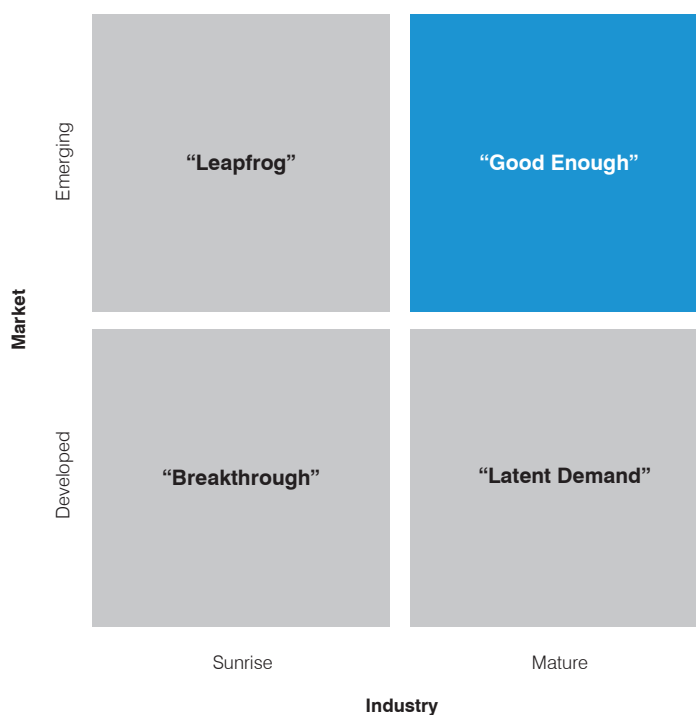
Attractive Chinese partners have the engineering capabilities and scale to produce low-cost, “good enough” products for emerging markets. They may already have distribution networks in place, and they may have experience navigating less developed institutional environments. Many Chinese companies can leverage their low-cost capabilities and extensive experience in emerging markets to expand their presence in countries in Southeast Asia and Eastern Europe as well as Africa and the Middle East.

Governments could take an active role to facilitate partnerships based on “good enough” products, but most opportunities don’t require government involvement. The Finnish government could provide incentives, potentially including export financing or guarantees, to encourage Finnish companies to grow abroad—although this could be politically difficult in Finland, as some stakeholders may resist initiatives that support companies’ overseas activities rather than employment at home. The Chinese government already provides some incentives to support Chinese companies that operate overseas. It could also provide financing to Chinese companies to help them to upgrade or expand their production

capabilities to increase efficiency or scale and further reduce costs.

A recent example of this kind of partnership is the one involving Huawei and Microsoft, which seeks to capture “good enough” smartphone opportunities in Africa. Huawei brings low-cost manufacturing capabilities and extensive experience in Africa; Microsoft brings its Windows Phone 8 operating system and the technical expertise to tailor it for specific markets. In 2013, the partners launched the 4Afrika Windows Phone in Angola, Egypt, Ivory Coast, Kenya, Morocco, Nigeria, and South Africa. Sweden’s Volvo acquired Shandong

Exhibit 9
The “Good Enough” Strategy



- This strategy involves joint development of low-end or midmarket versions of existing products for emerging markets.
- Exploring “good enough” opportunities in emerging markets may require Finnish and Chinese companies to establish relationships in China first.

Source: Booz & Company analysis

Lingong Construction Machinery (SDLG) in 2007 to add value and basic brands to its portfolio and to expand its presence in China; it subsequently developed plans to expand into other emerging markets as well. Volvo used its existing supply base, manufacturing facilities, and distribution networks to boost SDLG's expected export volumes by 156 percent by 2015, compared with 2011 volumes. The availability of new excavators based on Volvo technology drove SDLG's Chinese sales volume up 513 percent from 2008 through 2011.

The Chinese and U.S. automakers SAIC and GM leveraged the partnership they developed in China to gain

access to the automotive market in India. GM provided manufacturing facilities, distribution networks, advanced technology, and its world-renowned brand; SAIC provided low-cost engineering expertise. In 2012, the joint venture produced the first Indian launch of a Chinese-designed car, the GM-branded Chevrolet Sail. And 2013 saw the launch of the Chevrolet Enjoy, a rebranded version of the popular Wuling Minivan that sells under the SAIC brand in China.

Latent Demand

Finnish and Chinese companies can join forces to develop low-cost, midmarket products for developed economies. These opportunities may

be most likely to emerge when company executives recognize that there is latent demand in developed countries for “good enough” products that they have already launched successfully in emerging markets. (See Exhibit 10.)

Finnish companies with international brand recognition and marketing and service expertise can act as end-to-end facilitators to tap latent-demand opportunities. They can help Chinese companies establish relationships and influence key stakeholders in developed markets, and they can provide the training and support that Chinese companies will need in order to deliver critical after-sales services. Finnish companies can also leverage their international operations experience to help their Chinese counterparts understand underexplored opportunities in developed economies as well as build critical “go to market” skills.

Chinese companies can leverage their low-cost engineering and manufacturing capabilities to bring low-cost, high-quality products and services to developed markets. Large Chinese companies are likely to have the scale to keep manufacturing costs low and thus deliver at the required price points.

Geographical proximity is important, and therefore countries in Europe as well as Japan and Korea are likely to represent the most attractive opportunities. But it may often be wise for Finnish and Chinese companies to establish relationships in emerging markets first, potentially including joint ventures in China, before tackling the greater challenges posed by developed markets.

As with “good enough” opportunities, success does not hinge on government involvement. But the Finnish government could play a role in helping partners navigate highly regulated European economies, and the Chinese government could provide financial support to Chinese companies to help

Exhibit 10
The “Latent Demand” Strategy



- This strategy describes the activation of latent demand for low-end or midmarket products for developed markets.
- Exploring latent demand in developed markets may call for Finnish and Chinese companies to first establish relationships in other emerging markets—perhaps even in China. In mature markets, direct cooperation may be more difficult and will demand careful nurturing by the Finnish partner.

Source: Booz & Company analysis

them keep costs down by increasing efficiency or scale.

Mahindra & Mahindra’s entry into the U.S. agricultural equipment market is a good example of a successful latent-demand play. Founded as a steelmaker in 1945, Mahindra partnered with International Harvester in the 1960s to manufacture a line of sturdy, affordable 35-horsepower tractors for the Indian market under the Mahindra name. In the 1990s, the company realized there was an opportunity to provide tractors to hobby farmers, landscapers, and building contractors in the United States who couldn’t afford the expensive machines offered by dominant players such as Deere & Co. that catered to industrial-scale agribusiness.

Under the Mahindra USA name, Mahindra built strong relationships with dealerships and offered highly personalized service to consumers. The company delivered tractors within 48 hours of receiving an order, liberating dealerships from the burden of maintaining expensive inventories. As many as 15 percent of consumers who bought a Mahindra tractor received a phone call from the company’s president asking if they were satisfied with their machine. Mahindra also offered special incentives such as horticultural scholarships to neglected market segments such as female hobby farmers. The high-touch strategy enabled Mahindra USA to achieve an average sales growth of 40 percent from 1999 through 2006.

Breakthrough

Finnish companies could partner with Chinese companies to develop superior technologies for developed markets, particularly when domestic demand is not sufficient to justify capital investments. Chinese companies would provide financing in exchange for the opportunity to

acquire technology, build capabilities, and gain access to developed markets. (See Exhibit 11.)

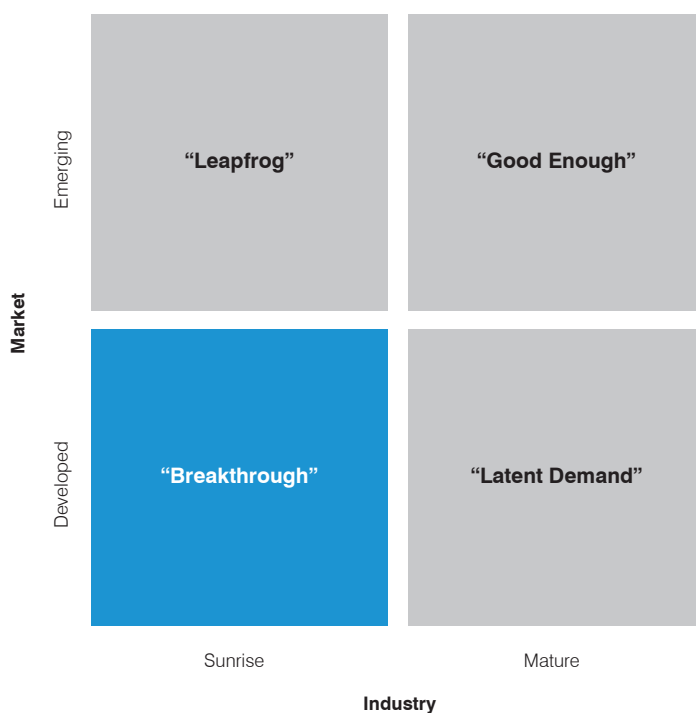
Emerging industries where Finnish companies already have some advantages, such as clean tech and electric vehicles, offer the most promising breakthrough opportunities. Market familiarity is critical, so proximate countries such as some European and Baltic countries as well as Russia are the most promising targets.

Chinese SMEs may be suitable partners given that scale may not be as important a factor as ambition, creativity, and the ability to provide capital to support technology development. The

Chinese government should have a role in providing extensive incentives and other support to Chinese companies (mainly state-owned enterprises) that seek to penetrate developed markets with cutting-edge sunrise products. The Finnish government can help partnerships that are focused on clean tech to navigate thorny European environmental regulations.

It’s important to note that none of the breakthrough-opportunity partnerships we identified have produced a financial impact at this early date—they were all formed fairly recently—but many do show promise. Also worth noting is that breakthrough opportunities often emerge from plays

Exhibit 11
The “Breakthrough” Strategy



- This strategy involves creating truly cutting-edge products for developed markets (by combining high-end and low-cost capabilities, for example).
- Cooperation in sunrise industries is more likely to occur first in developed markets and then be transferred to emerging markets.

Source: Booz & Company analysis

in other quadrants, as illustrated in the Wanxiang example cited below.

LDK Solar, a China-based solar-energy company, acquired a 70 percent stake in U.S.-based Solar Power, Inc. (SPI) in 2001 to tap into the U.S. solar market. LDK provided financial resources to accelerate business development, leveraging SPI's strong relationships in the Americas. The deal couples SPI's downstream design expertise with LDK's world-class upstream capabilities (the company is a leading producer of solar wafers). LDK will open joint manufacturing operations in the United States to enhance SPI's competitive advantage in North America.

Similarly, Hanergy, China's largest privately held energy company, acquired Sweden's Solibro, the world's leading producer of CIGS thin-film solar-cell materials.⁶ The 2012 deal gives Hanergy access to Solibro's thin-film technology and European distribution network.

Wanxiang, the Chinese auto parts manufacturer, has made successive acquisitions in the United States to capture "latent demand" opportunities and expand its U.S. presence. This includes the purchases of U.S. auto suppliers Zeller, LT Company, Universal Automotive Industries, and Rockford Powertrain in the early 2000s. The strategy positioned

Wanxiang for its 2012 entry into the sunrise space via its acquisition of A123 Systems, a leading U.S. battery and energy storage company. The purchase gave Wanxiang access to cutting-edge battery technology that it will use to commercialize the electric vehicles it is developing. A123 also has strong supply relationships with leading automakers in the United States and across the globe that Wanxiang hopes to leverage to advance its global electric-vehicle ambitions.

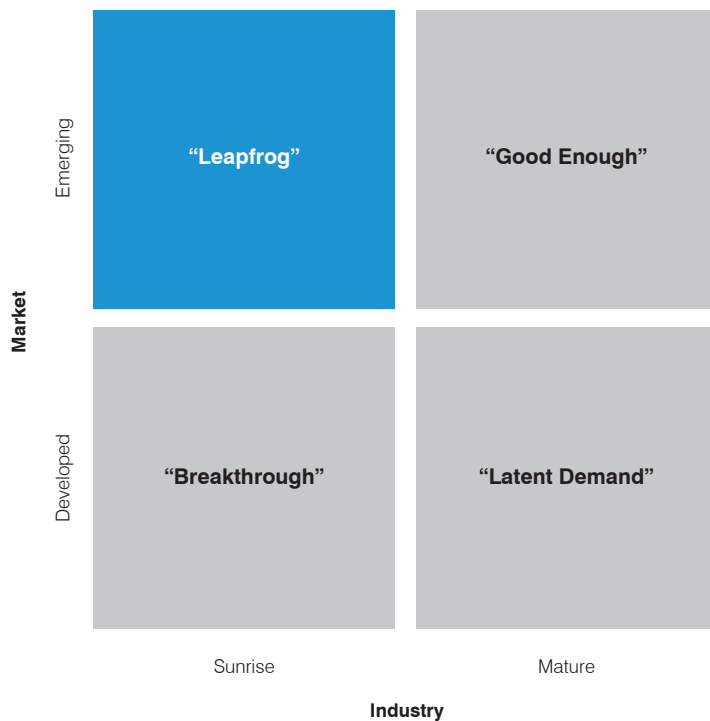
Leapfrog

Chinese and Finnish companies can leverage latecomer advantages to bring sunrise technologies to emerging markets. The opportunity usually arises when a company is able to launch a new product or technology in an emerging market without having to replace or overcome an installed base for an existing product or technology. (See Exhibit 12.)

The Finnish company will typically bring proven technology to the partnership, dramatically reducing the need for R&D investment. The Chinese company typically provides market access. Partners should prioritize markets where one participant has previous experience, but Chinese companies can sometimes facilitate entry into emerging markets where they have little presence, given their extensive experience in emerging markets around the globe. Chinese companies can also contribute low-cost production capabilities and capital.

Partners may often start by targeting the Chinese market itself, particularly when they can tap the country's huge domestic demand to ramp up sales volume without having to overcome an installed base. Targeting China first makes most sense when the sunrise industry is one that China considers strategic, such as electric vehicles or clean tech.

Exhibit 12
The "Leapfrog" Strategy



- This strategy involves developing new products or technologies for emerging markets that lack installed bases of those products or technologies.
- There may be opportunities for sunrise industries to transfer to developed markets when legacy costs are not significant—in electric vehicles, for example.

Source: Booz & Company analysis

Breakthrough plays may also open “leapfrog” opportunities. This can happen when companies adapt sunrise technologies for emerging markets that they first successfully launched in the West. Indeed, the Chinese government may provide incentives to local companies that target developed as well as emerging markets with cutting-edge sunrise technologies, knowing that they will later be deployed at home.

Similarly, the Finnish government may provide incentives to support Finnish companies that are involved in important emerging industries, particularly when this may advance the development of an industry cluster at home.

In 2004, China’s Huawei, the world’s largest telecom-equipment maker, partnered with Siemens, the German engineering and electronics conglomerate, to develop 3G telecommunications businesses in emerging markets. Siemens provided its intellectual property, and Huawei contributed R&D to design products and sales networks in target markets. Huawei achieved a 40 percent share of the 3G market in China and a 10 percent share globally.

BYD Auto, a Chinese hybrid- and electric-vehicle manufacturer, along with its parent, BYD Group, a leading manufacturer of lithium ion batteries, partnered with Daimler, the German auto giant, to produce electric vehicles in China. Recognizing that it will be difficult for Chinese companies to reach parity with foreign automakers in developing

traditional vehicles, the Chinese government has focused on building advantage in electrified vehicles in recent years. As part of the effort, it provides robust incentives to encourage development of vehicle electrification in China. The BYD-Daimler partnership enables Daimler to bring its technology to China, coupling it with BYD’s technology and low-cost capabilities, and supported by government incentives. The partnership is scheduled to launch its first vehicle, the Denza, in 2013.

Picking Partners

Selecting the right partner is never easy, and it can be more difficult for companies seeking partners from very different cultural, economic, and political contexts. International partnerships are more challenging precisely because the partners are less likely to understand one another.

To facilitate partner selection, we first highlight important characteristics that indicate the type of Finnish companies that may benefit from partnerships with the Chinese; we then do the same for Chinese companies vis-à-vis Finns.

Characteristics of Potential Finnish Partners

Two sets of characteristics are particularly important in determining the types of partnerships that make sense for Finnish companies to pursue with Chinese partners: strength of industry cluster and company size.⁷

Strength of Industry Cluster Finnish companies that can offer

world-class capabilities and technology are the most attractive partners, and these types of companies are most likely to hail from industries that have strong or semistrong domestic clusters. Finnish industries with strong clusters include forestry, base metals, energy, and telecommunications. Companies in these industries are often regional or international players and thus have experience operating in a variety of markets. They also tend to have strong R&D and sales and marketing capabilities. But owing to their strengths, they may have the luxury to take a “wait and see” approach to collaboration, demanding more than others might in return for their contribution and taking extra care to evaluate potential partners.

Companies in industries where clusters are nascent or fragile may also have strong capabilities and technology to offer, and they may be more eager to enter into partnerships. Finnish industries with developing clusters include construction, clean tech, and healthcare. Positive signs abound in these industries, but capacity is usually underutilized. These companies are often proactive in seeking partnerships—particularly when domestic demand is too weak to support large capital investments—but their value to partners may not extend much beyond what they can offer through their core technologies. Nevertheless, they can be game changers when their technology advantage is strong.

Company Size

Large companies as well as SMEs can benefit from cooperating with Chinese companies, but their size will affect the underlying logic and success factors for partnerships.

Large Finnish companies are most likely to seek Chinese partners in order to gain access to emerging

International partnerships are more challenging precisely because the partners are less likely to understand one another.

markets and get help navigating them. Most have little experience in the developing world, and few have expertise creating midmarket products that emerging consumers can afford. Large companies such as Wärtsilä, Metso, and Nokia may have the technology, brands, management know-how, and international experience that Chinese companies need.

Finnish SMEs often have superior innovation and technical capabilities, and they can be much more nimble than large companies, adept at tailoring niche propositions to new markets and consumer segments. SMEs lack scale economies, however, and they may not have the capital to expand their operations even if domestic demand were sufficient to justify their investments. They are most likely to seek partnerships to gain access to larger consumer segments and the financing to expand, but they also need help navigating emerging markets.

Both large companies and SMEs should consider taking a “real options” approach to collaborating with Chinese companies. Large companies can minimize their risks by collaborating first and making select purchases later to acquire assets that they have identified as critical to their success, and they should consider structuring deals to reserve the option to buy when possible. Of course, the option approach will enable them to cut collaborations short when they don’t pan out. SMEs are not likely to be able to purchase assets at the outset, and thus may have no choice but to seek partnerships. But they might build a capital base over the course of a partnership that enables them to purchase assets down the line.

Characteristics of

Potential Chinese Partners

Chinese enterprises may be state- or non-state-owned, and those that

MNCs should consider for partnership will typically have already established an international presence, whether it is broad or narrow in focus. Based on combinations of these factors, Chinese companies can be classified into four categories that reflect their internationalization profile.⁸

- *World-Stage Aspirant:* Non-state-owned enterprises with broad international diversification. They offer an array of products in a variety of countries, and they play a significant role in shaping global competition where cost is a critical competitive advantage.
- *Transnational Agent:* State-owned enterprises with broad international diversification. They’ve invested extensively abroad to foster overall business growth and support economic development at home.
- *Niche Entrepreneur:* Non-state-owned enterprises with narrow international diversification. They usually don’t receive government funding or have rich industrial experience, and they focus on a small set of products in a handful of markets where their particular strengths stand out.
- *Commissioned Specialist:* State-owned enterprises with narrow international diversification. They focus on a small set of foreign markets where they can leverage their competitive strengths and sometimes fulfill government-mandated initiatives.

The category that a company belongs to can determine which strategies are viable for a partnership. For example, state-owned companies may have access to more capital than non-state-owned companies, but non-state-owned companies may be more nimble and more acceptable to foreign governments. For instance, transnational agents and commissioned specialists receive more support from government than world-stage aspirants and niche entrepreneurs do, but they also face more red tape and political intervention. Consequently, risk-taking behavior, investment strategies, subsidiary governance, and parent–subsidiary relations may vary significantly between state-owned and non-state-owned groups. Moreover, state-owned enterprises may have less discretionary power in international circumstances, and thus transnational agents and commissioned specialists may not be at liberty to pursue certain opportunities. World-stage aspirants and transnational agents may have greater freedom to pursue returns, but they may also bear more risk.

Getting Started

Finnish companies that are beginning to consider partnerships with Chinese companies should ask themselves some basic questions to get an early sense of the factors that will be critical for success. We highlight important questions in three areas below: partner objectives, market and industry maturity, and partner size and the role of the state. The Market

Finnish companies of all sizes should consider “real options” approaches to collaborating with Chinese companies.

Opportunity Matrix provides a framework for considering these and other questions in detail.

Partner Objectives

Are potential partners primarily seeking to gain market access or to acquire technology?

The objectives for entering into a partnership can determine which markets the partnership targets. Geographic proximity may be important when market access is the primary objective, because companies may be more familiar with and knowledgeable about markets that are near home. Chinese companies are more likely to facilitate entry into emerging markets, while Finnish companies are more likely to facilitate access to developed markets. But Chinese companies may often have links to Japan and South Korea, and Finnish companies may have ties in emerging markets in Eastern Europe. When technology acquisition is the primary objective, geographic proximity is less important.

Market and Industry Maturity

What capabilities can potential partners contribute, and what markets and industries should companies target as a result?

Finnish companies should take the time to identify their own strengths and weaknesses first, and then look for Chinese companies that possess the resources and capabilities that they lack. The universe of potential Chinese partners will help them determine which markets and industries to target.

Success in developed markets is more likely when at least one partner has a strong brand, a stable business model, and a reputation for good corporate governance. Success in developing markets typically depends on the ability to make quick deci-

sions, maintain flexibility in setting up and running the business, and tightly manage costs.

In sunrise industries, partnerships involving innovative companies that own value-adding technology platforms and have the ability to shape emerging-industry policies are best positioned to succeed. In mature markets, partnerships need strong branding capabilities, established sales and distribution networks, and the ability to manage across product and consumer life cycles.

Partner Size and the Role of the State

What company size is appropriate and what role should governments play?

To avoid power imbalances, Finnish companies should usually seek Chinese partners that are of similar size. This will help ensure that no party has disproportionate bargaining power. Chinese SMEs often make good partners for this reason—they are commensurate in size to most Finnish companies—and also because they face intense competition from large domestic companies and MNCs and may be particularly motivated to enter partnerships.

Governments can facilitate partnerships through policy, including providing tax incentives and shaping regulations to encourage cooperation with foreign companies. The Chinese government may be motivated to contribute capital and other incentives to finance the international expansion of Chinese businesses. The Finnish government may be able to help partnerships gain a footing in developed markets, particularly in Europe where it has strong relationships with other governments.

CONCLUSION

Both China and Finland face challenges that will be difficult to solve without expanding their international reach. China must make the transition from a low-cost to a high-value economy, and it is not likely to succeed in doing so within the required timeframe unless its companies pursue opportunities to improve their capabilities and acquire technology through international partnerships. Finnish companies often lack the resources to commercialize innovation, in part because domestic demand is insufficient to justify investments, and most Finnish companies don't have enough capabilities to succeed in emerging markets where the potential for growth is most promising.

Opportunities for Sino-Finnish partnerships abound precisely because Chinese and Finnish companies so often possess complementary capabilities. They can achieve their own objectives by addressing one another's challenges—and in the process, they can develop the competitive advantages to secure a strong economic future for their countries.

Endnotes

¹ See David Beim's 2011 working paper "The Future of Chinese Growth" for more details about these periods in China's economic development.

² John Jullens discusses five factors that could mitigate the effects of rising costs in China in his 2013 *strategy+business* article "Is China the World's Next Rust Belt?" Also see the 2012 *strategy+business* article "The New Chinese Economy" by Sarah Butler, Edward Tse, and John Jullens for a perspective on how China might evolve and what MNCs can do to position themselves for success in the country.

³ S.L. Sun, M.W. Peng, B. Ren, and D. Yan. "A Comparative Ownership Advantage Framework for Cross-Border M&As: The Rise of Chinese and Indian MNCs," *Journal of World Business*, 2012,47: 4-16.

⁴ See *Winning in Emerging Markets* by Tarun Khanna and Krishna Palepu, published in 2010 by Harvard Business School Press, for details about the ways that "institutional voids" create obstacles for companies trying to operate in emerging markets.

⁵ For more details on mid-market innovators, see "China's Mid-Market: Where "Good Enough" Just Isn't" by John Jullens and "China's Mid-Market Innovators" by Edward Tse, John Jullens, and Bill Russo, both published in *strategy+business*.

⁶ CIGS, which stands for copper indium gallium selenide, is a direct bandgap semiconductor that is used in the manufacture of solar cells. Note that Hanergy bought Solibro from the German company Q-Cells, which owned it since 2006.

⁷ Instrumental to our analysis on Finnish industry clusters was the 1996 report *Advantage Finland: The Future of Finnish Industries* by Hannu Hernesniemi, Markku Lammi, and Pekka Ylä-Anttila.

⁸ Our analysis in this section draws on the article "International Expansion of Emerging Market Enterprises: A Springboard Perspective" by Yadong Luo and Rosalie L. Tung, which was published in the *Journal of International Business Studies* in 2007.

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About the Authors

John Jullens is a partner at Booz & Company with more than 20 years of management consulting and industry experience in North America, Europe, and Asia. He currently co-leads the firm's engineered products and services practice in Greater China. He has advised numerous multinational and local Chinese companies on a wide range of strategic challenges, including market entry into China as well as international expansion out of China and how to achieve top-line growth through organic or inorganic means. He currently resides in Shanghai with his wife and daughter. He blogs at www.johnjullens.com.

Hannu Suonio is a partner at Booz & Company with more than 17 years of management consulting and investment banking experience in Finland, the United Kingdom, and the United States. He currently co-leads the firm's Helsinki office and further development of the capabilities-driven-strategy concept. He has advised numerous leading Finnish companies on a wide range of strategic challenges, including international acquisitions and expansion in emerging markets. He resides in Helsinki with his wife and three children.

Tony Tang is a senior associate at Booz & Company with more than 10 years of management consulting experience in the United States and China. He focuses on topics such as Sino-foreign cross-border cooperation and investments, joint ventures and M&A, postmerger integration, and organizational alignment and has particular functional expertise in consumer goods and healthcare. He has copublished articles such as "Sustainable Development Model for Fast-Growing Chinese Cities" and "Organizational Alignment for Fast-Growing Chinese Businesses." He resides in Shanghai.

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