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Commentary

Girding For China's Next Great Leap

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This viewpoint is drawn from Ms. Gadiesh's remarks at the World Economic Forum's session on China Goes Global.

In case the world needs another reminder of the determination of Chinese companies to become global competitors, economic data released on Wednesday, Jan. 25, confirms that China has become the world's fourth-largest economy. Already home to 16 of the world's 500 largest companies, China has set its sights on creating as many as 50 by the year 2010, including such rising stars as **Shanghai Automotive Industry** and appliance-maker **Haier**.

China still has a lot of ground to cover in its current Great Leap Forward. But for large multinational firms, the implications are clear: They must find a way to prevent Chinese firms from landing in their core markets with both feet.

Multinationals must learn from the Chinese where they excel, in areas like low-cost manufacturing and speed to market, and run as hard as they can to build on their strengths, in areas like customer insight, product development and organization, where multinationals still have advantages. The point is to outperform yourself *before* Chinese companies catch up and to lengthen the lead where you have it now. How far and how fast will Chinese companies leap? Looking back at how Japanese and Korean companies became global leaders, a trajectory emerges with three phases: Japanese and Korean companies *built* local manufacturing, often in order to provide low-cost sourcing to multinationals. They *borrowed* capabilities through technology licensing and joint ventures to improve quality and processes and begin exporting. Finally, they *bought* assets and brands abroad to secure their global positions.

Chinese companies are traveling the same route--but could arrive in ten to 15 years, compared with the average 25 years it took Japanese and Korean firms to become global leaders. How? Chinese manufacturers are folding "borrow" into "build" and even "buy."

First, Chinese companies are borrowing capabilities and technologies as they supply giants such as **Wal-Mart Stores** (nyse: WMT - news - people). To speed the process, China's policymakers now encourage foreign direct investment that includes a China-based research and development component. It's now the world's third-largest exporter after Germany and America, fueled by multinationals' manufacturing in China.

Second, Chinese firms are buying management know-how as well as global brands, such as Lenovo's successful bid for **IBM**'s (nyse: IBM - news - people) personal computer business. The Chinese government also plays a role in creating local companies with the reach to compete globally in a number of ways, by directing foreign investment and technology transfers to selected companies, for instance, and consolidating fragmented industries to build strong local firms.

The automotive sector shows how this fast-forward march is playing out--and what happens when multinational companies fail to compete on cost. Looking back at history, Japan's **Toyota Motor** (nyse: TM - news - people) became the most profitable automaker in the world, building its global manufacturing capabilities and leadership over 34 years. After conquering its internal market, Toyota initiated global exports in 1957. By 1974, the Toyota Corolla had become the world's best-selling model. Korea's Hyundai started in 1968 as a supplier for **Ford** (nyse: F - news - people). It took 28 years to move from its first exports in 1976 to top-selling car brand in 2004, with 5% of global market share. Neither Toyota nor Hyundai bought foreign assets until their products were well established abroad.

Turn now to China: Shanghai Automotive, which began as an original equipment manufacturer in 1985, has entered into 18 joint ventures and attempted to buy Britain's **Rover** group in 2005. Eventually, Shanghai Automotive purchased two Rover models that it could export under its own brand, which is viewed as a serious contender to become one of the world's six largest automakers by 2020. Meanwhile, China's **Nanjing Automobile** bought Rover outright.

Chinese companies aren't invincible. They struggle with "soft" issues, like understanding customers, building brands, innovating and developing human resources and organizations. But global firms must prepare soon to meet the challenge. There are four key ways. First and foremost, global companies will need to plunge in and learn how to play in the most competitive market in the world. They'll have to cater to local tastes and relearn how to compete on cost. **Colgate**, for example, became China's top oral care company, in large part by cutting local production costs through sourcing locally and passing those savings on to consumers. Such lessons will reset global cost competition.

Second is innovation: developing faster product cycles in major markets around the globe. To get there, multinationals need to be more willing to take calculated risks, and to set higher quotas for new and innovative products. That requires companies to look outside their own walls for innovation, and outside their industry, as well. Constant innovation, creating faster product cycles, makes it harder for Chinese companies to fashion knock-offs.

Global firms must also treat human resources as a strategic function, to ensure top notch talent, labor and leadership at every level, in every country. The most successful global companies have figured out how to motivate the front line through distributed leadership, rather than command-and-control.

Most critical is understanding customers and delivering what they want. Chinese companies are closing the gap, in part by acquiring big non-Chinese firms. The challenge for multinationals is to get even closer to customers and their cultures--knowing more about them than they may even know themselves--in order to design the right experiences for the right customers in the right way. This kind of customer insight is ingrained in the most successful global firms and takes time to develop.

China's next economic leap is aimed squarely at foreign shores. The question is, will Chinese firms stumble when they arrive? The answer to that depends on what global leaders do now.

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