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LESSONS FROM AN UNLIKELY CANDIDATE: NOKIA IN CHINA (2001 TO 2008)

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To many observers, the growth of the mobile phone market in China is staggering. According to the research firm Canalys, during the first quarter of 2012 sales of smartphones in China saw a year-over-year growth rate of 102%, in contrast with a mere 5% growth in the US market. Yet the market opportunity in China does not represent immediate bounty for Western multinationals. The indisputable smartphone king – Apple – found its market share in China hovering slightly below 5% and then it was surpassed by a Chinese startup – Xiaomi – in 2013. Other Chinese giants such as ZTE and Huawei have been busy expanding abroad, encroaching on home-base territories that were once dominated exclusively by Samsung, LG and other bellwether companies.

Such upheaval, however, is a recent phenomenon. Throughout the 1990s and early 2000s, smartphones remained a high-end novelty, reserved for a small group of jet-setting executives with a constant need to e-mail their colleagues. The majority of the mobile phone market at the time was served by "feature phones," which were capable of only voice calling and text messaging. The long-standing winner in China at that time was Nokia.

To be sure, Nokia's setback in the smartphone market was regrettable. Its inability to migrate from feature phone to smartphone eventually undermined the entire enterprise, causing the rapid erosion of its market position and leading up to the final acquisition by Microsoft. Even so, one cannot deny the company's remarkable performance in the basic feature-phone market in China from 2001 to 2008.

Nokia entered China at a time when mobile telecommunications were highly regulated. It expanded into cities far beyond the coastal areas and achieved the leading position in the country until the smartphone came along. Perhaps most intriguing was Nokia's ability to turn its Chinese operation into a global platform for other emerging markets, consistently churning out winning products for countries and regions such as India and Africa. Instead of dismissing Nokia's history out of hand, our research has uncovered a number of important lessons still relevant for managers seeking growth in emerging markets today.

The Growth Dilemma

Ask any senior executive which emerging market their company must win in the next five years and China will probably be a top priority. These same executives will likely express deep frustration that their firms have not made sufficient inroads into regions and cities other than Shanghai, Beijing and Guangdong. This is worrisome because across industries, less-profitable, less-advanced market segments that were previously ignored by Western multinationals have become the training grounds for local rivals. The consequences can be devastating.

Consider the classic textbook case of Chinese PC maker Lenovo. Unable to compete head on with HP and Dell, it initially focused on the rural retail sector in China. It invested aggressively in infrastructure – including local offices, sales teams and supervisors – to directly manage a sprawling retail network that covered even the most remote cities and villages. HP and Dell, by contrast, concentrated on coastal cities where reputable, third-party distributors operated. As local demand soared, Lenovo achieved greater economies of scale and lower production costs, allowing it to generate healthy profits for reinvestment. When the company finally entered the Shanghai and Beijing markets, its cost structure gave it a hard-to-match competitive advantage. In 2005 Lenovo acquired IBM's personal computing division, thereby paving its way to more developed markets outside China. Eventually it surpassed Dell as the world's second largest PC manufacturer.

Once you recognize the pattern, you see examples everywhere: Haier first specialized in subcompact refrigerators for small homes before overtaking

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David Ho

Whirlpool as the world's largest home appliance manufacturer; Sany began focusing on low-end concrete machinery before acquiring German company Putzmeister to expand overseas; Wahaha initially developed its soda business focusing entirely on rural village consumers before confronting Coke and Pepsi in Shanghai.

The implication is clear. Western multinationals cannot wait for emerging segments to become attractive and then hope to sell their existing products there. They must grow alongside the seemingly unattractive but rising market to preempt emerging competitors in the future.

While this logic is simple, executing the strategy is far from straightforward. The Chinese government still exerts a critical influence across some sectors of the economy. To make meaningful progress in an emerging sector, it is essential to manage all local stakeholders, not just regular suppliers and customers. And to sustain the momentum, the strategic initiative must be profitable. No company can fund an unprofitable venture indefinitely, so it must find ways to reintegrate its activities to wring out profits even in a seemingly low-margin market. Finally, the local requirements of the new target group usually differ from the company's existing customers. To grow alongside the new sector, the company must delay standardization and instead embrace practices that it would normally shun in other mature markets. A deep trust between managers on the ground and corporate headquarters is therefore paramount.

Lessons from Nokia

Nokia sold its first product in China through its Hong Kong-based distributor in the 1970s. By early 2000, the firm cemented its leading position as China's top provider in telecom network infrastructure and mobile phones. Nokia split half a whopping 64% market share with Motorola while local handset producers only accounted for a meager 2%. But from 2001 to 2003, when the industry started to boom, Nokia's market share kept sliding despite growing sales. During this period, hundreds of domestic handset producers were making "Shanzhai" phones – cell phones manufactured by unauthorized small-scale factories. Some of these Shanzhai phone makers were quite innovative, introducing features like dual SIM cards, loud speakers, built-in radios or even flashlights for rural dwellers. By the summer of 2003, domestic mobile phone manufacturers were making a killing, having grabbed 43% of the market while Nokia's and Motorola's shares were reduced to 32%. The prospects for network business were equally gloomy. A strict regulatory regime coupled with new competition from local rivals such as Huawei and ZTE made the industry extremely challenging. But in a dramatic move, Nokia redirected its Chinese operation and later became the market leader in the country, leaving behind Motorola, which never recovered its former status.

Enlisting a cross-cultural leader

In 2004 Nokia appointed David Ho as the president for Greater China, responsible for its local businesses and strategies. Ho was raised in China (Hong Kong) but spent his early career working for several US multinationals where he developed an appreciation of the subtle cultural differences. After joining Nokia China in 2001 as senior vice president, he spent much of his time building strong ties between corporate headquarters and local subsidiaries, dedicating nearly three months to meeting people in the China office and the headquarters. "In a complex organization like Nokia, who you know is far more important than what is written on paper. You've got to understand the motivation of your counterparts, their fears and their hopes." Ho explained.

Headquarters also set the tone. At Nokia, only three countries had a country president – China, India and the US. CEO Jorma Ollila traveled to China at least three times a year. When in China, he would spend a day at the local office in Beijing and then meet separately with dozens of people in the company's local business operations, listening to them talk about what they were working on, what their pain points were, who their competitors were and so on. During one such visit, he realized that there were several competitors that Nokia had to address quickly. Ollila would also talk with local Chinese officials to understand the government's plans to develop China's economy and how it was making telecommunications more accessible for its citizens. It takes conversations like that to fully appreciate the threats and opportunities in the country.

Cleaning up the house

At the time, Nokia China was involved in four joint ventures: two for the handset business and two in networks. They were all set up at different times and responsible for particular geographic markets with diverse local partners. They all had their own manufacturing facilities and sales functions. But there was little cross-coordination: There was duplication in the management system and the joint ventures were competing for sales with Nokia's own sales force. Ho recalled, "Some customers had three different sales teams knocking on their doors – two from our joint ventures and one from ourselves. This could not work. We were fighting for margins against each other and it was simply too confusing for our customers."

Nokia began a rigorous campaign to merge the four joint ventures into one. Negotiating with the Chinese partners, Ho's team learned that short-term financial pay-off was not necessarily the primary concern. Local government officials were usually evaluated based on their ability to generate employment and economic growth in the area that they controlled. They worried most about the ability of these individual ventures to sustain growth over the long run. Nokia thus helped them to see that it was in their own interest to follow the company's lead. Nokia argued that consolidating these joint ventures would allow Nokia China to offer both network services and mobile products under one entity, thereby reducing the business risk previously faced by the individual ventures. Further, by surveying existing customers, the Nokia China team compiled a detailed analysis that demonstrated the root cause of many unsuccessful projects. By convincing the local partners that it was to everyone's benefit to consolidate the sales function, Nokia was able to separate sales from the local joint ventures. However, the company was careful to set up a fair internal price transfer so that any business improvement would also be reflected in the financial results of the local partners, which were now only responsible for manufacturing. Nokia China eventually consolidated the four local ventures into one and later became the majority shareholder with over 70% ownership. Ho explained, "You really can't do this overnight, but by offering something tangible to your counterpart from day one and building a reputation of fair play, we were able to cut out a lot of inefficiency and move to where we wanted to be."

Shifting the center of gravity

Margins in the industry were coming down year after year. At the time, Nokia was only taking advantage of the cheap labor in China to assemble the final products, yet it would have seemed logical to source components locally instead of relying on foreign imports. The problem was that the products were engineered in Europe so the components required were supplied by other European manufacturers. But importing these foreign components for final assembly prevented Nokia from achieving the level of cost and efficiency it required to stay competitive in China where local rivals were doing everything locally. "We knew the local brands could only compete on price, we wanted to beat them at their own game," Ho said.

A key turning point came when Nokia moved the design – and the related R&D center – of its entry-level handset from Copenhagen to Beijing. With 40% to 45% of Nokia's annual sales generated by the entry-level segment, this radical shift brought Nokia important long-term advantages. Understandably, the relocation plan met with fierce resistance in Europe. Managers voiced concerns regarding quality and intellectual property rights. Several executives even threatened to resign if the plan moved forward. But the discussion continued. Whenever CEO Ollila or other senior executives traveled to China, the China team took them to the local marketplace and showed them handsets made by local manufacturers, explaining how the "unique" Chinese features were attractive to local consumers. Ho recalled, "Seeing is believing. We took our CEO and the global leaders away from the comfort of Beijing and traveled to rural areas and small towns to meet local retailers." Timing was also critical. By 2004 local companies had gained up to 45% of the Chinese handset market share. More critically, many of the leading domestic players were not from coastal cities, like the high-tech companies; they were local electronics companies based in the rural markets and they were rapidly gaining ground and building strong positions in the local area. Nokia had to act fast.

Unflinching pragmatism

By the end of 2004, Nokia China had built a complete value chain for the local operation: product development, sourcing, manufacturing, marketing, sales and services. This enabled the team to keep a close eye on local competitors and quickly react to the market environment based on its continually improved understanding of customer needs.

Through first-hand, in-field market research in rural cities, the Nokia team discovered that its Chinese competitors hired a lot of merchandise support staff on the ground but typically gave them little support. When it emulated the local strategy, Nokia provided its 7,000+ merchandise staff with an IT system, and each staff member monitored four or five shops to capture the daily sales volume across different brands and models.

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Armed with the daily data, Nokia was able to act faster than its local competitors in a rapidly changing environment.

The daily statistics exposed another anomaly. During the peak months around the Chinese New Year festival and the October national holiday, when the Chinese customarily go on shopping sprees, sales volumes for Nokia mobile phones dropped. To understand the root cause, sales and regional managers were asked to cancel their holiday and were dispatched to retail stores to observe what was happening. They quickly discovered that during these times, the retail stores became so crowded that customers could not reach the Nokia counters, many of which were located at the back of the store – a prestigious spot often reserved for foreign brands. The team resolved the issue by more than doubling the number of merchandise staff during those peak seasons taking the battlefield from the counter to the shop floor and onto the street. Sales volumes not only bounced back but also even exceeded the previously projected levels.

From 2003 to 2008, Nokia China's market share grew from 16% to 42%, not only surpassing other Western competitors but also preventing local firms from encroaching on its top position in the feature-phone market.

Key considerations

The key challenges that Nokia faced are remarkably similar to those that many multinationals are confronted with today. Many multinationals have realized that they can no longer wait for the emerging market segments to become mature enough for their existing product lines, and then hope to extend their business models to serve these markets. Instead, they must find ways to grow alongside seemingly less attractive segments in order to preempt emerging competitors later. Doing so requires discipline to experiment with different operating models that could profitably capture these critical business opportunities. We found that the following questions help focus the discussion among top managers when contemplating their emerging market strategies:

1. How do you create awareness that a firm's existing business model will not work in emerging markets? And how do you create an environment that will allow an appropriate strategy to emerge? In Nokia's case, top management accorded the local management team a high level of autonomy without imposing unnecessary policies from headquarters. This allowed the local team to experiment based on what it knew was required rather than simply following conventional corporate guidelines and strategies.

2. Given the pervasiveness of government intervention in many emerging markets, how can multinationals engage central and local government stakeholders as well as regulatory stakeholders? And how can it help them see the firm as a valuable partner rather than one that is driven by profit alone? When Nokia merged its local ventures, local government benefited directly from greater business stability.

3. How can multinationals reconfigure activities along the entire value chain in a way that maximizes the firm's competitive advantage in each local market? Nokia was aggressive in relocating R&D capabilities to China to take advantage of the booming expansion of its manufacturing base and its component suppliers. As the country began to transition from "made in China" to "designed in China," Nokia positioned itself to contribute to the realization of this lofty goal set by the government.

4. Finally, as important as the Chinese market may be, the real rewards will come from leveraging the Chinese platform for growth in other global emerging markets beyond China. How can the top management of multinationals with a portfolio of businesses ensure that the total value generated by the different parts of the company is greater than the sum of its parts. The "in China for China" strategy is no longer sufficient. The real game is being in China for China and for the world.

Final thoughts on Nokia

The Nokia case delivers one last important message. Multinationals have to keep an eye on two aspects. Becoming successful in emerging markets is a must, not just to increase revenues but also to preempt future competitors. In addition, multinationals must continue to commercialize other cutting-edge technological innovations. A number of companies stand out as solid and inspirational role models: IBM, GE, Unilever and Nestlé seem to have mastered the ability to advance the technological frontier in generating demand in developed markets while simultaneously innovating relentlessly in emerging markets by reintegrating different business models to achieve scale and scope in their global operations. The function of senior executives is to oversee the realization of such differentiated strategies across a wide geographical area.

Note: All the quotes in this article are from interviews conducted by the authors