Transform and Thrive: How to Win in China’s Era of Uncertainties

Lars Fæste and Fang Ruan

July 2019
## Contents

- **Executive Summary**  
  1

- **Industries that Will Feel the Impact**  
  2

- **Big Opportunities in Disruption**  
  2

- **The Time to Act Is Now**  
  3

- **What Makes a Transformation Successful?**  
  4

- **The Transformation Process**  
  10
Executive Summary

“If it ain’t broke, you should fix it anyway.” The old adage has been turned upside down in the business world.

In China, it is time for business leaders to start fixing their companies to ensure resilience in a rapidly changing landscape—transforming preemptively. Even if everything is going well so far, winners will anticipate the effects of new competitors, technology disruption and new business models, tariffs and even economic slowdown ahead of time. Many Chinese businesses have expanded and become much larger in the past few years but will not be resilient enough to survive the changes in the next era. Winners focus on how their business can grow stronger rather than bigger.

Most leaders in China today face a situation in which parts of their business stand to lag behind amidst change while other parts hold massive potential. They need a dual approach, managing for operational excellence with the required details and discipline to improve day-to-day, while at the same time identifying the most attractive growth opportunities and aggressively executing on those.

In important but vulnerable Chinese sectors such as technology, electronics, and automotive manufacturing, we are seeing companies start to recognize the urgency of acting.

In this working paper we show how Alibaba Group, Carlsberg Group and HSBC have mastered transformation and come out stronger in turbulent times. The findings presented here are the result of our latest research and experience working with more than 750 corporate transformations across different industries over the past decade.
Business has been riding a wave of largely uninterrupted growth in China for more than three decades, but for most companies the breakneck pace that has allowed them to thrive is now slowing down. What has led to success in past years will no longer be enough to continue to win.

A host of well-known macro-economic challenges are reshaping China’s economy, especially tariff changes, higher costs and the credit squeeze. Most companies are feeling the heat.

Even the fastest growing companies in nearly every sector are facing a slowdown in which revenue growth is expected to decline. As a result, they will need to trim expenses and manage for excellence and maximum cash flow—while at the same time aggressively pursuing new growth avenues.

**Industries that Will Feel the Impact**

China’s efforts to curb excessive debt are likely to weigh on growth, although we do not expect to see a crisis in relation to deleveraging. Household debt as a percentage of GDP has nearly tripled in 10 years, mostly from mortgages, and has had a dampening effect on the real estate market and consumer products. Notably, automobile sales plunged in 2018 for the first time since the 1990s and continued to decline in 2019.

Industries that rely on the export market might see a negative impact if forecasts for a global slowdown materialize. The electronics sector stands to take a particularly large hit from U.S. trade tariffs, particularly over the long term if tariffs make higher retail prices necessary, as consumer electronics such as computers and smartphones are a major contributor to China’s GDP and the U.S. trade deficit. Footwear and apparel makers that assemble their products in China are also at risk of seeing sales drop if they have to raise their prices or if the global economy declines, as are makers of textiles, paper products, chemicals, metal products, rubber and plastic, furniture and toys, and equipment. (See Exhibit 1.)

**Big Opportunities in Disruption**

The uncertainties in China today present an important incentive for companies to transform preemptively, anticipating future scenarios and maximizing their operational excellence now. From there, they must continue striving to optimize the business to fund
the journey and produce cash flow that allows them to invest aggressively in new growth areas that are coming to the surface.

In “Transformations that Work—and Why,” the BCG Henderson Institute defines transformation as “a fundamental reboot that enables a business to achieve a dramatic, sustainable improvement in performance and alter the trajectory of its future.”

**The Time to Act Is Now**

It pays to be paranoid, always questioning whether what you’re doing is good enough, even when your company is winning. Certainly, in China there is no guarantee that today’s largest companies will be in first place tomorrow. (See Exhibit 2.)

When the economy begins to slow down, companies that think ahead and embark on a transformation strategy will have an advantage over slower-to-act competitors. Those competitors might even become inexpensive acquisition targets.

Our research found that companies that transform preemptively showed a growth in value created, reflected in total shareholder return (TSR) that, on average, was 6% higher over a three-year period than the TSR of companies that had transformed reactively. Further-
more, preemptive transformations were accomplished in 15% less time, at 20% lower costs, and with 20% fewer changes needed in the leadership.

In our report “Unpacking the U.S.-China Tech Trade War” we recommend that companies analyze how increased technology restrictions and tariffs from the U.S. might affect their value chains in terms of revenue, costs and asset allocation, then create a playbook of actions to take under various potential scenarios. A company can protect its supply chain by prequalifying new suppliers, for example, or change the economics through automation or a shift to more flexible, regional approaches to manufacturing supply chains.

A durable-goods company with a preemptive strategy began reviewing the implications as soon as the US began indicating it would raise tariffs on products imported from China. By doing so, the company was able to set up more than two dozen cross-functional mitigation projects, so that they had a 9- to 12-month advantage over competitors that had been simply waiting for the U.S. and China to make a deal that would bring back the previous status quo.

What Makes a Transformation Successful?

None of what we’ve said should minimize the formidable challenges and risks that come with transformation. It’s an expensive undertaking, and can distract everyone from the
day-to-day business. We have found, however, that the transformations that increase a company’s value tend to have at least five elements in common—the five primary drivers of success:

- Efficiency drive to fund the journey
- Revenue growth
- Long term orientation and R&D investment
- Leadership
- Formal transformation programs

Efficiency drive to fund the journey. Typically, corporate leaders start looking at how they can retrench when the economy slows down. Our research has found that leaner spending is necessary to fund the transformation and make it viable in the short term—certainly during the first year. China is becoming a high cost environment, and if a company doesn’t have a cash generating operation, it will not have the strength to keep transforming. But simply cutting costs is not enough to boost value. Create an organization-wide plan to fund the journey. (See Exhibit 3.)

Cut costs and right-size non-core areas so that you can create a more efficient organization. Achieve excellence in operations by creating transparency and applying best practices in areas such as procurement, production processes, and logistics to boost margins and cash generation. Allocate capital out of the non-core functions and into such areas as R&D, innovation, talent acquisition, M&A opportunities, and precision marketing—the engines that will contribute to future revenue growth.

PSA, the parent company of Peugeot, Citroën, Opel, Vauxhall Motors, and DS Automobiles, which is partly owned by Dongfeng Motor Corporation, went through two massive cost-driven turnarounds in just 5 years. First PSA was able to turn around from near-bankruptcy after a capital injection from Dongfeng. Then, only three years later, PSA had gained the financial muscle to buy Opel from General Motors. Though GM had lost over $20 billion on Opel over 20 years, PSA was able to turn a profit of nearly US$1 billion in the first year.

Revenue growth. In an era when companies must adapt to a new environment, it’s particularly critical to view preemptive transformation as a strategy for continued growth—not just a temporary turnaround strategy. You cannot cost-cut your way to greatness.
## EXHIBIT 3 | Funding the Journey

<table>
<thead>
<tr>
<th>PRIMARY LEVERS</th>
<th>CATEGORIES</th>
<th>COMMON TOOLS</th>
<th>TYPICAL IMPACT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COST REDUCTION</strong></td>
<td>Procurement</td>
<td>Create transparency, better manage categories and suppliers, and improve procurement</td>
<td>Cuts procurement costs by 5% to 20%</td>
</tr>
<tr>
<td></td>
<td>Supply chain</td>
<td>Improve logistics, optimize the network, and streamline the product portfolio</td>
<td>Reduces operating expenses by 10% to 30%</td>
</tr>
<tr>
<td></td>
<td>Personnel cost</td>
<td>Increase efficiencies where possible. Outsource or offshore when cost advantageous</td>
<td>Potential cost reduction of 20% to 40%; part of savings should be reinvested in new capabilities</td>
</tr>
<tr>
<td></td>
<td>Non personnel cost</td>
<td>Cut spending on travel, utilities, facilities, IT, and services</td>
<td>Lowers overhead costs by 20%</td>
</tr>
<tr>
<td><strong>REVENUE</strong></td>
<td>Pricing</td>
<td>Revamp pricing model, reduce discounts, and develop new pricing capabilities</td>
<td>Raises revenue by 2% to 8%</td>
</tr>
<tr>
<td></td>
<td>Sales force effectiveness</td>
<td>Improve customer targeting and enable the sales learn</td>
<td>Increases revenue and profit by 10% to 15%</td>
</tr>
<tr>
<td></td>
<td>Marketing</td>
<td>Optimize spending and implement data analytics</td>
<td>Reduces marketing costs by 10% to 20%; boosts sales volume by 3% to 8%</td>
</tr>
<tr>
<td><strong>ORGANIZATIONAL SIMPLICITY</strong></td>
<td>Streamlining management structure</td>
<td>Trim the number of layers and increase the spans of control</td>
<td>Shrinks indirect labor costs by 15% to 30%; improves accountability, decision making, and operational agility</td>
</tr>
<tr>
<td><strong>CAPITAL EFFICIENCY</strong></td>
<td>Net-working-capital improvement</td>
<td>Reduce inventory and handle payables and receivables more efficiently</td>
<td>Increases working capital by 20% to 40%</td>
</tr>
<tr>
<td></td>
<td>Fixed-asset productivity</td>
<td>Sell assets, outsource functions, and increase overall equipment effectiveness</td>
<td>Lowers capital expenses by 20% to 30%; increases EBITDA by 2% to 8%</td>
</tr>
<tr>
<td></td>
<td>Project portfolio optimization</td>
<td>Analyze net present value, prioritize projects, and eliminate failed projects</td>
<td>Improves relative TSR by 20% to 40%</td>
</tr>
</tbody>
</table>

Source: BCG analysis.

Note: EBITDA = Earnings before interest, taxes, depreciation, and amortization; TSR = Total shareholder return.
Case Study: Carlsberg Saves $300 Million and Reinvests for Growth

Carlsberg, a 170-year-old global consumer goods company, had been stagnating for several years, owing to heavy debt and challenging market conditions. The company’s sales volumes were declining in several markets, and EBIT margins trailed behind those of its competitors.

In 2015, Cees ‘t Hart joined the company as CEO with a forceful idea of a strategic transformation aimed at restoring growth, focusing on premium products, and reorienting the company toward more attractive market segments. The company’s considerable debt burden complicated the challenge, but Hart addressed that by launching a comprehensive two-year program. The goal was to save approximately $300 million and reinvest half of that in strategic measures that would boost growth, employee engagement, and new capabilities.

In addition, Hart set out to reconnect with Carlsberg’s original purpose so that the organization could draw strength from its foundation and heritage.

This comprehensive approach allowed the company to reduce debt significantly, raise EBIT margins, and position itself to invest in the future. The share price shot up during the first two years, reaching an all-time high and—in terms of shareholder returns—beating Carlsberg’s main peers.

In the past, rapid growth in China has laid the groundwork for expansion, but now many industries would do well to re-calibrate their business units with a focus on strength—i.e. growth engines—rather than size as they seek future revenue growth. Focusing on strength might mean cutting back or eliminating weaker product lines, re-purposing human resources, or emphasizing value-added products or services.

M&A activity is an important component of any visionary growth strategy. We anticipate that there will be interesting opportunities ahead to acquire other businesses at lower prices. This is a particularly powerful strategy for companies with strong operational performance and the ability to lift the performance in acquired units.

**Long term orientation and R&D investment.** We have found that the companies most likely to realize outsized gains in value creation following a transformation are those that make significant commitments to R&D. Investing in digital initiatives and new business
models is also key to effective long term success. These allocations tend to create more value than investment in capex.

Use digitization to enable further cost efficiencies and personalize client or customer services. Continue to gather data that can be analyzed and leveraged to constantly improve operations, products and services. A large real estate developer in China, for example, expanded its internal digitized systems to create an ecosystem of related business. The company developed an online real estate sales and service platform, so that customers can buy properties then continue to access information about property management and maintenance services.

Case Study: How Alibaba Created New Growth Engines

When Jack Ma started Alibaba with 17 friends in 1999, he announced that their competitors were not going to be in China, but in Silicon Valley. In less than two years Alibaba had become a global company. The timing was inopportune, however. The company was burning through its cash, and in 2001, with dot.com companies everywhere collapsing and investors cutting their losses, Ma had to lay off the high-salaried international staff. It was a difficult time, but after making dramatic cuts in operating expenses and bringing the organization back to Ma’s hometown of Hangzhou, Alibaba’s founders took stock of their overly-ambitious expansion and began looking at how they could re-invent the fledging company.

At the heart of Alibaba’s transformation was a new emphasis on core values. All employees were trained to embody a set of values that included placing the client’s needs first, teamwork, embracing change, integrity, passion, and dedication. In performance reviews, cultural fit counted equally with job performance, and even those who brought in great sales figures could be dismissed if they weren’t compatible with the culture and collaborative with the team.

Ma’s global ambitions were put on hold temporarily as the company concentrated on a business-to-business (B2B) clientele, focusing on the small and mid-sized enterprise suppliers that were expanding rapidly on the heels of China’s accession to the World Trade Organization. Alibaba trained a local sales team called the “Iron Army,” salespeople who were expected to be self-driven and dedicated to their clients’ needs, not just helping clients find buyers but also solving their problems. Incentives, which included a low base against a high commission, frequent rotation to learn new skills, and promotions for star performers, were designed to keep salespeople working hard to meet targets but also serving their clients at any cost.

The plan worked, and as the company’s fortunes improved, they started a business-to-consumer (B2C) business with the online shopping site TaoBao. By the time the tech industry began to recover from the dot.com bust, Alibaba was an entirely transformed organization, with a culture that continues to encourage constant self-reflection and striving for improvement. That has included frequent re-organization of its more than 20 business units.
Leadership. The right leadership team, capabilities, and performance management are of course critical. We’ve seen that, on average, transformations lead to higher value creation when they are executed by new management teams, although there is a higher variance in outcomes. What this means for incumbent management teams is that they need to be open-minded—and paranoid enough to constantly question what they can do better.

Furthermore, while the transformation may be run under a consolidated agenda, pre-emptive change generally works best when it relies on a culture that encourages new

---

**Case Study: HSBC Simplifies the Organization**

In the wake of the financial crisis of 2008, HSBC faced rising costs and regulatory challenges. From the 1990s to 2006, the bank made a series of acquisitions and grew its balance sheet fivefold. It ended up with operations—many of them standalone entities with their own processes and IT systems—in 88 countries. The result was a complex operating environment and few economies of scale.

When Stuart Gulliver (who started at HSBC at age 21) took over as CEO in 2011, a position he held until 2018, he immediately launched a turnaround, starting with rapid streamlining and simplification measures to fund the journey. The company reduced its head count by more than 20% and the number of countries where it operated from 88 to 67. Despite this geographic contraction, HSBC still covers 90% of global trade and capital flows, more than just about any other bank in the world. In all, these measures saved $4.7 billion by the end of 2016 and close to $6 billion in savings, mostly from middle- and back-office functions, by the end of 2017. In terms of operations, HSBC improved its capital performance, reducing risk-weighted assets by nearly $300 billion.

HSBC also restructured the organization to eliminate excess management layers and give leaders the right level of accountability. The structure consists of four global businesses supported by a set of globally run support functions. That has led to significant efficiencies. “It is only now, running businesses as single global verticals, that you can negotiate your procurement in ways that derive full economies of scale,” Gulliver told Euromoney, a trade publication, in 2017. “We used to have countless separate contracts with IT companies, with the people managing our properties, with every supplier in fact.”

More important, the company is making a big bet on digital, investing $2.1 billion from 2015 to 2020. Digital initiatives include automating back-office functions, improving the customer journey with mobile platforms, and creating an intelligence unit to spot financial irregularities among customers. HSBC also announced a partnership with Google Cloud for analytics and machine-learning capabilities. And the bank has a dedicated innovation unit to help it stay attuned to the movements of fintech players and digital-only competitors.

The turnaround won praise from investors and analysts, and in 2017 Euromoney named HSBC the world’s best bank.
ideas, employee participation, and consensus building, rather than a heavy-handed, top-down approach. “Jazz leadership” describes the most effective style for leaders in the ’20s. A winning organization should be structured like an orchestra, but its innovation and high-level decision-making should resemble the practices of a jazz ensemble. Each player should perform according to his or her strengths, without restrictions on their role. Today, in the fast-evolving and unpredictable business environment, traditional command and control leadership is neither feasible nor effective; leaders should be agile, welcome new diverse ideas and able to improvise to reach new heights.

**Formal transformation programs.** Our research shows that the most successful transformations take place under a formal, structured program that the company defines at the beginning of the process. We recommend one full umbrella program, often with a time horizon of 2-3 years or more, that factors in the entire company, as opposed to a collection of smaller programs for each business unit.

Our research also found that larger programs, with restructuring costs of at least 2% of sales, led to an increase in value creation that was five percentage points higher, on average, than that of companies that enacted smaller-scale changes.

**The Transformation Process**

We have organized the overall process into three distinct phases: rapid assessment, 100-day impact, and realization of full value. (See Exhibit 4.)

**EXHIBIT 4 | A CEO’s 3-Step Transformation Framework to Win Tomorrow**

1. **Rapid Assessment**
   - Assess full potential
     - Analyze company’s situation
     - Articulate a compelling purpose for the transformation program
     - Define a formal transformation program
     - Launch no-regret initiatives that can generate results in 3-10 months

2. **100-day impact**
   - Begin to capture value
     - Deliver impact of quick wins and prepare to launch longer-term initiatives
     - Reduce costs while launching measures to boost revenues and improve capital efficiency
     - Establish agile teams and build agile culture
     - Implement digital quick-wins

3. **Realization of full value**
   - Ensure disciplined execution of initiatives
     - Execute initiatives to boost innovation, revenue growth, and long-term value creation
     - Build capabilities among senior and front-line leaders through coaching and training
     - Energize the organization through multi-way dialogue and change management
     - Empower and equip HR team to act as a transformation partner

Source: BCG analysis.
In the rapid assessment phase, senior leaders take stock of what can be accomplished—and how to fund the journey. At this stage they should set targets and acquire the tools needed for a successful new operating model. Short-term no-regret initiatives, designed to provide flexibility in uncertain scenarios, are appropriate at this stage and set the tone for what is to follow. At the same time, this is when leaders must let all stakeholders know about the purpose of the transformation and put a long term formal program into place.

Somewhere between two and three months into the transformation, prepare to assess the 100-day impact. At this point there should be some improvement in earnings and a positive market response, key indicators that the company has begun to capture value. This is the time to plan longer-term moves for growth, build an agile culture, implement digital initiatives that will allow for quick wins, and strengthen your performance management, and well as get down to business with cost reductions and organizational efficiency.

After one to two years, and into the future, you should be able to gauge your success in the realization of full value phase. This is when you ensure continued disciplined execution of initiatives throughout the organization, building a culture of sustainable high performance and cost excellence. By then there should be an operating model in place that has changed the cost base and can make speedy changes as new initiatives and new technologies create more efficiencies—so that you can continue to reallocate capital to the company’s growth engines.
A transformation is a complex undertaking, and the majority fall short of expectations for achieving their full target value, coming in on time or doing both. But the economic uncertainties in China today, especially when combined with the increasing pace of technological change and volatility, all point to a need for corporate leaders to be vigilant in determining what risks they might face in the next few years and acting preemptively.

Fundamental to a successful execution is the realization that you can never afford to declare the job completed. After you incorporate a formalized preemptive transformation program and the goals have been realized, it will be time to segue into more action to keep boosting efficiency and allocating capital to the company’s most promising growth engines. Preemptive transformation is based on a constant sense of urgency that requires building permanent transformation capabilities and strengthening the adaptability of the organization.
For Further Reading

**Advantage in Adversity: Winning the Next Downturn**  
An article by Boston Consulting Group  
February 2019

**The Comeback Kids: Lessons from Successful Turnarounds**  
A report by Boston Consulting Group  
November 2017

**Preemptive Transformation: Fix it Before it Breaks**  
An article by Boston Consulting Group  
August 2018

**Transformation: Delivering and Sustaining Breakthrough Performance**  
A book by Boston Consulting Group  
November 2016

**Unpacking the U.S.-China Tech Trade War**  
An article by Boston Consulting Group  
June 2019

**The Truth About Corporate Transformation**  
A media article by MIT Sloan Management Review  
March 2018

**The Transformations That Work—and Why**  
A focus by Boston Consulting Group  
November 2017
About the Authors

Lars Fæste is a managing partner with BCG Greater China, where he is the global leader of BCG Transformation and TURN. You may contact him by e-mail at faeste.lars@bcg.com.

Fang Ruan is a managing director and partner at BCG. She leads BCG’s China Academy and People & Organization practice in Greater China and Asia-Pacific. You may contact her by e-mail at ruan.fang@bcg.com.

Acknowledgements

The authors would like to thank Khushal Puri, Gao Bo, Gu Li, Peter Toth and Zhan Hui for their contributions to this working paper, and Jan Alexander for her assistance in writing the working paper.
Boston Consulting Group partners with leaders in business and society to tackle their most important challenges and capture their greatest opportunities. BCG was the pioneer in business strategy when it was founded in 1963. Today, we help clients with total transformation—inspiring complex change, enabling organizations to grow, building competitive advantage, and driving bottom-line impact.

To succeed, organizations must blend digital and human capabilities. Our diverse, global teams bring deep industry and functional expertise and a range of perspectives to spark change. BCG delivers solutions through leading-edge management consulting along with technology and design, corporate and digital ventures—and business purpose. We work in a uniquely collaborative model across the firm and throughout all levels of the client organization, generating results that allow our clients to thrive.

For more information about BCG, please email greaterchina.mkt@bcg.com.

For more insights from BCG, pls follow us on WeChat, account name: BCG波士顿咨询; ID: BCG_Greater_China; QR code:

© Boston Consulting Group, Inc. 2019. All rights reserved.
7/19