Forget the idea that the rise of Chinese competitors simply means cheap, low-quality imitations flooding world markets. Chinese companies are starting to disrupt global competition by breaking the established rules of the game. Their tool of choice is cost innovation, the strategy of using Chinese cost advantage in radically new ways to offer customers around the world dramatically more for less.
The unlikely but highly effective tactic of cost innovation

Cost innovation has three faces: First, Chinese companies are starting to offer customers high technology at low cost. Computer maker Dawning, for example, has put supercomputer technology into the low-cost servers that are the everyday workhorses of the world’s IT networks. This novel strategy is demolishing the conventional wisdom that high technology is restricted to high-end products. Rather than slowly migrating new technology from high-priced segments downwards, the Chinese are deploying high-technology products directly into the mass market.

Second, the emerging Chinese competitors are presenting customers with an unmatched choice of products in what used to be considered standardized, mass-market segments. The manufacturer Goodbaby, for example, offers a product line of over sixteen-hundred types of strollers, car seats, bassinets, and playpens – four times the range of its nearest competitor – all at mass-market prices, thus challenging the idea that if customers want variety and customization, they have to pay a premium.

Third, Chinese companies are using their low costs to offer specialty products at dramatically lower prices, turning them into volume businesses. For example, consumer appliance maker Haier has transformed the market for wine-storage refrigerators from the preserve of a few wine connoisseurs into a mainstream category sold through Sam’s Club at less than half the then-prevailing price. The end result: Haier has grown the market more than ten-fold and won a 60 percent market share.

Cost innovation is enabling China’s emerging dragons to win share across a wide spectrum of industries. Galanz now supplies more than half of...
Business strategy

all microwave ovens sold in the global market; BYD is the world's second-largest maker of rechargeable batteries; China International Marine Container (CIMC) dominates the world of shipping containers with more than 55 percent global market share; and Pearl River Piano has become the world volume leader selling 100,000 pianos each year and controlling 15 percent of the U.S. market (40 percent in upright pianos). Wanxiang, the world's largest producer of universal joints, has established an industry fund to buy North American firms in auto components and has made 18 acquisitions already.

Moving up-market probably won’t be enough

In our experience, shifting focus to high-end segments is the most common strategy managers in high-cost countries are planning to adopt in response to the new competition from China. But focusing on what one manager we interviewed called "the sunlit uplands" of the market more often than not proves ineffective, because falling volume means this strategy is difficult to sustain over the medium term. Volumes at the top end of the market tend to be small, which means it becomes more and more difficult to continue investing in the high, fixed costs of R&D and product development. Established competitors are left with insufficient units over which to spread the cost once they lose the volume business and focus solely on the upper end.

Winning in the new global game

Radical new approaches are called for. The first strategy is to learn the tricks of cost innovation and combine these with your existing strengths to beat the dragons at their own game. This starts with a change in mind-set. Gilbert Cloyd, Procter and Gamble’s chief technology officer, explains the required shift in thinking this way: “Prior to 2000 we were always going to deliver the absolute best, then ‘cost save.’ We have changed that to ‘cheaper and better.’ That’s the innovation standard. The game is now about accepting up front that the true innovation goal is being both better and lower cost. And that has caused us to rethink a lot of things.” This new mind-set of cost innovation is the first step in preparing your response to disruptive
competition from China.

For companies that already have operations in China, a second strategy to accelerate learning about cost innovation is to transfer the global mandate for running certain businesses, products, or worldwide customer segments, including strategic decision-making, to China. A few companies have already taken the step of giving their Chinese subsidiaries global responsibilities. Intel’s global Channel Platforms Group is now run from Shanghai. Philips now manages its global business of supplying TV sets – from R&D through design, manufacture, and global marketing – from China. General Electric (GE) Medical’s Chinese subsidiary is responsible for the bulk of GE’s global R&D in CT medical scanners. In each of these cases the goal is the same: to access the know-how of cost innovation from China and apply it to those global products and market segments where finding innovative ways to improve value-for-money is the top priority.

A third strategy is to follow the old adage: “If you can’t beat them, join them.” Historically, joint ventures between foreign and Chinese companies were aimed either at breaking into the Chinese market or securing an effective, high-quality supply chain. Today, combinations such as the alliance between Cummins Inc. and Beijing’s Beiqi Foton to design and manufacture efficient diesel engines are rightly aimed at the global market for specific product segments.

Meeting the challenge of cost innovation

Whether you are an established multinational, a national champion, or an entrepreneurial start-up, you need to find a way to tap into the secrets of cost innovation if you are to continue to prosper now that the Chinese dragons are knocking at the door.

Peter Williamson is Professor of International Management at Judge Business School, University of Cambridge, and Fellow of Jesus College.

Zeng Ming is Professor of Strategic Management at Cheung Kong Graduate School of Business in Beijing.

They are the co-authors of Dragons at Your Door: How Chinese Cost Innovation Is Disrupting Global Competition (Harvard Business School Press, 2007). They can be reached at p.williamson@jbs.cam.ac.uk and mzeng@ckgsb.edu.cn.