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Nirmalya KUMAR
Singapore Management University, nirmalyak@smu.edu.sg

Jan-Benedict E. M. STEENKAMP
University of North Carolina

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We are the champions

By Kumar, Nirmalya; Steenkamp, Jan-Benedict E. M.

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From China Mobile to Coal India, state-supported firms are on the march. Nirmalya Kumar and Jan-Benedict EM Steenkamp map out the route from being a national champion to becoming a global brand.

State-backed oil firms account for more than 75 per cent of the world's oil reserves; the world's largest natural gas company is Russia's national champion Gazprom. The largest cellular service provider is China Mobile, with 700 million customers. Saudi Basic Industries Corporation is one of the world's most profitable chemical companies. Dubai Ports is the world's third-largest ports operator. Coal India is the world's largest coal-miner. State companies make up 80 per cent of the value of the stock market in China, 62 per cent in Russia and 38 per cent in Brazil. Between 2003 and 2010, they accounted for one-third of the emerging world's foreign direct investment as well as a growing proportion of the world's very largest firms.

Firms as diverse as Airbus, Michelin, Hyundai, NEC, Samsung, Singapore Airlines, Volkswagen and LG started as national champions, companies supported by state governments at a time when their home countries were emerging or recovering from the economic ravages of war.

Despite their ubiquity, many national champions have historically, from a financial perspective, performed poorly. For every success, there are multiple failures, national basket cases rather than national breadwinners. They usually tend to succeed in quasi-monopolistic industries like energy and utilities, but rarely in hypercompetitive business to consumer (B2C) industries such as consumer electronics or packaged goods. Beyond financial failure, most national champions fall short on brand-building.

Various experts have called the policy of bolstering national champions "a boulevard of broken dreams" or "usually an ill-advised attempt," but we take a more nuanced view. We believe that a state can successfully incubate national champions into global brands in consumer markets, provided that the government leaders consider these three conditions: community, competition and company.

Community

The state can play a positive role in the business community, such that it helps to launch healthy national champions that develop global capabilities. Here are the necessary traits.

1. Competent, not corrupt

State capitalism works well only when directed by a competent state, and not by one mired in corruption and cronyism. By "competency," we mean a state that operates consistently and predictably, that is, with openness, accountability and honesty in decision-making and action-taking, and manned by highly educated bureaucrats who have to pass rigorous exams. East-Asian countries have a decided advantage over other emerging markets on this front because of their strong mandarin culture and long history of a reasonably well-organised, highly educated state bureaucracy inspired by Confucius. According to Confucianism, society is structured around hierarchical and reciprocal relations (e.g., between the government and the people). Ruthless rulers and

disobedient citizens are both morally unacceptable. China's state employees are selected based on rigorous examinations testing applicants' knowledge on a wide range of subjects — a tradition that dates back to the Song dynasty, and before.

In contrast, the Middle East, Latin America and Africa have neither a comparable cultural tradition nor a history of impartial courts and the rule of law to counter the arbitrariness of the state. Argentina is an example of a potentially rich country — it was the eighth most prosperous nation in 1909 — whose incompetent leadership has repeatedly destroyed its economy. It recently grabbed control of oil and gas producer YPF from Spain's Repsol. We predict that it will run this company into the ground within the next 10 years — as Venezuela did with its state oil company PDVSA.

2. Supportive, not directive

The state should support rather than direct business activities. The state should set up economic and knowledge infrastructures in which national champions can seed and flourish. By "economic infrastructure," we mean a market mechanism that protects national champions for a short time against foreign encroachment, subsidises R&D, and finances state purchases. By "knowledge infrastructure," we mean a rigorous primary and secondary education system for all citizens, both vocational and university options, and ongoing job training programmes. For national champions to compete globally on quality rather than price, the state must cultivate scientists, technologists and engineers to conduct first-rate R&D.

For example, Brazil recently took the initiative to improve its knowledge infrastructure. By the end of 2015, it will have sent more than 100,000 Brazilians, half of them undergraduates, half graduate students, abroad for a year to study such subjects as biotechnology, ocean science and petroleum engineering that the government regards as essential for the nation's future as a manufacturing power. The initiative will cost $1.65 billion, a quarter of which will come from business and the rest from the state.

3. Minority, not majority, shareholder

If the state hold shares in the national champion, it should hold few. The minority-shareholder model, pioneered in Brazil, has been called, by The Economist, "one of the sharpest new tools in the state-capitalist toolbox". It limits the state's ability to use national champions for rewarding clients or pursuing social policies. Private shareholders have just enough power to insist on greater fiscal and operational efficiency and managerial effectiveness. A McKinsey study found that companies in which the state holds a minority stake are 70 per cent more productive than wholly state-owned ones. Moreover, by taking a minority stake, the state can assist many more companies for the same resources.

4. Temporary and conditional, not permanent and unlimited, protection

Finally, state support must be short term and conditional on market performance. Without clear limits on the duration and the nature of state support, the company will never learn to compete. Market-based performance metrics force the company to focus on its customers as well as its bureaucratic owners.

We are fans of "hard" metrics such as market share, profit and return on investment (ROI), but these metrics can be misleading. Given cheap money and strong protection, even corporate sluggards can show a high market share and good ROI. For example, according to the Unirule Institute of Economics, the real interest rate for Chinese state-owned enterprises is only one-third of the market interest rate. Under those terms, it is actually difficult not to turn a profit. A more useful metric is customer satisfaction, for which validated measurement instruments exist. If the state applies such market-based measures, it will spot the national champion's failure to deliver desirable goods and services much earlier. After all, satisfying customers in the home market is a conditio sine qua non to compete for consumers in the global arena.

Competition

Just like football teams in the English Premier League improve by playing each week against strong rivals, firms sharpen their skills by competing both in their home market and abroad.

1. Home market rivalry, not quasi-monopoly

If the national champion enjoys a quasi-monopoly in the home market, it does not learn to stand on its merits. Monopolies breed complacency and stifle innovation. Given its protected position, the company lacks incentive to develop innovative capabilities or to listen to the voice of the consumer. Such companies stand little chance outside their home market.

The national champion must face competition from other firms, including cutting-edge international firms on its home turf. And this competition should be fierce, not token, relegated to a niche. The government should encourage foreign competitors to put the national champion on edge. In the short term, the absence of competition may make the industry more attractive; but in the long run, more rivalry in one's home market puts pressure on national champions to innovate, improve and move beyond basic advantages that the home country may enjoy, such as low factor costs. After cutting their teeth at home, national champions should take their brands abroad.

2. Foreign, not just domestic, markets

The trend toward globalisation is very powerful, if not unstoppable. Industry boundaries no longer stop at national borders, and competition intensifies in industry after industry. Even national champions can no longer hide behind high tariff walls that work in the short run but hobble the champion in the longer run. They must go global, and the earlier the national champion faces the rigours of global competition, the sooner it will adapt its operations and adopt a customer-based brand-building approach.

Company

Last but not least, the successful national champion should possess certain key characteristics to build strong consumer brands. Three traits stand out.

1. Market, not product/political, orientation

Too often, national champions focus on output (product-orientation) or on the government (political orientation). Ajit Singh, India's civil aviation minister, charged with the turnaround of Air India, observed, "It is very difficult for the government to run any service sector business. For government employees, they are the kings; the customer is never the king. That's ingrained." While this focus may serve a company without global ambitions, it is a handicap to the development of successful global brands and world-class service. The primary, if not sole, orientation of the B2C company should be toward the needs of the consumer. Which segment should we target? How can our brand serve this segment effectively using our marketing mix — our brand positioning, product assortment, pricing and promotion strategy, and distribution channels?

If market orientation does not guide the company's thinking, developing a brand will be difficult, because configuring the marketing mix depends on the needs and characteristics of the target segment. After all, strong brands originate in the minds of the consumer. Consumers love strong brands because they fulfill important needs: functional needs (what does it do for me or help me to do?), emotional needs (how does it make me feel?) and self-expressive needs (what does it say about me?). Numerous studies have shown that strong brands command higher consumer loyalty, reduced price sensitivity, higher advertising effectiveness and greater trade leverage. But these benefits accrue to the firm only because the brand stands for something and delivers something that the target consumer group values.

2. Business executives, not political appointments

While it is unavoidable that there are ties between the national champion and the government, this can easily result in the C-suite being filled by political appointments, bureaucrats rather than businessmen and entrepreneurs. After an in-depth study of state-owned enterprises, the Unirule Institute of Economics concluded, “Enterprise senior executives enter the government for policies and resources, while governmental officials enter enterprises to materialise their economic profits earned while in the position.” These people have little incentive to develop their companies’ brands despite having access to vast resources and political pull, since their career is tied to the state, not to the vagaries of the marketplace.

It is important to emphasise that cosy ties between business and politics, and political appointments are not restricted to emerging markets. The Financial Times criticises the omnipresence of the Elysée (that is, the Office of the President) in pulling strings and nominating the heads of French industrial champions: “The politics of patronage often dictate the appointments of top managers in state-controlled or quasi state companies with inevitable disturbing results.” And some also see the common practice of US companies hiring former politicians as senior executives or corporate lobbyists to obtain regulatory favours, from tax breaks to other subsidies, in this light.

3. Worldwide learning, not home market, knows best

To succeed in developed markets, national champions must develop an organisational capacity for worldwide learning, rather than adopting a home-centric (called “ethnocentric” in the strategy literature) view of the world. The company-wide generation of market intelligence pertaining to the current and future needs of existing and potential customers around the world, the dissemination of intelligence within the company, its responsiveness to this intelligence in its product development, marketing strategy, and organisational form, and the ability of the company to learn from its successes of failures in different markets are preconditions for the growth of brand-building capabilities.

Some analysts have argued that national champions have the potential to be “the corporate world’s greatest learning machines.” Their CEOs often maintain they have the best of both worlds: the ability to plan for and invest in the future, but also to respond quickly to changing consumer tastes, without the shackles of meeting quarterly expectations. This is nice in theory, but learning takes a long time. What can these companies do to accelerate learning on a worldwide scale?

First, they can acquire foreign companies to gain rare technological and brand-building expertise. China’s car company Geely gained access to cutting-edge car-making and brand-building skills when it took over Volvo for $1.8 billion. Organic learning of these crucial skills would have taken many years.

Second, listing the company on foreign exchanges introduces the brand to the world’s most sophisticated bankers and analysts, although ongoing market scrutiny and expectation of returns may undermine a national champion’s ability to plan for the long term.

Third, the national champion should hire foreign talent trained at the world’s top business schools. The company must become global, not only in its strategy, but also in its culture and people. Lenovo for example, has adopted English as its official language, which greatly facilitates company-wide learning, and contributes to fostering of a global corporate identity. But this human resource objective is not easy. In most successful global companies, executives from the home country prefer to prepare local managers who may accede to senior jobs at headquarters. Because national champions are still in essence tied to the state, their leaders must remain home-country nationals.

The Emirates flightpath

Consider Emirates Airlines and its development. It is now the largest airline in the Middle East, a subsidiary of The Emirates Group, wholly owned by the government of Dubai. Operating over 2,400 passenger flights per week, Emirates serves 120 cities in 70 countries across all continents. Founded in 1985, Emirates became profitable within the first year and has steadily built its network. In the period 2000-2012, its compound annual growth rate was 17.6 per cent for passengers, 23.1 per cent for sales revenues, and 12.3 per cent for profits — remarkable for a brutally competitive industry. Moreover, Dubai is located in an area better known for threats to air travel than for a positive flight experience.

In the mid-1980s, Bahrain's Gulf Air began to cut back services to Dubai. This made Dubai less accessible, dramatically reducing Dubai's attractiveness for business and threatening the growth and prosperity of the home economy. As a result, the ruling Royal Family funded the founding of Emirates.

The leadership of Emirates made the right decisions and took the right actions in the three areas critical to a national champion's success.

1. Community

Even though Emirates received two used Boeing 727 and $10 million in start-up capital (repaid in a year), the government of Dubai required it to operate independently of government subsidies. The state did help Emirates by investing $4.5 billion to build a first-rate travel infrastructure and tourist draw, Dubai International Airport's Terminal 3, for the airline's exclusive use. Furthermore, there is the suspicion that the government financially supports Emirates, sponsoring activities in order to make Dubai a global hub and a tourism heaven. But the state profits from increased incoming traffic. After all, Dubai had limited resources. The oil is all in neighbouring Abu Dhabi.

2. Competition

Emirates has a negligible home market (the population of the entire United Arab Emirates is only 8 million), so it had to attract international passengers, who have many carrier options unless they plan to fly to, or through, Dubai. Thus, entering foreign markets early was not an option; it was a dire necessity.

3. Company

The state appointed Sir Maurice Flanagan as Emirates' founding CEO. Flanagan was an industry veteran: after serving in the Royal Air Force, he joined British Airways as a management trainee in 1953. Clearly not a government bureaucrat, but an industry buff, he has been largely responsible not only for Emirates' inaugural flight, but also for its ongoing success. Over his career, he has been repeatedly honoured for his contributions to the industry. The current chairman, Sheikh Ahmed bin Saeed Al Maktoum, is a senior member of the Royal Family, but four of nine members in the C-suite are non-nationals. Emirates employs those with business experience in general, and industry experience in particular, in its operations and governance.

"Open" is the watchword for Emirates. Its corporate philosophy emphasises its openness to change, to new ideas, to diversity, and to opportunity. It views diversity as a defining strength of the company: it actively recruits the world's best and brightest, and its sizable workforce hails from 163 countries.

Given the intense competitive environment and limited state support, Emirates needed to orient its services to the market. Otherwise it would have gone bankrupt before the end of the 1980s. In sum, Emirates had most, if not all, the conditions in place to build a strong brand.

Marketing strategy to create a strong brand

In contrast to a quasi-monopoly brand that consumers buy because they lack any other option, the principles of developing a strong national champion brand do not differ from those used by any other company. The national champion must define its target segment, develop a brand promise or position, and determine a marketing mix (product/service, price, promotion, and place/distribution) to fulfill the brand promise.

1. ComTarget segment

A senior executive at Emirates described its target consumer as "a person who is willing to pay a premium for additional services. Also for those customers who care about accessibility and availability as Emirates provides one of most extensive city pair connectivity with high capacity." The target segment is therefore international travellers who care about schedule convenience embodied in accessibility and availability, and who seek service rather than price. This target segment generally looks for a global brand. From the beginning, Emirates decided to operate outside the Middle East, as a global airline rather than a regional one. With connectivity and availability in mind, it employed the following slogans to reach this target: "Fly Emirates. To over 100 destinations" and "Fly Emirates, in six continents." Most recently, it has started to use "Fly Emirates. Keep discovering."

2. Brand promise

Mike Simon, Senior Vice President, Corporate Communications, formulates Emirates' brand promise, "From day one, Emirates has set out to be an innovative, modern and customer-oriented provider of high-quality air travel services. Our brand positioning is that of a leading international and quality airline serving the global community." Anyone who has flown recently on US carriers knows how ambitious this brand promise is to fulfill. But Emirates has delivered consistently through world-class service and an integrated marketing mix, wherein the various elements mutually support each other.

3. Product/service

Among the first airlines to fly the path-breaking Airbus A380, Emirates has one of the world's most modern fleets, making for fewer breakdowns and delays. It is famous for its high-end in-flight cuisine and wine, its high level of service quality, and its service innovations such as individual entertainment centres and phones for passengers in all cabins.

4. Price

Emirates has a prestigious global brand image, but its price positioning uniquely places its services between the world's most expensive airlines and the low-cost, no-frills carriers. The Airbus A380 helps Emirates to service those routes where it has limited landing rights, thus ensuring a larger volume of passengers on a single trip at a lower cost per head. High total volume and occupancy rates combined with low operating costs give Emirates a distinct cost advantage; staff costs are about 20 per cent of total versus an industry average of up to 35 per cent. Consequently, it can offer luxury travel/brand experience as its peers, but at prices of up to 40 per cent less. Thus, Emirates does not compete with price-based carriers, but it does offer better value than established rivals such as Air France or Lufthansa.

5. Promotion

The main component of Emirates' promotion activities is its sponsorship of sports events. In 2004, Emirates and Arsenal Football Club signed the biggest club sponsorship in English football history to date. The deal included naming rights for a 15-year term to the new stadium, "Emirates Stadium," in Ashburton Grove, London, as well as an eight-year shirt sponsorship ("Fly Emirates") deal from the 2006/2007 season onward, worth some £100 million. By the end of 2012, Arsenal signed a new £150 million deal with Emirates Airline, extending its shirt

sponsorship to 2019. The naming rights to the Emirates Stadium were also extended to 2028 as part of the deal. Emirates also concluded sponsorship agreements with a number of other football clubs, the Asian Football Confederation, and Fédération Internationale de Football Association (FIFA).

Football, the most popular sport worldwide, is the focus of its sponsorship activities. But Emirates has sponsored other sports with global popularity (e.g., the US Open and other tennis events, and the European Ryder Cup and other golf events) as well as sports with a local following (e.g., New Zealand yacht racing and Australian Rules football). Emirates strategically targets various sports events throughout different continents to reach the biggest audience possible, while allowing local variation. In 2011–12, it spent over $1 billion on these sales and marketing efforts.

Distribution

Dubai's location, within eight hours of most cities around the world, enabled Emirates to build a global presence that now flies passengers from one continent to another. Dubai International Airport's Terminal 3 is one of the largest and most comfortable terminals in the world. Emirates' international network does not focus only on large cities. It was also one of the first airlines to cater to traditionally neglected destinations such as Birmingham, Newcastle, Manchester and Hamburg within Europe, and Kochin, Kolkata and Ahmadabad in India.

Threats take off

The elements of the marketing mix work together in fulfilling the Emirates brand promise. But the financial crisis hit Dubai hard, established airlines are struggling, and rising oil prices are continuing to beleaguer the Emirates. Furthermore, Emirates is certainly not without disgruntled passengers, complaining of delays, missed connections and poor in-flight service. While 100 per cent satisfaction is impossible in service industries, many complaints indicated a lack of apparent effort to engage in service recovery.

Perhaps most worrisome is increased competition from Etihad Airways. Established by royal decree in 2003 and based in neighbouring Abu Dhabi (the largest and wealthiest of the United Arab Emirates), Etihad has borrowed from Emirates' marketing strategy. It went on a buying spree, placing what was the largest aircraft order in commercial aviation history at the Farnborough Airshow in 2008, for up to 205 aircraft — 100 firm orders, 55 options and 50 purchase rights.

Etihad received the title of "World's Leading Airline" four years in a row from 2009 through to 2012 at the World Travel Awards — according to The Wall Street Journal, the travel industry's equivalent of the Oscar's — as well as numerous other awards.

Etihad's promotion strategy also focuses on sports sponsorships. It is the official sponsor of Manchester City Football Club, winner of the 2012 Premier League title, one of the most prestigious prizes in football. Manchester City's stadium is now called the "Etihad Stadium." On the downside, its profitability is questionable. In 2011, it turned a profit for the first time in its history, a disappointing US$14 million on record revenues of nearly US$4.1 billion.

Notwithstanding these threats, one lesson is clear for national champions. Emirates Airlines has networked together a global empire, earned consistently solid profits and built a global brand that people love and respect without ongoing state protection and support.