Chapter 1

CORPORATE STRATEGIES OF CHINESE MULTINATIONALS

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1. Strategic Management in Chinese Enterprises

China has always considered the quality of management at the company level as a key factor of China's competitiveness.

This was made very explicit in the Development Report of China's International Competitiveness in 2001: "The international competitiveness of a nation depends, to a large extent, on the competitiveness of its national enterprises at the micro-economic level. In other words, without competitive enterprises, national competitiveness would be built on quick-sand and any sound macroeconomic policy would be nothing more than engaging in idle theorizing" (Renmin University, 2001).

Management and especially corporate strategy are the key drivers of Chinese companies' and China's competitiveness.

With the rapid progress of globalization, local competition has become global and global competition has become local. The implication is that Chinese enterprises will be facing ever greater challenges, locally and globally. In such circumstances, Chinese enterprises have had to elaborate new strategies in line with the economic globalization trend.

Multinational Companies (MNCs) are seen as key actors of economic globalization, which is why MNCs are a key instrument of China's economic global ambitions.

Multinationals have played a key role in the twentieth century and their influence will grow further in the future as a major force of resource allocation worldwide. Multinational enterprises have access to technology, physical assets and human capital, management, and markets. The opening-up of China has been accompanied by the internationalization of its domestic enterprises and the Chinese government is supporting this development and nurturing China's emerging multinationals.

This chapter describes these strategies based on HEC–Tsinghua SEM Research Project on Chinese Multinationals (2005–2008) and in-depth investigation and interviews with top management of leading mainland corporations.

1.1. *Strategy and the Chinese Economy*

The word "strategy" in China refers traditionally to the conduct of warfare. Business strategy is a relatively young discipline in the country which has been influenced by contributions of western scholars such as Chester Barnard's *Functions of the Executive* or Igor Ansoff's *Corporate Strategy*.

Corporate strategy provides overall direction, policies, and plans for the company as a whole to achieve long-term growth and stability in a changing environment. Strategic management traditionally includes three levels: corporate strategy, business strategies and functional strategies. This chapter deals mainly with the strategies of Chinese emerging MNCs at the corporate level.

Yang Rongping and Ke Yinbin (2004) have identified three stages of strategic development of Chinese enterprises linked to the transformation of their economic environment.

— *The 1980s.* In this period, the dominant economic system was the planned economy and the strategies of Chinese SOEs were generally specialized in production for a specific industry.
— *The 1990s.* In this period, China embarked on the transformation from a planned economy towards a market economy. Chinese enterprises made a major change in their corporate strategies: diversification became the leading strategy in the 1990s.
— *Since 2000.* The market economy has become the dominant economic system in China. The corporate strategies in China started to diverge: diversification remained the dominant pattern even if some companies started reducing their number or core businesses and if a few companies developed successful focused strategies.

1.2. *Corporate Strategy in Chinese Enterprises*

Chinese enterprises are in a complex and unique situation that influences their strategy in a very specific way. They have to adapt their strategy to a new environment and improve their capabilities before participating effectively in global economic integration.

However, strategic management of these enterprises is lagging behind other countries:

— there was no need for strategy in earlier times. Companies did not have the decision-making power during the previous regime of a planned economy. They could only implement the production and sales targets objectives defined by the state. They were managed as giant production lines.
— property rights remain ambiguous. Companies have more decision-making power, but in many cases corporate leaders are still nominated by the government. Another problem is that the careers of these leaders are not tied to the performance of the enterprises. Naturally, they tend to ignore changes in the business environment and long-term growth issues.
— strategy can be confused with planning. Some business leaders have a long-term view and commitment, but they can also be rather ambivalent towards corporate strategy. They still equate strategy to the rigid long-term plans elaborated by the state, even if the environment or the policies are changing. They have difficulty recognizing the need for flexible strategies and providing meaningful guidance for decision-making in an ever changing environment.
— strategy differs from day-to-day management. Chinese enterprises started to embrace a market economy not so long ago, and there is a temptation for business leaders to spend too much time in micromanagement and neglect strategic decision-making at the top.

The three growth avenues open to Chinese enterprises are closely interrelated and cannot be separated: integration, diversification, and globalization (Figure 1.1). When diversification and integration strategies cross the international boundary, they become part of the globalization strategy. Sometimes integration strategies

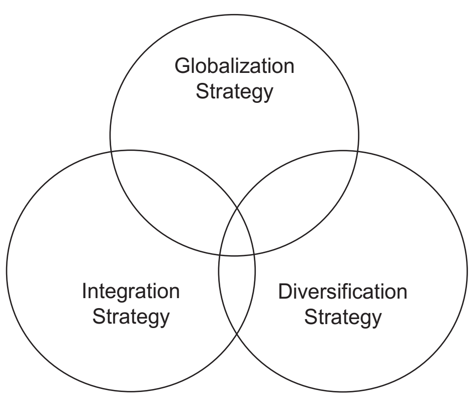

Figure 1.1: Corporate strategies: integration, diversification, and globalization.

and diversification strategies are combined. For the sake of analysis, however, the three strategies will be discussed separately here.

The authors have chosen the qualitative research approach to study the new strategies of Chinese enterprises. This is done to provide Chinese and international readers with a viewpoint that is both realistic and straightforward so that they can appreciate the specificity of strategies followed by Chinese enterprises. Of course, one or two examples of success or failure cannot represent the overall mode of strategy employed by Chinese enterprises.

Cases have been chosen based on two considerations. First, the authors focused on companies that accepted in-depth interviews and discussions on strategic issues. Second, a rather high number of non state-owned enterprises were chosen because they experienced less influence from the state. These private enterprises are investing more overseas in recent years and several of them have entered international markets. Some are structuring themselves as multinational enterprises, expanding their sales network and reorganizing their production capacity on a global basis. These companies represent a leading economic force in China and a new image of the country. Their strategies will of course have a decisive impact on the future development of enterprises in China.

2. Integration Strategies in Chinese Enterprises

The level of concentration is quite low in most sectors of Chinese industry. For instance, the total production of over 200 auto manufacturers is lower than that of General Electric. Even the production of the largest iron and steel company, Shanghai Baosteel Group, accounts for only 10 percent of the total production of iron and steel in China. This is far less competitive than other multinationals (Li Rong, 2004). Therefore it is imperative for Chinese enterprises to carry out integration strategies in order to create economies of scale, enlarge the scope of their activities, and achieve a better control of key elements of the value chain. This leads to strategies of both vertical and horizontal integration.

In recent years Chinese companies have favored M&A over organic growth in order to move and grow more rapidly, especially on the international scene.

2.1. *The Logic of Integration*

In the early 1980s, the prevailing trend was specialization, with several large scale enterprises having monopolies in such sectors as iron and steel, chemicals, telecommunications, railways, and aviation.

For example, the Report on the Development of China's Petroleum and Chemical Industry notes the following: "2003–2004 illustrates well a policy based on integration. The major move of reorganization of the industry in 1998 was to break the monopoly into two large enterprises: Sinopec (China Petroleum & Chemical Corporation) and CNPC (China National Petroleum Corporation), with different geographic responsibilities in China and which integrated upstream and downstream" (Lu Wei, 2004).

In 2004, the rise in oil price increased the production costs and reduced the profits of many refineries. Jilin petrochemical company — one of the nine petrochemical units of CNPC — integrated further refining and chemical activities and became very profitable.

In that case the integration strategy was closely related to the past monopoly framework and tradition. However, with the increasing maturity of the domestic market, more and more enterprises and sectors have also followed integration strategies to achieve growth.

This will be illustrated by two cases: Shanghai Baosteel and Tsingtao Beer.

2.2. *Cases of Integration: Shanghai Baosteel and Tsingtao Beer*

Case 1: Horizontal and Vertical Integration of Shangai Baosteel

Baosteel's objective is "to transform itself in a highly competitive integrated company in order to be publicly listed on an international capital market" announced Xie Qihua, the Chairwoman of Shanghai Baosteel, in 2003 (Annex 2 A1).The strategy was defined as the consolidation of Baosteel's presence in the steel industry and moderate diversification in steel-related industries (Baosteel, 2003).

At the beginning of August 2004, is was rumored that Baosteel was planning an acquisition and was going to pay dividends of RMB3.5 per share or make a free share allotment. On August 12th Baosteel publicized its plan to transfer quality assets to its listed subsidiary Baoshan Iron & Steel Co. Ltd. in order to integrate further its production, purchasing, and sales activities.

In 1998, when the Baosteel Group Corporation was created as the government-controlled holding company for the new group, the assets of the group were limited to those of Baoshan Iron & Steel Co., Ltd. (Baosteel Co.). The strategy since 1998 had been to enlarge the scale and scope of activities in three major dimensions: building production capacity in the iron and steel business, vertical integration along the value chain, and acquisitions in related industries.

To build capacity, Baosteel made a series of acquisitions, including Yisteel's steel smelting and rolling line which is the biggest in China in terms of production capacity and has state-of-the-art technology. Baosteel also bought Wusteel's newly installed special steel production line, Ningbo Baoxin Stainless Steel Co.

(the world's biggest steel cold rolling line), and Shanghai Meishan Iron & Steel Co. (a production base for top grade construction sheet and electric steel).

Baosteel also integrated vertically. Downwardly, the company developed a sales and distribution network throughout China and in 10 foreign countries. Upwardly, Baosteel has 10 overseas subsidiaries controlling key mineral resources in Australia and Brazil. The development of the Majishan ore terminal in the port of Zhoushan was also a strategic investment made to secure a stable and economical source of iron ore.

Investments in steel-related industries mainly consisted of Baoxin Software which specializes in information technology and automation services, and Baosteel Chemical which specializes in coal chemistry using by-products from steel manufacturing.

Through these investments, Baosteel was completing its integration process and strengthening its competitiveness in its core iron and steel business. Following the same principle, it developed also strong partnerships up and down the value chain. Upwardly, the company cultivated partnerships with the suppliers of minerals, coal, and shipping services to insure the long-term stability of supplies and efficient logistics. Downwardly, Baosteel partnered with key industrial clients in the car and electronic appliance industry to develop its sales.

These long-term strategic partnerships with suppliers and clients helped Baosteel meet demand in 2003 despite the fact that the average growth rate exceeded 40 percent in the car-making, electrical appliances, mechanics, logistics, and telecommunications industries.

Thanks to the integration strategy and alliances along the value chain, Baosteel built strong foundations and could move toward new objectives, such as becoming a world-class company in the iron and steel industry and being listed internationally. Baosteel ranked 300 among global 500 firms in 2006 with revenues of US$22,700 million. [*Fortune* Global 500, 2007. The company's assets reached RMB147billion (at end of the 3rd quarter, 2006)].

Case 2: Horizontal Integration at Tsingtao Beer

Tsingtao Brewery Co., Ltd. was founded in 1993 and is listed on both Hong Kong and Shanghai Stock Exchanges. US company Anheuser-Busch first made an investment in Tsingtao Beer in 1993 and the two companies formed a strategic alliance in 2002 to share their expertise in management and technology. This enabled Tsingtao Beer to become China's leading brewer. The Qingdao State-owned Assets Supervision and Administration Commission of the State Council (Qingdao SASAC) is the largest shareholder in Tsingtao, holding a 30.6 percent share. Anheuser–Busch is the largest nongovernment shareholder with 27 percent.

As described by a senior manager of Tsingtao Brewery Group (Tsingtao Beer), the company' development is based on a very clear strategy focus: "We focus on

Table 1.1: Tsingtao Beer Operating Revenue and Assets (RMB millions).

	Operating revenue	Total assets
Year 1998	1,760.95	4,119.76
Year 1999	2,503.44	5,447.05
Year 2000	4,068.45	7,577.43

Source: Development report on China's major companies (2001–2002), Association of Chinese Businesses Appraisal, Chinese Personnel Press.

the beer business because we believe that concentrating our resources and capabilities in this industry is the only way to develop our competitive advantage at an international level."

Tsingtao Beer decided not to diversify but to grow in the beer business through a strategy of integration which was mainly achieved through a series of M&As. Between 1998 and 2000, the total assets of Tsingtao Beer increased by 83.9 percent, while the operating revenue increased by 131 percent (Table 1.1).

Tsingtao Beer M&A Strategy

As early as 1994 and 1995, Tsingtao Beer started its integration strategy by the acquisition of Yangzhou Brewery and Xi'an Hans Brewers. Unexpectedly, it was not an immediate success. The company lacked experience, management skills and technology, and the environment was not favorable. Tsingtao learned from these lessons and accelerated the pace of its acquisitions. Since 1997, Tsingtao Beer has acquired as many as 40 breweries, including Pingdu, Rizhao, Pingyuan, Heze, Xuecheng, Rongchen, Ma'anshan, Huangshi, Yingcheng, Penglai, Wuhu, and Shanghai breweries.

Tsingtao Beer now controls a broad portfolio of subsidiaries:

— Heilongjiang Kaiku and Beijing Five Star breweries in the North,
— Xi'an Hans and Weinan breweries in the West,
— Sino-Japanese joint venture Shenzhen Tsingtao Asahi Breweries Ltd. and Zhuhai Sanshui breweries in the South,
— Sichuan Luzhou and Huoju breweries in the Southwest,
— Shanghai, Yangzhou, Wuhu, Ma'anshan in Central China and
— Huangshi and Yingcheng breweries in Hubei province.

The production capacity reached 2.5 million tons annually and Tsingtao Beer was one of the top breweries in China.

By the end of the first half of 2004, sales had gone up rapidly and production exceeded 1.2 million tons, which was a 40 percent increase from the previous year. Profit tax increased by 82 percent, and 60 percent of its profits came from the 38 companies that had been acquired. The 40 companies acquired by Tsingtao Beer are profitable with the exception of three or four which are in a process of reorganization. In 2004 Tsingtao sold 3,71 million kiloliters, being the No. 1 brewer in terms of volume, production, market share, sale income, gross profit and foreign exchange in China.

This strategy of integration was closely associated with a broader policy developed by Tsingtao Beer and defined as Development from a Strategic High Point and Expansion at Low Cost.

Tsingtao Beer Strategy Framework

Focusing on beer as the core business Although Tsingtao Beer was a latecomer to the market economy, it did not "follow the tide" by diversifying into related or unrelated sectors, at least in the short-term.

Instead, it kept its focus on beer brewing as its core business and built its competitive advantage by concentrating all of its financial, human, material, and technological resources in order to enlarge its market share and to become a leading force in the industry.

Expansion at low cost There were internal and external reasons to develop a low cost expansion strategy. In the early 1990s, Tsingtao Beer's production lagged at 200 to 300 thousand tons. In 1996, Tsingtao Beer's market share shrank to a mere 2 percent. One could infer that Tsingtao Beer had a brand name, but not much production. The company had to fight in order to survive. At the same time, foreign brands were entering China's market scale *en masse*, transforming domestic competition into an international beer war. Many small and medium-scale breweries went bankrupt. As a result, a few large brewery groups emerged and became the key actors in China's beer industry.

At that time, companies that would not grow quickly enough would rapidly lose market share and become bankrupt. Keep pace with competitors, or, if possible, take the lead, was the only way to survive the fierce competition.

Tsingtao Beer evaluated each of its acquisition targets on a case-by-case basis in order to minimize the investment. The company used several methods to grow: acquisition of a bankrupt company, M&A, and creation of a joint-venture.

Based on Tsingtao's estimate, the investment made in more than 40 newly acquired companies, plus the cost of renovation and upgrading, was two-thirds less than what it would have cost to build these companies from scratch. For each target company, Tsingtao Beer had defined specific criteria and conducted a detailed analysis of the company situation, the feasibility of the acquisition and the company growth potential.

One criterion was that the company should have a specific advantage in terms of human resource, technology, and equipment. It should also have an acceptable debt ratio. Another requirement was that the company should be able to stop losing money and become profitable after capital and management expertise being supported by Tsingtao's. These criteria ensured the quality of the acquisitions and the smooth running of the entire group.

Financial integration and management control After acquiring a company, Tsingtao Beer would make the necessary capital injections, nominate a chief financial officer, and create an effective financial and management control system. They would also appoint a manager in charge of operations to introduce Tsingtao Beer's up-to-date production technologies and modernize the existing management system based on Tsingtao beer expertise.

Brand policy and local cultures Tsingtao Beer maintained a strict control over the use of the "Tsingtao Beer" brand name in order to avoid problems at the level of the newly acquired subsidiaries. The subsidiaries would continue to use their local brands, which had a strong reputation in the local markets. Simultaneously, Tsingtao Beer introduced its production technology and management system to these companies so as to enhance their product quality and management expertise. Once they were up to Tsingtao standards, they would be authorized the use of the trade mark of "Tsingtao Beer series" and the logos of Tsingtao Beer.

Such measures protected the value of Tsingtao Beer's brand name and created the opportunity to build well-known local brands. When the technological and management level was reached by the local subsidiaries, the parent company would introduce its major brand "Tsingtao Beer" to the local markets. As a result of this process, Tsingtao Beer successfully penetrated domestic markets and increased its market share.

Tsingtao Beer has been able to create synergies between its corporate identity and local cultures by building on the loyalty of local consumers. The group adapted its own management culture to local specificities while disseminating its management expertise and promoting harmonious interpersonal relationships. This led to extraordinary brand loyalty from local consumers and explains why demand exceeded supply a few months after Tsingtao Beer first launched its marketing strategy. The strategy was to keep the original brand name of the local beer while also promoting the Tsingtao Beer series. By respecting cultural differences, Tsingtao Beer managed to spread its corporate culture to its acquired subsidiaries and, at the same time, inherited and enhanced the existing local cultures, thereby achieving a successful cultural integration.

Post-acquisition Integration and Project Teams

To transfer its management culture and implement its management philosophy in newly acquired subsidiaries, Tsingtao Beer would send three project teams to the subsidiary. The first team was in charge of implementing Tsingtao Beer's management philosophy and spreading its management model of "one center, six systems, two supports". This team introduced up-to-date and effective management techniques such as competition among executives for management positions, optimization of work organization, tendering and bidding procedures for large procurements, marketing methods, and cost management.

The second team was in charge of the enhancement of production technology by introducing Tsingtao Beer's brewing technologies and processes.

The third team was in charge of quality. This team introduced a quality assurance system based on ISO9000, as well as strict standards of quality management. Three vice-directors were in charge of leading the three project teams and were responsible for the transfer of management expertise and performance enhancement.

Establishing Distribution Channels

Tsingtao Beer marketing policy is to sell directly to the consumer and to exert a strict control over the distribution network. This policy included door-to-door service for example, which means direct selling to final consumers. Another policy was "carpet bombing", which means not ignoring a single marketing outlet. Acquired subsidiaries had to follow this model in order to increase control over the final user. The distribution network of Tsingtao Beer was classified according to three levels of population density: urban area — where the subsidiaries are located, the periphery, and special markets. Market share rose to 90 percent in urban areas and to 80 percent in small and medium cities after several months of network building.

2.3. *Lessons from Integration*

Integration is the common trait between these two strategies. Baosteel implemented a horizontal and vertical integration strategy, and, through low cost acquisitions, expanded into an integrated group, aiming at being publicly listed on an international market.

Tsingtao Beer implemented its strategy of Development from a Strategic High Point and Expansion at Low Cost, focusing on core business and increasing its market share.

Baosteel and SOEs' Reform

The upward integration strategy is an interesting characteristic of Baosteel. The investments made by Baosteel to secure raw materials helped the company to grow in its domestic market and limit the growth of its foreign competitors. Penetrating foreign markets could be a second phase of development, after creating a powerful domestic basis.

The restructuring of Baosteel is also quite unique. As a large SOE, Baosteel, through the implementation of an internal integration strategy, was able to complete its capital restructuring and transform itself into an independent market-oriented enterprise. Its listed subsidiary, Baoshan Iron & Steel Co. Ltd. (Baosteel Co.), has been able to acquire the assets of its parent company, generating enough resources to implement the market reforms without external support. Thus, Baosteel has opened a new path for SOE structural reforms and is a good example of a successful integration strategy by a Chinese company. The company has not only protected independent operations but also avoided being acquired by foreign multinationals.

In the framework of Chinese SOE reform, China has seen a wave of creation of groups of enterprises, which is in fact a regrouping of Small or Medium-sized Enterprises (SMEs), bundled together by the local governments. This is done without creating a modern share holding system in the majority of cases. Local governments play a key role in many of these groups of enterprises and in some cases, following government policy, have transformed administrative units into groups of enterprises just by changing their name, which did not give them real unity from a management point of view.

Chinese enterprises wanting to do businesses internationally and compete with foreign multinationals, must establish an independent market-oriented legal status before transforming their management system and improving their competitiveness. From this point of view, the transformation procession of Baosteel and the creation of a real integrated company is an example to follow.

Tsingtao Beer and Branding Policy

By the end of 2000, the total market share of the four largest firms (concentration ratio CR4) in the beer brewing industry was below 20 percent nationwide, which is a typical low market concentration ratio. Tsingtao Beer seized this opportunity to increase its market share through a series of acquisitions. Beijing Yanjing Brewery, China's second largest brewery, followed the same strategy and contributed to the consolidation of the industry. In 2005, the top 10 Chinese breweries represented 61 percent of the national market, a 6 percent increase compared to the year before.

The type of horizontal integration strategy implemented by Tsingtao Beer was well adapted to China's industrial sectors with a low concentration ratio. Many industries such as candies and sweets, purified water, pharmaceutical retailing, and the iron and steel industry still do not have a high concentration ratio. This leaves ample opportunities for growth among companies that have sufficient capital and management expertise to build their strength in the domestic market before expanding internationally.

3. Diversification Strategies

3.1. *The Logic of Diversification*

Diversification strategies involve a process of redeployment of the company's resources, assets, capabilities and human resources. Success in diversifications strategies is mainly linked to the quality of this resource allocation process. Classical typologies of expansion strategies will help clarify the specificities of the Chinese companies' diversification process.

Horizontal diversification refers to developing new products and services in the same economic sector. Vertical integration refers to extending companies' operations upwards or downwards. Concentric or related diversification builds on the company core capabilities and can be further classified into sales-related, technology-related, and sales and technology-related (Ansoff, 1957).

Conglomerate diversification refers to enterprises developing new products and services in an unrelated sector (Table 1.2).

The specialization ratio (Wrigley, 1970) — the percentage of a firm's revenues attributable to its largest single business — is also interesting in the case of Chinese companies. This allows us to define four degrees of diversification (Table 1.3).

In the 1970s, a wave of diversification spread throughout the world. In the 1980s, Chinese enterprises also tried to adopt diversification strategies, looking for new growth opportunities. After the 1990s, there were numerous instances of failed diversification. But despite the failures, the strategy of diversification is still popular among enterprises in China. Meanwhile, more and more enterprises are beginning to realize that it is not good to blindly pursue diversification in order to expand.

Table 1.2: Expansion strategies.

Horizontal	
Vertical integration	Downwards–Upwards
Concentric (related)	Sales related
	Technology related
	Sales and technology related
Conglomerate	Unrelated diversification

Source: Kang Rongping and Ke Yinbin (1999); adapted from Ansoff.

Table 1.3: Specialization ratio.

Degrees of Diversification	Specialization ratio (SR)	Growth pattern
Homogenous products	$0.95 < SR < 1$	Expanding the scope of production in same activity
Dominant products	$0.7 < SR < 0.95$	Focusing on dominant product and conducting minor diversification projects
Related products	$SR < 0.7$	Entering new businesses related to core technology and capabilities
Unrelated products		Entering (usually through acquisition) in businesses not related to core technology and capabilities except finance

Source: Li Jing, 2002; adapted from Wrigley.

They are now inclined to diversify around their core business or capabilities in order to improve their management efficiency, technology, sales and clientele. They employ mature strategies with a greater emphasis on related products or services.

3.2. *Cases of Successful Diversification: Haier and Hisense*

Case 1: Haier Diversification Strategy

Haier's diversification strategy had two phases: related diversification and unrelated diversification. The former achieved great success, while the latter turned out, to some extent, to be a failure.

In the first phase of related diversification strategy, Haier penetrated into the market of penetrate household electrical appliances soon after it secured a dominant share of the Chinese refrigerator market. After the acquisition of Tsingtao Air Conditioner Factory, Haier launched such products as freezers, air conditioners and washers, one after another. In the air conditioners market, Haier soon over took Chunlan Group to become the market leader. In the washing machine business, Haier replaced Little Swan (Little Swan Group Company Ltd) as the consumer's first choice. It also became the market leader in the freezer market.

The success of Haier's core business of refrigerators, freezers, air conditioners, and washing machines drove the Haier Group forward and stabilized its position as one of China's leading brands. Haier has made a strong impact on the public with its campaign "Try your best and strive to be the number one". This corporate culture is regarded as one of Haier's most valuable assets and the soul of the company's reputation and brand identity. From this perspective, Haier's related diversification was a great success.

In the second phase of the unrelated diversification strategy, Haier entered the market of pharmaceuticals in 1995. The company then entered the food and beverage, television, PC, mobile phone, software, logistics and finance industries. That was, unfortunately, not a good decision. Evidence shows that Haier is still suffering from losses in its pharmacy business. Its pharmaceutical product, Caili, specially designed for the health and fitness market, could never meet Haier's standard of success. Most outlets of the noodle restaurant chain Haier Dasaozi ("elder sister-in-law"), founded in the 1990s, have now closed down. It suffered losses from sales of computers, eversince these were launched. In the mobile phone business with a very competitive market with actors like Bird, Kejian, Xiaxin, Panda, and TCL, Haier did not have a clear competitive advantage and had difficulties building its market share.

Though Haier claims to be the second General Electric, it is still facing great challenges in living up to that model. The move from the refrigerator business to other home appliances and to brown products was quite successful, but further diversification in markets which are less related is questionable.

Case 2: Hisense Diversification Strategy

Hisense is a large-scale Information Technology enterprise with a major shareholder, Hisense Group Corporation. Founded in 1969 as "Qingdao No. 2 Radio Factory" in 1979 the company became "Tsingtao Television Factory", and in 1993 it was named "Hisense Electric Co. Ltd." Hisense, which today is a well-known high-tech company, focused on its core businesses of radio and television in the 1970s and the 1980s. The company launched a wave of diversification in the 1990s when it diversified into new sectors such as household electrical appliances, telecommunications, and information.

Major activities included the production of televisions, air conditioners, computers, mobile phones, refrigerators, software, internet facilities, as well as real estate development (Table 1.4).

Since then, Hisense has developed rapidly with sales increasing from 410 million RMB in 1992 to 27.3 billion RMB in 2004 (Table 1.5).

In the mid-1980s, there were 57 color television manufacturers identified in China, as well as more than 100 local brands. At that time, the color television industry had a low level of market concentration but faced fierce competition and high risks. Large companies dominated the market and having a good reputation was not enough to survive. The only solution for Hisense was to expand its manufacturing volume in order to gain a competitive advantage.

Table 1.4: Hisense diversification process.

Period	Types of products
1970s	Radios, black and white television sets
1980s	Radios, color television sets
1990s	Color television sets, video, cash registers, computers, air conditioners, information technology, telecommunications, real estate
2000s	TV (plasma, LCD, conventional), VHS, cash registers, computers, air conditioners -information technology, telecommunications, real estate -mobile phones, refrigerators, household electrical appliances

Source: Company data.

Table 1.5: Hisense revenue (RMB billion).

1981	0.025
1992	0.41
1998	8.25
2000	13.98
2004	27.3

Source: Chinese enterprises appraisal association.

Hisense allocated financial resources and other assets to its diversification process according to two guiding principles:

— First, focusing on growth through product development and being a low cost leader,
— Second, leveraging the financial structure and available stocks to finance mergers, acquisitions and joint ventures.

The major diversification targets outside of the core business of household electrical appliances were the personal computer and telecommunications sectors. In 1996, Hisense invested in a start-up computer company and an optical fiber company. In 1997, it developed the biggest manufacturing base for frequency conversion air conditioners in China. In 1998, it shifted its focus to the high-tech information industry by developing its own software company and an IT industrial park. As a result, the technological wing of Hisense's portfolio of activities and profits increased significantly.

During the interview, Hisense representative pointed out that the company was not considering to increase its degree of diversification. On the contrary, Hisense now attaches great importance to focusing on a few core businesses and nurturing its competitive advantages in these areas. Hisense, which today controls 50 percent of China's television market, has adopted a mature strategy.

3.3. *Cases of Unsuccessful Diversification: Apollo and Chundu*

Many Chinese enterprises diversify in order to spread their operational risks. However, without an in-depth evaluation of the firm resources, business environment, and characteristics of the target business, the result of diversification can be the opposite: increased risks and potential failure. The dangers of such superficial diversification strategies are explicit in the following cases.

Case 1: Apollo Diversification Strategy

At the end of 1987, the predecessor of the Apollo Group, the Huangjiang Health Products Factory, was set up in Dongguan, Guangdong Province. Later, the factory took part in a national program of evaluation of health products and was awarded gold medal for its product Wanshida, a bio-nutritional food. The event was widely reported in the media. At the beginning of 1988, Huai Hanxin, the holder of the technology for Wanshida quit his job and invested in the production of Wanshida, changing the name of the factory and brand name to Apollo. In the same year, Apollo sales revenue reached RMB 7.5 million. The strategy of the Apollo Group at the time was to focus systematically on vertical integration, with horizontal development as a second alternative. In 1990, the sales revenue increased to RMB 240 billion. Next, Huai Hanxin recruited a group of young elite businessmen at a high salary to take over the firm and introduce information technology-based management. In 1993, sales revenue rose to RMB 1.3 billion and market share rose to 63 percent. Looking for new avenues for growth, Apollo Group implemented a diversification strategy by investing heavily in such industries as real estate, petroleum, international trade, hotels, cosmetics and computers. In two years, the amount invested in these industries reached RMB 340 billion. In 1995, Apollo went public in Hong Kong. It suffered losses of RMB 159 billion in 1997. At one time the share price was as low as HK$0.09, prompting the resignation of Huai Hanxin from his position as the chairman and the recruitment of Wang Zhen, a Harvard MBA graduate, to be the new chairman. However, things did not happen as planned. As he knew little about the nutritional food industry, Wang Zhen's efforts did not improve the situation and the volume of sales continued to decline.

Case 2: Chundu Diversification Strategy

The predecessor of the Luoyang Chundu Group was the Luoyang Meat Processing Factory, founded in 1958. In 1986, after the production of the first western style sausage in China, Chundu became famous throughout the country for its so-called "Dancing Sausage". At the same time its market share rose to 70 percent and assets increased to RMB 2.9 billion. Building on the success of its ham sausage, Chundu Group began its diversification by entering six new businesses: meat processing, frozen meat products, biochemical pharmaceuticals, drinks, packaging materials, and feedstuff processing. From then on, the Chundu Group became a large enterprise. It diversified into many sectors such as industry, commerce, and trade and tourism. The company developed from a meat-processing factory with net assets of only RMB 20 million to a diversified group with net assets of RMB 1.35 billion. Despite its prosperity, the diversification strategy laid the foundation for hidden trouble in the future; the activities were unrelated and this would increase the difficulty in mobilizing financial resources when necessary.

In 1998, the sales volume of its major product — the Chundu sausage — declined, with its market share sliding to 20 percent. The production of jujube tea, in which Chundu Group had invested, was forced to stop. The drinks factories it set up in Luoyang and Zhengzhou (Henan Province) had not begun operations, leaving behind a heap of idle equipment. Even its Lixin brand of health products, which once enjoyed a good reputation, finally collapsed owing to the frequent change of brand names. In 2005, up to 100 production lines had been stopped and the Group was suffering a loss of RMB 670 million as well as a substantive liability of RMB 1.3 billion.

3.4. *Lessons from Diversification*

From the mid to late 1980s many companies diversified. The rapid growth of the consumer market and the excess of demand over supply created lot of opportunities for enterprises. Leveraging these opportunities, some far-sighted enterprises adopted diversification strategies and grew very quickly.

This trend, however, vanished by the late 1990s. In a fast growing economy and with opportunities fully leveraged, profits began to decrease as most companies wanted to retain their market shares. Supply gradually exceeded demand. In addition, many enterprises faced problems of cash flow owing to over-expansion. They had no choice but to drop out and come back with a more focused strategy.

The year 2000 was another turning point. Seeking new avenues of profit, many enterprises re-adopted diversification. For example, Wahaha dealt mainly in nutritional food at first. When this field had been fully exploited it diversified further, into children's clothing, for example. Compared to the diversification strategy in the 1980s, enterprises are now focusing on financial dimension of diversification.

They do not interfere with the management of the projects in which they invest. Instead they employ professionals to take charge of each business, diversifying their investment but also betting on specialized management per industry.

Successful Diversification Experiences

Haier and Hisense had success moving from a single business to related diversification and then to new opportunities, in a virtual circle. Haier became a leader in the refrigerator business in seven years and then expanded into household appliances and finally into unrelated industries. Wahaha began its business of children's clothing after 13 years of dominating the soft drink industry. Hisense first became a leader in China's television industry in term of branding, after-sales service, and management before it entered related industries in the 1990s with freezers and air conditioners. Those products offered synergies with television in terms of core technology, marketing channels, and final consumers. Hisense moved afterwards to unrelated businesses such as information technology and telecommunication.

During the diversification process these companies carefully managed their activities as an integrated portfolio of core businesses and new ventures; they used the cash flows generated by the core businesses to finance the development of new activities that would in turn contribute to profits and diversify risks. Haier's profits in its core household goods business financed the development of the computer, mobile phone, and kitchen segments, which were promising industries. This portfolio management was however less successful in unrelated businesses than in related businesses.

Timing has been key in the art of seizing opportunities. Companies started their diversification process just after achieving relative dominance in their core business in the early and mid-1990s. During the same period, the "reform and opening up" policy at the national level offered ideal conditions for the business environment.

Unsuccessful Diversification Experiences

Companies that faced difficulties were vulnerable in their core business. They entered unrelated businesses before firmly establishing their leadership in their core business.

The companies ultimately did not have enough resources to diversify successfully. They entered blindly into unrelated businesses instead of moving step by step from related to unrelated sectors.

The Apollo Group invested RMB 340 million when sales in the core initial business were reaching RMB 1.3 billion. Since there was no specific knowledge or experience in these unrelated activities at the holding level, the needed financial resources far exceeded the available resources; the new activities faced cash flow problems and soon ran out of steam.

These enterprises also could not keep up with their expansion strategy due to a lack of management capabilities. Chundu Group, for example, did not have the corporate culture or the individual and collective talents to taken on such diversification.

Finally, the companies that failed had neither a clear competitive advantage in the sectors they wanted to enter nor a strong management culture and the necessary capabilities at the corporate level.

4. Globalization Strategies

Chinese enterprises have a strong interest in actively taking part in the international division of labor and in expanding from the domestic to the international market. Having reached an optimal size, they are interested in reorganizing their value chain in a more complex way at a global level. At the corporate level this means increased integration and interaction with the world economy in terms of production factors, capital, technology and human resources, as well as in terms of business functions such as R&D, supply, production, and marketing.

4.1. *The Logic of Globalization*

Since the beginning of the opening-up policy 30 years ago, Chinese enterprises have been exploiting their comparative advantages in production and market potential, thereby attracting multinationals from developed countries to invest in China. These investments have contributed to industry restructuring, enabling Chinese enterprises to enter the global supply chains of multinational enterprises. Such investments have also raised Chinese industries, products, and markets to international standards, enabling China to become an actor in the global economy. In 2005, China had accumulated a total of US$12.3 billion in foreign investments, but its overseas investment was only US$57 million. The "bringing in" policy has been the main form of China's participation in the globalization of the world economy. From a micro-economic perspective, China's international-oriented economy has been rather passive because of the major role played by foreign multinational enterprises in integrating China's enterprises and resources. Nowadays, "bringing in" can no longer satisfy the development needs of the globalization of Chinese enterprises. Chinese enterprises have to "go-out" and actively take part in global economic activities.

The ratio of wholly or partly private large enterprises that have invested successfully abroad is increasing rapidly and firms like the 999 Group (one of China's largest traditional herbal medicine manufacturers), Jiangsu Little Swan Electronic Appliances Company, TCL, and Haier are good examples of successful "going-out" strategies.

The key challenge for these Chinese corporations on the global scene is to increase their competitive advantage in their core business through continuous innovation.

Nevertheless, the current globalization process among Chinese enterprises is still in its infancy. It is taking place in a developing economy, in sharp contrast to the environment of developed economies such as the United States and Japan and newly industrializing countries. Since the opening-up policy, China has been developing its export businesses with the help of foreign investments. Although China has opened quite a number of industries to foreign investments, Chinese enterprises are not fully equipped to face the challenges posed by the international market due to long-time protection by the government. After China's entry into the WTO, Chinese enterprises have had to engage foreign multinational competitors head on. Therefore, a globalization strategy had to be adopted. Meanwhile, multinational enterprises have been moving their production into China in order to reap the benefits of cheap labor and explore the huge market potential. In the face of such severe challenges, Chinese enterprises have to be flexible enough to enter the international market by adapting to the dynamics of globalization.

For Chinese enterprises, the road to globalization is not simply to sell products or services to international clients, but rather to achieve international standards of corporate strategy and management. Only a few companies such as Sichuan Changhong Electric Co., Haier, and TCL have significantly begun this globalization process. Transnational mergers and acquisitions have also begun only in recent years with TCL's acquisition in 2004 of the color television division of Thompson Multimedia in France, BOE's acquisition of the TFT-LCD business of Korean Hyundai, Lenovo's acquisition of IBM's PC division and Shanghai Automotive Industry Corporation (SAIC) attempt in 2005 to buy MG Rover.

With the further opening-up of the domestic market and the development of M&As at the global level, these first steps signal the entry of emerging Chinese MNCs into the business of transnational acquisitions.

The Chinese market is the domestic market with the highest potential, providing sufficient room for both Chinese and foreign enterprises to expand further. As it occupies a key position in the global market, companies that are not present in China cannot be considered fully globalized.

Generally, multinationals have to first achieve sufficient presence in their domestic market to generate the financial resources necessary to enter the global marketplace. But for Chinese enterprises in particular, both domestic and international markets are important because they provide significant opportunities for development and expansion. Thus, Chinese enterprises should actively cooperate with foreign multinational enterprises in the domestic market and, at the same time, seize every opportunity to enter international markets and increase their presence at the global level by leveraging on their strong positions in the domestic market.

4.2. *Cases of Globalization Strategies: Wahaha and Wanxiang*

All Chinese enterprises participating in the HEC-Tsinghua SEM Research Project on Chinese Multinationals have formulated a specific globalization strategy. They only differ in their stage of development: either preparing for international expansion, entering foreign markets, or structuring a global presence.

Two cases will illustrate the process, stages of development and specificities of emerging Chinese multinationals' globalization strategy.

Case 1: Wahaha Globalization Strategy

Wahaha's strategy is based on two combined principles. The first is to serve Chinese consumers' needs in order to increase the penetration and market share in China's domestic market. From Wahaha's point of view, this was the reason to work with foreign partners in the Chinese market.

The second principle is to internationalize Wahaha's capital structure to facilitate the development of its international operations and globalization. This led to the cooperation with Danone.

In 1996, Wahaha's annual revenues reached RMB 1 billion with RMB 200 million net profit. In order to develop further, Wahaha entered into a joint-venture representing US$ 40 million in foreign investment with the French company Danone, the world's sixth largest enterprise in the food and beverage industry. This decision had two main consequences.

First, Wahaha bought world-class production lines for purified water, fruit-juice milk and soft drinks with this capital injection and housed these production lines in newly built factories of 200,000 square meters.

Second, Wahaha found a technically competent partner. The joint-venture allowed Wahaha to achieve its goal of expansion, while at the meant same time strengthening its brand in the domestic market. This meant that the collaboration between Wahaha and Danone was at the same time cooperative and competitive. Wahaha oversees and manages its own subsidiaries and the Danone–Wahaha joint-ventures. But Wahaha does not sell Danone products because Danone has other activities in China, including products that can be competing with Wahaha's products.

With a growing demand in the Chinese market, it was a win-win strategy for the French partner. The policy for the JV was to have separate branding policies and to exclude Danone from day-to-day management of the operations. Human resource policies of the joint-venture stated that their employees above 40 would not be fired and their compensation would be based on performance. Danone's brand name was not a major issue in the venture and many Chinese clients are unaware of the join-venture between Wahaha and Danone.

The results of the JV have been very good, with sales doubling in the second year of collaboration.

The two companies decided to invest jointly in Indonesia in 2004, Danone controlling 70 percent of the JV and Wahaha as a minority shareholder with 30 percent. The Indonesian factory produced Danone dairy products and biscuits, as well as Wahaha dairy drinks for children. Wahaha sent its engineering teams to manage the production process of dairy drinks, a Wahaha specialty.

Case 2: Wanxiang Globalization

The Wanxiang Group, a privately owned company, is China's biggest auto parts supplier. Wanxiang specializes in auto parts such as universal joints, bearings, constant drive shafts, propeller shafts, shock absorbers, rolling elements, rubber sealers, suspension, and brakes.

Wanxiang's policy incorporates three standards: world-class R&D capabilities, world-class production system, and a global marketing and service network.

Wanxiang Group is one of 120 experimental enterprises supported by the State Council, and the only auto parts manufacturer on the list of 520 key national enterprises as defined by the central government.

Wanxiang started to specialize in the early 1980s by introducing modern production technology and focusing on growth in the domestic market; exports would start in a second phase. The company, which produced universal joints in large quantities, was making profits of RMB 100,000 per day thanks to economies of scale.

The Wanxiang Group took its current form in 1990 when after 20 years of successful operations, the Zhejiang Provincial Government approved the proposal of Lu Guanqiu to formally establish the Zhejiang Wanxiang Machinery & Electronic Group (The "Wanxiang Group").

In 1994 a subsidiary of the Wanxiang Group, Wanxiang Qinghai Co. Ltd., was listed on the Shenzhen Stock Exchange and Wanxiang America was founded in Chicago's Industrial Park to become the center of Wanxiang's overseas strategy.

This was the founding step of Wanxiang's globalization strategy and the beginning of a series of international acquisitions with a clear focus on the USA.

From 1994 to 2006 Wanxiang America took control of Zeller, ID Co, LT C, QAI Co, American Universal Automotive Industries Inc (listed on Nasdaq), and Rockford Powertrain, using a variety of financial techniques, majority or minority shareholding, or cross-shareholding.

For Lu Guanqiu, the founder and, until 2003, the Chairman of Wanxiang, globalization and localization are two sides of the same coin: "We have to become more local in order to become more international. Our guiding policy is to take root in our own soil and make every effort to become as local as possible."

Wanxiang's localization policy includes four dimensions.

The first is the localization of human resources. Wanxiang America employs only five Chinese expatriates among a staff of 60. Wanxiang employs local staff, including general managers, in its European and South American branches. The salary scale is in complete accordance with local standards. A business manager at Wanxiang America earns US$200,000, more than double that of his/her Chinese counterpart.

The second policy is localization of management practice and style. Wanxiang's objective is not only to adapt to local regulations and the business environment, but also to merge with local business culture.

The third policy is localization of capital. Currently, Wanxiang America's financing, which originates in the USA, is twice as much as Chinese funding. Wanxiang America maintains close relationships with leading US financial institutions such as Citigroup and Merrill Lynch, and Wanxiang plans to be listed in the USA in order to have access to a large financial market.

The fourth dimension is localization of quality standards. Wanxiang Group's products achieved the (ISO) 9002 standard to meet the requirements of the three biggest American auto manufacturers and are constantly adapted to new market demands.

Since its foundation, the Wanxiang Group has created, acquired, or invested in 30 companies in eight countries, including the US, Great Britain, Germany, Canada and Australia.

4.3. *Lessons from Globalization Strategies*

In the context of China's late developing economy, Chinese enterprises' globalization strategies differ significantly in their respective experiences. Each company exhibits a specific stance.

Wahaha's major internationalization move is its alliance with the foreign multinational Danone, which allows both cooperation and competition on the domestic market and potential joint activities abroad.

Wanxiang focused on the US market and emphasizes a localization strategy of staff, management, and capital.

The history and the globalization strategies of Chinese companies do not depend only on the internal and external conditions they face today.

Globalization strategies are path-dependant: they depend on the stages of development that companies had followed in the past. They also depend on leaders' vision of the internationalization process at an early stage of development.

Chinese Companies and Localization Policy

A first general trend is that Chinese enterprises are developing an integrated network of production, R&D, and marketing overseas. An international marketing strategy and network, in particular, have become key elements in enterprises' core competitiveness. Huawei has established marketing networks in over 40 countries and regions, leading to a stable growth in the market share of those markets. TCL has established, through its forward integration strategy, an extensive domestic distribution network which multinationals such as Philips and Panasonic have to share before they are able to tap into the Chinese market. Access and control of distribution networks are key in the globalization of Chinese enterprises.

A second trend is based on China's sustainable comparative advantage in specific industries such as consumer electronics. Chinese companies will build on this comparative advantage as they globalize. However, the objectives of acquisitions made by Chinese enterprises overseas still differ from foreign multinationals' objectives. The major motivation for Chinese enterprises is to learn how to manage the internationalization process from their acquisitions. They are especially eager to acquire the ability to upgrade their technology through R&D. For Chinese enterprises that are already globally competitive, further expansion in the international market remains a logical priority.

A third trend is localization, which for Chinese multinationals is the only path to successful globalization. Mature multinationals have reorganized their staff, production facilities, marketing network, and R&D on an international basis. Emerging Chinese multinationals have to employ local staff in host countries, utilize local resources, adapt to local laws and cultures, manufacture locally, develop production, marketing, and R&D locally to reach maturity. They can realise their ambition of going global only through a high degree of localization.

— *Localization of Manufacturing* — Initially Chinese enterprises exported domestic products overseas. Then, when volume increased, they began investing in local factories to manufacture locally so as to reduce the cost of transportation and avoid trade barriers. This allowed them to lower trade tariffs, thereby reducing the product cost and increasing their market share locally,

— *Localization of management* — This goes hand-in-hand with the localization of production. Wanxiang built its top management teams overseas with local managers. Except for one, all Wanxiang America teams, are locals with rich experience in the US car industry. The company is managed American-style.

— *Localization of R&D* — facilitates the intimate coordination of development, production, and marketing to adapt to local demand, and allows local talent to enlarge the company's global knowledge pool. According to the US Department of Commerce, 375 multinational enterprises had established 715 R&D centers in the United States by the end of 1999, supporting the proposition of growing localization of R&D abroad. At the same time, Microsoft, Bell, and other foreign multinational enterprises are doing the opposite, that is localizing their R&D centers in China.

— *Localization of human resources* — This is the core element of the localization process. By the end of 1998, multinationals had some 35 million employees working globally. Experience shows the limitation of an internationalization process based on expatriate employees. This is not only costly, but also fosters imperfect communication with local employees, government, suppliers, and customers. To avoid this weakness, Chinese emerging multinationals will have to seriously invest in the development of local staff.

Chinese Companies Alternative Internationalization Processes

"The Easy Way First"

The "easy way first" means investing first in emerging markets (Figure 1.2). By 2004, there were over 6,000 overseas subsidiaries owned by Chinese enterprises in over 160 countries and regions, with Hong Kong and Macau alone accounting for 2,185 of them — or 35 percent — of the total number. The rest were scattered in developing markets of Asia, Europe, and South America. For example, Huawei set up key subsidiaries in developing countries and regions. China has many SMEs which are good at investing in small-scale, labor-intensive projects. Such projects are easy to handle and production can be shifted locally in virtually no time. They can meet the needs of emerging markets. Large enterprises can first try their hand at directly investing in developing countries. After accumulating enough experience, they can proceed to more developed markets in America, Europe and Japan to further enhance their own competitiveness.

SMEs have more difficulties in implementing global strategies. To minimize these difficulties, they could build strategic alliances with one another, or enter into stable, cooperative relations with large enterprises so as to share resources,

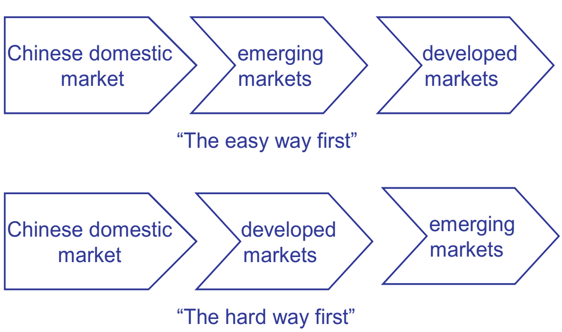

Figure 1.2: Investment priorities: emerging markets versus developed markets.

risks and profits. This would be a shortcut to explore the global market and an important strategy for international specialization. TCL is a typical example of the implementation of such a model. During the early stages of its globalization process, it entered Southeast Asian market such as Vietnam and the Philippines, whose cultural backgrounds are similar to China. It then expanded into developed countries step-by-step, through large-scale acquisitions.

Such a model could be implemented with low risks and high profits for three reasons. Firstly, it enables Chinese enterprises to expand their scale by releasing excess production into the global market. Secondly, it enables Chinese enterprises to accumulate experience in globalization, to recruit and train specialists in international business, and to learn foreign trade rules. Lastly, it avoids any large-scale investment and waste of resources. This model yielded positive results for TCL whose overseas sales grew from US$716 million to US$1.16 billion in 2002.

However, this strategy has two limitations. First, in emerging markets and especially in Southeast Asia, Japanese companies occupy the upper segments of the market, leaving the middle and lower segments to Chinese manufacturers. These segments are less profitable and sometimes Chinese companies are left with little or no profit.

Second, the presence of Chinese companies in emerging markets might have a negative impact on their brand image when they enter the European and North American markets.

"The Hard Way First"

The "hard way first" means investing first in developed markets. That was the case for Haier, which had clear ambitions in the USA and in Europe, as illustrated by the founding of Haier America and the opening of a plant in the USA (1999), and the creation of Haier Europe and acquisition of a factory in Italy (2000).

The Chinese market was saturated, so Haier positioned itself to enter developed markets and face the intense competition there. The success in these countries would then ease entry or growth in emerging markets.

Evidently, not all Chinese companies have the ability to follow this model. It requires a strong brand and capabilities of innovation since brand and products are the key success factors. It requires also strong financial resources because it takes a long time, especially in a country with a different cultural background, to create awareness of new brands among local customers. Without sufficient financial resources, the strategy cannot be sustainable and could lead to serious losses.

Thus the risks arising from this model might be too high for most Chinese enterprises. It is rather difficult for a country which is not a technological leader to export to the most developed markets. On the other hand, a few companies such as Haier are already mastering the necessary combination of resources — brands, product development capabilities, and financial resources — to successfully penetrate the very competitive but mature and regulated European and US markets.

The Gradual Development Process

According to their specific goals and their unique combination of resources, Chinese enterprises can choose different foreign market entry modes.

The traditional stages of the internationalization process cove exporting, licensing, entering strategic alliances, acquisitions, and creating new wholly-owned foreign subsidiaries (Hitt, 2002). Chinese companies in the early stages of their internationalization operate mainly along the first three stages. More mature companies go on to stage four and five if they have higher ambitions of international market share and when they have accumulated the appropriate resources (Figure 1.3).

Generally speaking, most Chinese companies choose the “easy way first” approach by starting to focus on emerging markets before progressively moving up the ladder through acquisitions and wholly-owned subsidiaries in developed markets.

Conclusion: Challenges Faced by Emerging Chinese Multinationals

Emerging Chinese multinationals have successfully entered the first stages of their internationalization process, but will need time to catch up with leading

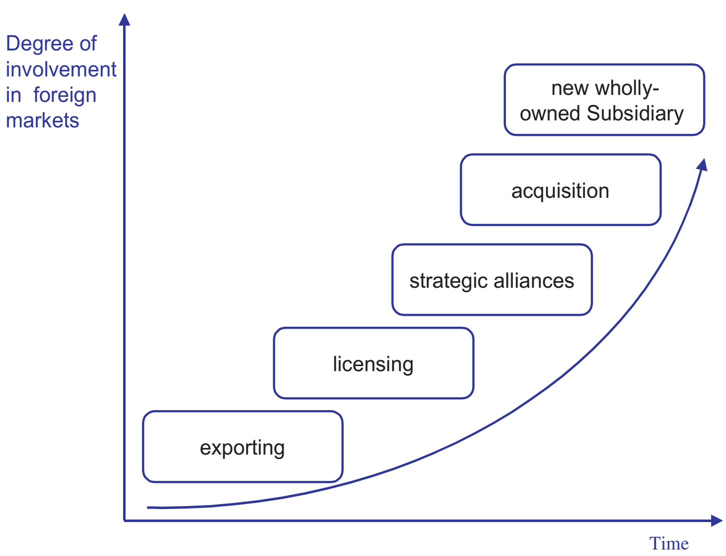

Figure 1.3: The gradual development process.
Source: Adapted from Hitt (2002).

multinationals. Many companies already face serious troubles in their investment overseas. Some of them have not delivered on their announcements, while others are still struggling on the global scene. They still face a series of challenges in their "go-global" strategy.

- Chinese enterprises lack sufficient financing to compete in overseas markets. Abundant financial resources are needed for marketing, advertising, communication, and distribution. Chinese companies do not have the same resources as established multinationals.
- Emerging Chinese multinationals still have difficulties with money transfers because of the restrictions and lengthy foreign exchange procedures. Managers of private companies such as Huawei are not even able to travel easily for business due to visa procedures.
- Emerging Chinese multinationals are not yet fully familiar with the foreign investment environment and thus face high risks. The majority of Chinese companies target emerging markets which are characterized by relative instability in economic policy, credit, and security. This results in higher risks than developed markets. Furthermore, insurance mechanisms are not yet sufficiently developed in those countries.
- Emerging Chinese multinationals do not always have a sustainable competitive advantage. They have less management experience and R&D capabilities than other multinationals. Additionally, only a few companies are mastering their core technology. The majority of the companies are still competing on low cost, which is not sustainable in the long term because of increase in Chinese labor costs and competition from other countries.
- China's competitiveness is limited by its lack of high technology and innovation. Among non-trade overseas investments, nearly 40 percent are labor-intensive projects with low added value and technology. The demand for such projects is not growing in the global market, which leaves little room for expansion. In China's large and medium-scale enterprises, R&D expenses account for only 1 percent to 2 percent of sales. The 500 biggest companies spend between 5 percent and 20 percent on R&D. Currently, two thirds of the large and medium-scale SOEs have not set up their own R&D departments.
- Emerging Chinese multinationals do not have many well-reputed brands. According to a survey completed by the United Nations Industrial Development Organization (UNIDO), famous brands represent only 3 percent of brand names but have a market share of over 40 percent. There is no Chinese brand among the top 50 brands worldwide.
- Chinese emerging multinationals lack management professionals and have to further develop their entrepreneurial and managerial skills.

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