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# **Strategic Management of China Local Knowledge:**

## **European Multinationals in China**

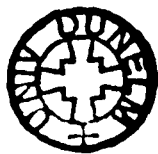
**Shenxue Li**

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**University of Durham**

Durham Business School

2004



**30 SEP 2004**

**Dissertation submitted in partial fulfilment of the requirements for the Ph.D. degree**

Dedicated to my son, Matthew, who was born and grew in the course of this study.

## Abstract

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### Strategic Management of China Local Knowledge: European Multinational in China

**Key words:** local knowledge, knowledge management, multinational, China

*Shenxue Li*

China has been attracting significant foreign investment since it opened up. Yet, foreign investors' performance in this strategic market has been variable. Previous literature does not fully investigate the causes and forces that explain their performance differences. This study contributes to our understanding of this issue by looking into the role of local knowledge and investigating its management strategies. It examines the concept and the nature of local knowledge, identifies local knowledge sources, explores the local knowledge management process, and investigates its implementation in terms of resistances and strategies.

The study first advances a general framework of knowledge management. It then introduces the key argument of this theoretical framework into the Chinese business context and develops a theoretical model of strategic management of China local knowledge, from which eight qualitative hypotheses are derived.

A multi-method qualitative empirical study was undertaken in order to examine the concept of local knowledge and investigate how local knowledge was actually exploited by multinational firms. Eleven face-to-face interviews with managers from 11 European multinationals in 10 sectors, field observation of 2 Chinese projects involving 6 European companies, and 17 multi-level interviews with local managers from 4 Chinese organizations were conducted.

The empirical findings were compared with the key arguments of the theoretical model in order to assess the extent to which they support the theoretical stand, and propose a justified model of strategic management of China local knowledge.

It is concluded that the findings supported many, but not all, of the theoretical arguments. The most striking findings are as follows:

First, unlike global knowledge transferred to China market, which is codified and accessible, China local knowledge is highly tacit, undiffused and fast-changing. It is this intrinsic and fast-changing nature of China local knowledge determines its greater impact upon the multinational firm's business performance in this dynamic market.

Second, local knowledge cannot be effectively managed unless specific management conditions are created. These conditions include common knowledge, multi-layered knowledge interfaces, and a 'pull and push' system.

Third, knowledge transfer is not an optimal choice of managing local knowledge; to exploit the full value of local knowledge both knowledge transfer approach and knowledge integration mechanism should be employed.



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This study has benefited very greatly from the comments and support generously given by the numerous European expatriates and Chinese managers of 18 European companies and 5 Chinese organizations in China. Without their sincere help and co-operation I would not have had the empirical evidences relevant to this study. I am very grateful to them all.

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## **Declaration**

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This dissertation is the result of my own work and includes nothing which is the outcome of work done in collaboration.



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# Chapter One

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## Introduction: The Quest for Competitive Advantage in China

“The majority of foreign direct investments are missing their original profit targets in China. ... Just 31 percent reported that their profitability levels were on target, and another 17 percent reported that their profitability was ‘better’ or ‘much better’ than targeted. The rest, 52 percent, failed to reach their profitability goals. Reaching Western levels of profitability in China, in virtually all industry sectors, continues to be a challenge.”

*(A.T. Kearney China Profitability Survey, 1998)*

### 1.1 Objective of the Study

This thesis presents a study of local knowledge and its management strategies in China. The study seeks to understand the causes and forces that explain performance differences between multinational firms in the Chinese market. It explores local competitive advantage by studying management strategies for mitigating the local knowledge disadvantage faced by foreign investors.

The study firstly examines the concept of local knowledge and its nature. Previous studies suggest that the location-based disadvantage, local knowledge disadvantage in particular, faced by foreign investors can greatly impede effective decision-making and threaten performance.<sup>1</sup> However, much research on management strategies for mitigating such a disadvantage has focused upon how multinational firms can create and sustain ownership advantage, home-based technology and management practices that can be transferred to host markets, assuming that local knowledge disadvantage faced by foreign investors in

host markets can be offset by their ownership advantages.<sup>2</sup> The puzzle, however, is that why a large proportion of multinational firms with established global strengths do not reach their full potential in China. Does this suggest that the dominant proposition about the multinational firm's cross-border business strategy is not tenable in the case of China? Certain scholars (for example, Lord and Ranft, 2000; Makino and Delios, 1996; Tsang, 2002; Tayeb, 1998) have addressed a reverse knowledge diffusion approach to tapping the value of local knowledge by looking at the local and cultural specific business context in international markets. However, such studies are relatively fewer, and rarely conducted in the China business context. Studies on organizational learning in China (e.g. Antal et al., 1999; Lee, 1999; Lindholm, 1997) are generally limited to the simple acknowledgement of the importance of managing local knowledge and who expatriate managers could learn from. However, they left the question about to what degree local knowledge can be learnt unanswered, and the means through which multinationals could manage the learning process almost untouched. The reason for this imbalance may stem from an over-emphasis upon the role of the multinational firm in transferring know-how and expertise gained in its home market to host markets at low cost, and thereby offsetting the unavoidable extra costs of doing business in a foreign country, which has been dominant in the international business literature. However, some researchers such as Tayeb (1992; 1999) have found that local and cultural specific factors not only impose difficulties for foreign business conduct but also affect successful transfer of home-based management practices. This may further suggest that local knowledge, the relatively less explored intangible factor, is a key competitive advantage in international markets. It is, therefore, the objective of this study to discover whether and why it is a key source of competitive advantage in the China market through examining the concept of local knowledge and its nature.

Secondly, the study identifies local knowledge holders. Within the local knowledge management literature, the scope of local knowledge management has not been fully determined thus far. Who are the main local knowledge holders? What unit of analysis is appropriate to address the entire local knowledge management issue? Researchers in international business often look at learning effects from joint ventures (Doz, 1996; Hamel, 1991; Inkpen, 1998; Lyles, 1988; Makino and Delios, 1996; Parkhe, 1991; Richter and Vettel, 1995) and internal knowledge transfer (for example, Lord and Ranft, 2000; Tayeb, 1998; Tsang, 2002). Other potential local knowledge sources essential to international business conduct have not been equally well explored. However, in order to develop local competitive advantage it is crucial for the multinational firm to explore strategies towards the full exploitation of local knowledge sources. It is, thus, the objective of this study to determine who should be managed.

Thirdly, the study investigates what management process can be employed to develop competitive advantage from local knowledge. The field of knowledge management is still in its infancy. On the one hand, there is still a lack of agreement on what constitutes strategically valuable knowledge (Eisenhardt and Santos, 2002), making it difficult for management to gain strategic focus. On the other hand, there is no agreement on how tacit knowledge is actually best managed in the knowledge management literature itself, even though its importance is recognised. There are possibly two competing approaches towards tacit knowledge management. Scholars such as Nonaka (1991; 2002) and Teece (2000) argue for the knowledge transfer approach while others such as Grant (1996; 1997; 2002) and Spender (2002) emphasize integration mechanisms while grounding their arguments upon management efficiency gains. '*Whether extensive knowledge transfer is strategically wise?*' (Eisenhardt and Santos, 2002, p.152). There is not much additional insight, especially empirical evidence, regarding this important issue (op cit). It is the objective of

this study to find out what constitutes the multinational firm's valuable knowledge and how such knowledge is created.

Finally, the research identifies the management barriers constraining local knowledge management process, and investigates the conditions under which those constraints might be overcome. Many studies explore knowledge management process models (e.g. Grant, 1996a; Nonaka, 1991; 2002;) without paying attention to the human factors in knowledge management process which might hinder its implementation, especially in an international business context where cultural issues prevail (Almeida et al., 2002; Joynt and Warner, 2002; Tayeb, 1992; 1996). How do knowledge holders in China differ from those in other markets from a cultural point of view? Do these cultural differentials necessarily impede local knowledge management process? Could those factors be better managed and how? The answers to these questions should be instructive to successfully exploit the full potential of local knowledge sources. It is again the objective of this study to identify the historical and cultural traits of local knowledge holders that pose particular difficulties in the management process and explore strategic means for resolving them.

Methodologically, this study employs a qualitative multi-method. Much previous knowledge management strategy research has used theoretical deduction and survey methods, which are unrealistically limited in exploring the 'soft', exploratory, and difficult-to-measure local knowledge management issues in China. It is also the objective of this study to show how the use of a qualitative multi-method allows greater understanding of human and social interactions that convey and use knowledge within and beyond the multinational firm.

## 1.2 Sino-European Business and Research Questions

Sino-European business has been selected as the research context in which the research questions are investigated for the following reasons.

Firstly, China, an immense nation with more than a fifth of the world's population and two decades' stunning economic growth, is increasingly eyed as '*a trove in the world where the treasure has dried up*' (Leander, 2001, p.1). It became the world's largest recipient of foreign direct investment (FDI) for the first time in 2002 (OECD Observer, 2003). Being second in the row of major attractions to FDI it has been the place for corporate grand strategy<sup>3</sup>. The recent increase in utilized FDI in China clearly signals the increased interest of foreign investors.<sup>4</sup> It is the belief that China's '*unparalleled potential*' (Studwell, 2003), WTO membership, and its long-committed social economic reforms will generate more future business opportunities for multinationals and make China a more competitive environment, which fuels multinational enterprises' sustained investment enthusiasm<sup>5</sup>. Viewing at its strategic position and potential in the world the European Union (EU) policy has been finely-tuned towards engagement with China.<sup>6</sup> As a result, European companies espoused greater investment interest in this market compared to their American and Japanese rivals in 2000.<sup>7</sup> Germany alone was among the top six foreign investors in 2002.<sup>8</sup> In the first quarter of 2003 European FDI in China was up by 77.7%.<sup>9</sup> Established in relatively small countries with demonstrated technological and managerial strengths certain European companies have a long history of international business interest. China's recent rise has created fresh business opportunities beyond anything anticipated before, and thus new managerial challenges as well. However, many have accumulated substantial China experience that could still be useful to those who have struggled since. Already, in some sectors of China economy, its most unprotected sectors in particular, some European

multinationals are becoming a dominant force, like, for example, Ericsson and Nokia in telecommunication equipment, Siemens and ABB in electronics, and Novartis in pharmaceuticals. It is the aim of this study to investigate those emerging best practices which might be beneficial to other European investors and beyond.

Secondly, foreign investors' success rate in this strategic market has been lower than in Western markets (A.T. Kearney China Profitability Survey, 1998). European multinationals have experienced even lower success rates.<sup>10</sup> However, Lawrence's (2000) China risk assessment indicates that China market is not riskier than other markets. Rather, it is suggested that there has been a lack of understanding of local issues among Western companies, particularly European multinationals (Beamish and Jiang, 2002; Imamura, 1999). Some researchers (for example, Pan, 1994; Ritchie, 1997) have found that European multinationals face more difficult challenges in China than their Japanese, Offshore Chinese, and even sometimes American rivals because of their less distinctive roots in China, more diversified cultural background, and apparently conservative traditions. Fundamental differences between business practices in Mainland China and Europe, which go far beyond the explicit hurdles of languages and legal differences, pose significant difficulties for Europeans when deciding upon the most appropriate approaches to exploiting the China market and adapting to its host business system (Dickenson et al., 2000). Such difficulties are potentially exacerbated by the intrinsic nature of local knowledge stemming from under-developed communication infrastructure, imperfect administration systems, and the local tradition of implicit communication (Worm and Frankenstein, 2000). In addition, with a strong emphasis on technology many European investors often under-estimate the impacts of local knowledge on business performance. Some indeed hold the perception that they can hardly learn anything from any such developing country<sup>11</sup>. Nevertheless, the fact that their existing key capabilities may no

longer be their best practices under new and more dynamic business context can help explain the reason for their underperformance. Hence, there is the need for European multinationals to understand the nature of China local knowledge, its impacts on Sino-European business operation, and its management strategies. To this end, this research will focus upon investigation into the following questions:

1. What is China local knowledge? (its exact scope, classification and nature)
2. Is local knowledge a key source of competitive advantage in China market?
3. Who are the local knowledge holders?
4. How to develop competitive advantage from local knowledge sources?
5. What are the likely management barriers?
6. What are the conditions for effective local knowledge management?

### **1.3 Methodology**

In order to achieve its objectives, the research methodology followed an inductive and qualitative approach because knowledge and the interactions which convey it are not immediately fully measurable. The core of the study is based on multiple methods encompassing multi-level face-to-face interviews with managers of three Chinese organisations, single-level face-to-face interviews with managers in eleven European multinationals, and further field observations involving six European and two Chinese firms. Each sub-method put the emphasis upon certain particular issues. In addition, the research drew upon supportive data about the nature of local knowledge through conducting an in-depth interview with the director of a research institute acting as the central information centre of its industry. In order to reach more generalisable conclusions



to inform both theory and practice the research included European multinationals from eight countries and ten sectors. In-depth discussions of the selection of the sample can be found in Chapter 4. To alleviate unduly biased interpretation of data the research results were sent back to selected interviewees for insightful comment and confirmation regarding key issues raised. This produced richer data with less biased results, more suitable for local knowledge management - a 'soft' issue in related management theories.

## **1.4 Thesis Outline**

The thesis is structured as follows. Following Chapter 1, the guiding chapter, Chapter 2 explores how knowledge can be managed from theoretical and general point of view. It sets the stage for the analyses that follow. It reviews the concept of knowledge and its management from existing literature, and advances a theoretical framework by linking knowledge to the concept of core competencies which impact most upon business performance. It identifies knowledge underpinning core competencies to suggest the firm's general knowledge management strategy, a strategy that emphasises the complementary use of knowledge transfer and integration. It then argues that the firm's strategy should be built on renewal of its core competencies by introducing the concept of core rigidity and identifying the dynamic nature of core competencies themselves. The implications of this knowledge management strategy highlight the need for new knowledge, in new market territory in particular. In an international business setting this indicates the need for local knowledge and explains why firms with established strengths in home market underperform in host markets. Chapter 3 discusses the economic, industrial, political, social and cultural context within which foreign investors operate. It provides the contextual knowledge to Chapter 4, which follows. Chapter 4 attempts to investigate how

local knowledge can be managed from a theoretical point of view in the Chinese business context. It introduces the key argument developed in Chapter 2 to the China business setting and develops a theoretical model about exploiting China local knowledge. It examines the concept of China local knowledge, questions its transferability, and argues that a conventional knowledge transfer approach may not fit China's situation. It then identifies the scope of local knowledge sources and determine the unit of analysis for the theoretical model proposed thereafter. It particularly emphasises the impacts of human factors upon local knowledge management initiatives and implementation processes by analysing the main historical and cultural features of local knowledge holders, and suggests management strategies for overcoming associated barriers. Chapter 5 considers and describes the most appropriate research methods for the investigation, and argues that a qualitative approach fits in the purpose of this study, given the 'soft' nature of the issues concerned. Chapter 6 empirically examines the nature and scope of China local knowledge, and investigates the correlation between China local knowledge and Sino-European business performance. Drawing from empirical evidence it concludes that local knowledge is the key source of competitive advantage in China market. Chapter 7 empirically examines the scope of local knowledge sources, and tests the suitability of the unit of analysis used for developing the theoretical model. It argues that China local knowledge sources are highly dispersed, hence, the scope of local knowledge management involves both individuals and organisations far beyond business transactions. Chapter 8 investigates how local knowledge is actually managed by European multinationals. My inquiry focuses on the strategic management process of local knowledge, the management barriers hindering its effectiveness, and the management conditions under which constraints are overcome. Drawing from empirical evidence it argues that knowledge transfer is not an optimal choice of exploiting China local knowledge; to realise the full value of China local knowledge knowledge integration should be employed as well. Therefore, knowledge

management strategies need to be more context-specific. This provides insights into the transfer-or-integration dilemma revealed in the literature. Chapter 9 draws together the key arguments from both the theoretical examination and empirical findings to argue how local knowledge should be managed in China and presents a justified local knowledge management model which can inform both theory and practice. Chapter 10, the concluding chapter, brings together the main research findings and assesses what has been learnt, followed by a discussion of the implications of this study and its limitations, as well as suggestions for further research.

## **1.5 Contribution of the Study**

The study will make substantive as well as methodological contributions to the unexplored conceptual issue of strategic management of China local knowledge, and thus redress the gaps revealed in both the knowledge management and international business literature, and move relevant theoretical knowledge forward.

Substantively, this study will, first of all, argue that the multinational firm's business success in China is largely determined by its local knowledge of the host market. It will show how a multinational firm with superior home-based strength fails to realize its potential in a new territory because of a lack of local knowledge. It will empirically test the proposition that local knowledge, by nature, differs significantly from global knowledge, technology and management methods in particular, transferred to the China market. It will examine the concept and nature of local knowledge and argue that local knowledge is highly tacit, undiffused, and fast-evolving. It is this intrinsic and fast-changing nature of

local knowledge that determines its greater impact upon multinational firm's business success.

Secondly, it will explore what type of knowledge management process fits the characteristics of local knowledge. It will argue and provide empirical support to the contention that conventional knowledge transfer is not an optimal choice for overcoming local knowledge disadvantage in China. It will show that knowledge integration can complement knowledge transfer. This search for context-specific management strategies aims at providing insights into the transfer-or-integration contradiction revealed in the existing literature. It will identify and show what knowledge has particular strategic value, and how firm strategies need to align with management focus in the case of China.

Thirdly, it will empirically examine the scope of local knowledge sources and argue that local knowledge holders include people and organizations beyond business transactions. This may suggest that past studies that solely focus on learning effect from joint ventures or internal knowledge transfer is unrealistically limited.

Finally, it will identify the historical and cultural traits of local knowledge holders that pose particular difficulties in the management process and explore strategic means for resolving them. It will investigate and illustrate how those deep-rooted features can impede knowledge flow and integration in multinationals and consider what measures can/should be taken to resolve the problems. It will argue that human factors, which have been neglected in conventional knowledge management studies, do affect the outcome of knowledge management initiatives.

The arguments will be based upon a theoretical model developed before fieldwork and empirical investigation. By assessing the defensibility of the theoretical model in the face of empirical evidence, and analysing the limitations of that empirical work, it offers a revised management model of China local knowledge which can better inform both theory and practice. In this model, the multinational firm first maps what knowledge it possesses and what knowledge needs to be managed. Second, it identifies local knowledge holders, and locates the rooted knowledge communication barriers. Third, it creates management conditions for its knowledge management initiatives. This includes establishment of multi-layered knowledge platforms and the creation of common knowledge between communicators, followed by the establishment of a 'pull and push' system for resolving the rooted cultural huddles. Finally, it strategically exploits the full value of local knowledge. It emphasises that knowledge transfer approach is limited; in order to realize the full value of local knowledge, both knowledge transfer and knowledge integration mechanisms should be employed.

Methodologically, an important contribution of this study is the use of a qualitative multi-method that allows greater understanding of human and social interactions that convey and use knowledge within and beyond the multinational firm. It is argued that a quantitative approach would be unrealistically limited in exploring the 'soft', exploratory, and difficult-to-measure local knowledge management issues in China.

## Notes

<sup>1</sup> See, for example, Buckley and Casson (1976), Calhoun (2002), Caves (1982), Dunning (1977), Hennart (1982), Hymer (1976), Johanson and Vahlne (1977), Johanson and Wiedersheim-Paul (1975), Lord and Ranft (2000), Luo et al (2002), Mezas (2002), Miller and Parkhe (2002), Miller and Richards (2002), Petersen and Pedersen (2002), Sethi and Guisinger (2002), Welch and Wiedersheim-Paul (1980), Zaheer (1995), Zaheer and Mosakowski (1997).

<sup>2</sup> See, for example, Buckley and Casson (1976), Caves (1982), Dunning (1977, 1988, 1993), Hennart (1982), Kogut and Zander (1993), Porter (1986).

<sup>3</sup> According to the latest FDI Confidence Index, conducted by the global-management consulting firm A. T. Kearney (Feb. 2001), China gained the spot as the second most attractive target for FDI, just after USA.

<sup>4</sup> 'China rises to world sixth place in soliciting foreign capital' (People Daily, 18 September 2002); the Ministry of Foreign Trade and Economic Corporation reported that utilized FDI in 2002 reached USD52.7bn, up 12.51% year-on-year growth (Foreign Direct Investment in China, Bank of China Group, 1 January, 2003; Agencies, 26 August 2003); China used US\$33.35 billion of FDI in the first seven months of 2003, a rise of 26.63 percent year-on-year growth (Shanghai Daily, 5 September 2003).

<sup>5</sup> See, for example, The Economist (10 March 2001).

<sup>6</sup> See, for example, "EU Strategy towards China: Implementation of the 1998 communication and future steps for a more effective EU policy". (2001, 15 May). *Communication from the Commission to the Council and the European Parliament* (COM (2001) 265 final), Commission of the European Communities; "Report on the implementation of the communication 'Building a comprehensive partnership with China'". (2000, 8 September) *Report from the Commission to the Council and the European Parliament* (COM (2000) 552 final), Commission of the European Communities; "A maturing partnership: Shared interests and challenges in EU-China relations". (2003, 10 September). *Commission Policy Paper for Transmission to the Council and the European Parliament* (COM(2003) 533 final); "EU official: China to be second trade partner this year". *People's Daily*, 19 July, 2003.

<sup>7</sup> See "EU Strategy towards China: Implementation of the 1998 Communication and future steps for a more Effective EU Policy". (2001, 15 May). *Communication from the Commission to the Council and the European Parliament*. COM (2001) 265 final. Commission of the European Communities.

<sup>8</sup> According to the National Bureau of Statistics (8 July 2003), Germany and United Kingdom were respectively top 6 and 7 foreign investors in 2002.

<sup>9</sup> See "A maturing partnership: Shared interests and challenges in EU-China relations". (2003, 10 September). *Commission Policy Paper for Transmission to the Council and the European Parliament* (COM(2003) 533 final).

<sup>10</sup> See, for example, Investment Survey (1998). This was further proved through interviewing the country president of Multinational 11 on 26<sup>th</sup> Nov. 2001.

<sup>11</sup> See, Li, S. (1999) 'Strategic Consideration for German Meat Industry Suppliers to Expand to China.' Unpublished MBA dissertation, Nottingham University, UK. This point was also revealed from Goodall and Warner's (2002) study.

## Chapter Two

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### Developing Competitive Advantage from Knowledge: A General Framework

“In an economy where the only certainty is uncertainty, the one sure source of lasting competitive advantage is knowledge.”

*(Nonaka, 1991, p.96)*

“If the knowledge creation process is not managed, core competency and ability to sustain competitive advantage are diluted.”

*(Fiddis, 1998, p.19)*

#### 2.1 Introduction

Competitive advantage is at the heart of a firm’s performance in competitive markets. In the study of competitive strategies, focus on the structure-conduct-performance paradigm of the industrial organisation (IO) view of the firm,<sup>1</sup> has given rise to a stream of perspectives some scholars have referred to as *internal competencies of the firm*.<sup>2</sup> In these internal views, competitive advantage is rooted inside the firm, in competencies and resources that are valuable and inimitable.<sup>3</sup> They question the IO view by pointing out that the positioning perspective relies on a static picture of competition and thus understates the role of innovation that can revolutionise industry structure, and that it over-emphasises the importance of industry structure and the wider environment while simultaneously de-emphasising the significance of individual company differences in the possession of resources and competencies, the crucial means to fulfil the strategic objectives.<sup>4</sup>

According to Conner (1991) and Rumelt (1991) industry structure alone can only explain little of the variance in profit rates across companies.

Such a shift of research interest signals not only the need for understanding the internal drivers of sustained competitive advantage but also the quest for strategic means with which the firm develops its fundamental abilities to innovate and compete. The knowledge-based view of the firm, focusing on the critical intangible resource, knowledge, claims to meet such a challenge.<sup>5</sup> It sees the firm as a repository of knowledge sources and capabilities that are unique and difficult to imitate. Companies that have developed critical knowledge underpinning *core competencies* are able to provide more value to their customers and, thus, outplay their competitors.

However, as already found by researchers such as Eisenhardt and Santos (2002), research into this knowledge-based view is not consistent about how knowledge is conceptualized and measured, and it is unclear what constitutes valuable knowledge. Consequently, knowledge management strategies for achieving competitive advantage can appear vague (Davenport, 1999). The field of knowledge management strategy is arguably separated into two radically distinct domains – one in which it is maintained<sup>6</sup> that knowledge should be transferred,<sup>7</sup> and a second domain wherein writers such as Grant (1996a; 1996b; 1997) and Spender (1996b; 2002) emphasize the knowledge integration mechanism by grounding their arguments upon management efficiency. Should knowledge be transferred or integrated? Is extensive knowledge transfer really strategically wise?<sup>8</sup> There is still much to be explored about such critical issues. The objective of this chapter is to address these questions and develop a conceptual framework as the foundation for the theoretical model of exploiting China local knowledge developed in Chapter 4. It reviews the concept of knowledge to show its complexity and how diverse views on knowledge have led to



parallel but different management initiatives. It then reviews the concept of *core competency*, and its roots in resource-based view and knowledge-based perspective, aiming at identifying the critical knowledge that underpins it. The subsequent section reviews the main studies about knowledge management strategy, highlights the problems of the existing literature, and proposes a modified knowledge management framework regarding the strategic means with which the firm can build core competencies. This shows that the knowledge transfer approach towards managing knowledge is limited; to exploit the full value of knowledge both a knowledge transfer approach and knowledge integration mechanism should be employed. This key argument is introduced into the China business setting in Chapter 4 in order to develop a theoretical model of strategic management of China local knowledge. It ends by analysing the performance issue faced by the firm in a new business environment and proposing a strategic focus model to indicate the firm's need for new knowledge. It pinpoints that the firm's strategy should be built on renewal of its core competencies. This implies the multinational firm's international management strategy and forms the starting point for the arguments on China local knowledge management strategies that follow.

## **2.2 Knowledge and Knowledge Management Initiatives**

*Knowledge* is a centuries old and intrinsically ambiguous and equivocal concept. Despite the universal and historical recognition that '*knowledge is power*'<sup>9</sup>, no one common definition for this intangible factor exists. Philosophers and researchers define it from respective viewpoints. Traditionally, knowledge is defined as '*justified true belief*'<sup>10</sup>. However, the traditional Western epistemology pays particular emphasis on '*truth*' (Nonaka, 1994), while the '*constructionist perspective*' (Alvesson, 1993; Tsoukas, 1996),

which is fundamentally rooted in cognitive psychology and sociology (Eisenhardt and Sandos, 2002), promotes a personal, social and cultural view of knowledge.<sup>11</sup> The former sees knowledge as *'facts'*, not open to social interpretation (Bell, 1973; Lave and Wenger, 1991). In this view, knowledge is explicit, capable of being coded and stored, and transmitted to others (Dretske, 1981; Morgan, 1986; Taylor, 1911). Management initiatives following this scientific view of knowledge are limited to acquisition and assimilation (McAdam and McCreedy, 2000). In the high-tech era, the boom of IT-based solution packages is driven by such an information-processing perspective. The latter, however, views knowledge as *'half truth'*, context-specific, and subject to human interpretation (Blackler, 1993; 1995; Boisot, 2002; Clegg et al, 1996; Gioia and Ford, 1996; Lawson and Appignaneri, 1989; Reich, 1991). In this perspective, knowledge is tacit, stored in people's heads, and not easy to share with others (Chataway and Wield, 2000; Clark, 1993; 1995; Grant, 1996a; Kogut and Zander, 1993; Nonaka; 1991; Starbuck, 1992). Management initiatives following this social view of knowledge approach the tactical level and emphasise the need for social interactions and the knowing process.<sup>12</sup>

In addition, certain scholars (e.g. Grant, 1996a; Kim, 1993; Nonaka, 1994; Simon, 1991; Sparrow, 1998) view knowledge as an individual asset while others consider that knowledge has a collective dimension (e.g. Blackler, 1995; Glynn, 1996; Lam, 2000; Spender, 1996a; Tell, 1997; Walsh and Ungson, 1991). The former highlights human interaction while the later emphasises organisational learning.

One widely accepted knowledge taxonomy is the distinction between tacit and explicit knowledge. Based on Polanyi's (1958; 1966) original philosophical work on knowledge, scholars tend to accept that knowledge is either tacit or explicit. This is consistent with the practical perspective on knowledge that perceives explicit knowledge as *'know what'*,

which can circulate among population with relative ease, and tacit knowledge as '*know how*', which is hard to spread or copy (Fiddis, 1998). Though this taxonomy was derived from Polanyi's description on the concepts of tacit and explicit knowledge it is arguably a partial and static view of knowledge. Such a deficiency lies in misunderstanding of Polanyi's illustration of knowledge. He sees knowledge as a spectrum, with tacit and explicit knowledge at the two ends. Most knowledge therefore falls in between. Based on this more holistic view of knowledge Fiddis (1998) modified the definition as such:

“At the most simplistic level knowledge can be viewed as existing on a spectrum. At one end of the spectrum knowledge is totally tacit and held in the minds of people, it is therefore difficult to access. At the other end of the spectrum, knowledge is codified, structured and explicit and is easily accessible by others.”

(p. 1)

In order to explore the management strategies for exploiting the full value of knowledge this study adopts this wider view of knowledge.

However, within this definition there is another ambiguity that has led to diverse viewpoints on managing knowledge. Some (e.g. Brockmann and Anthony, 2002; Nonaka and Takeuchi, 1995) hold that all relevant tacit knowledge can eventually be made explicit, and thus they promote the knowledge transfer perspective. Those who question its transferability<sup>13</sup>, nevertheless, doubt whether the transfer approach is strategically wise and, accordingly, favour knowledge integration approach instead. Though both enjoy some popularity the knowledge transfer perspective has had a dominant position in the literature. Such differing viewpoints about knowledge may stem from inadequate or incomplete investigation into the concept of tacitness. This study assumes some tacit knowledge, an

individual's ability to infer meaning from sets of information, for example, is non-transferable even under specific conditions.

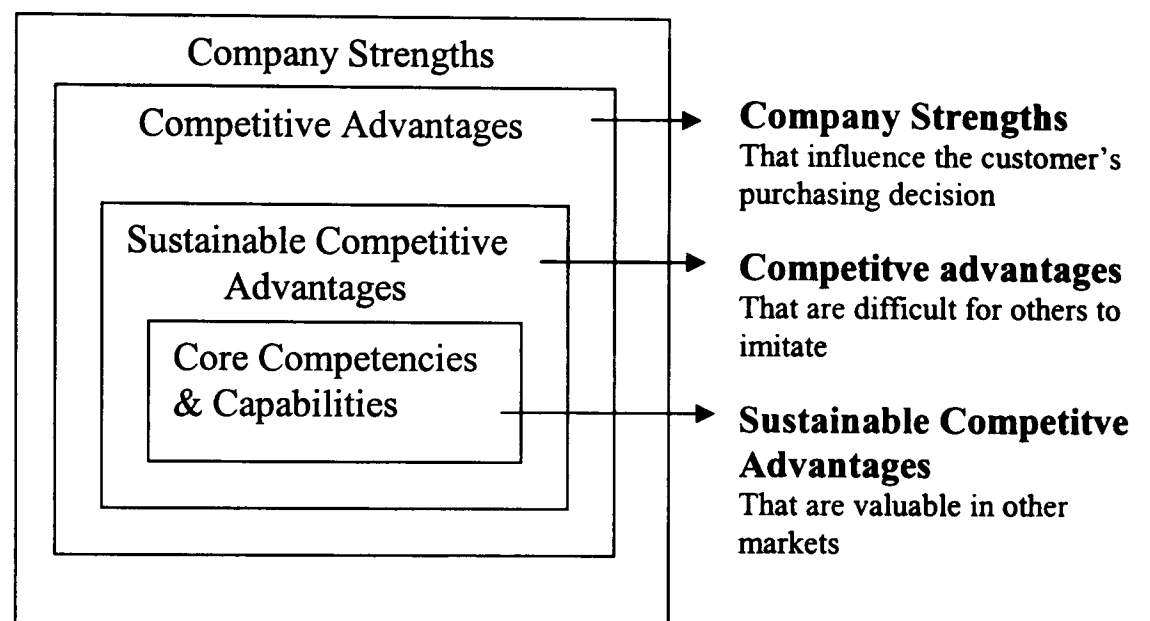
## **2.3 Knowledge and Core Competencies**

It is widely recognised among researchers and management that every firm has competencies but only core competencies have the greatest impact on its ultimate success in a competitive environment. If knowledge is the key source of competitive advantage, as asserted in the knowledge-based view, knowledge management strategies should be those that lead to the creation of core competencies of the firm. Yet, it is unclear from previous studies what knowledge underpins core competencies. Consequently, it is unclear what knowledge management strategies position the firm at the competitive edge. It is the aim of this section to identify such critical knowledge through examining the concept of core competency and its roots in resource-based view and knowledge-based view.

### **2.3.1 Definitions of Core Competency**

Researchers for the past forty years have failed to agree on a common definition for the concept of core competency, the key competitive factor. It has been interchangeably used with core capability, distinctive competency or distinctive capability by different researchers. It first appeared and was termed '*distinctive competence*' in the management literature to refer to leadership skills (e.g. Penrose, 1959). It has been widely used since late 1980s and early 1990s to mean the resources unique, inimitable and universally applied in different markets with the emerging of resource-based view. Prahalad and Hamel (1990) defined core competencies as '*the collective learning in the organisation,*

*especially how to co-ordinate diverse production skills and integrate multiple streams of technologies'* (p.82). By quoting the example of Sony's miniaturisation they further stated that *'core competence is about harmonising streams of technology, it is also about the organisation of work and the delivery of value'* (p.82). While Stalk et al (1992) attribute organisational success to a capability that is defined as *'a set of business processes strategically understood'* (p.62). By analysing Wal-Mart's cross-docking logistic systems, Day (1994) gave capabilities a more explicit meaning - *'complex bundles of skills and collective learning exercises through organisational processes that ensure superior co-ordination of functional activities'* (p.38). He characterised *'distinctive capabilities'* valuable to customers, matched by rivals and used in different ways to *'speed the firms' adaptation to environmental change'* (p.40). Collis and Montgomery (1995) suggest that strategies should be built on *'valuable resource'* - *'an organisational capability embedded in a company's routines, processes, and culture'* (p.120). They emphasise the business context in which core competence is deployed. Tampoe (1994) made the first effort to distinguish core competency and distinctive capability by emphasising that the true competency of an organisation lies in its technical subsystem. However, this is challenged by certain authors' arguments (e.g. Day, 1994; Stalk et al, 1992) due to its vulnerable nature amid environmental change. Chen (1998) addressed two key features - tacitness and complexity to distinctive capabilities in his research but then focused on internal managerial control. Marino (1996) made a breakthrough by depicting the firm's resources as the following (Figure 2.1).

**Figure 2.1 The Organisation of Firm Resources**

Source: Marino (1996, p.43)

Although capability-approach theorists have been trying to differentiate capabilities from competencies the dividing line between them is still unclear. Nevertheless, certain researchers (e.g. Day, 1994; Marino, 1996) have suggested that both core competencies and core capabilities possess the above characteristics and, thus, are equally important to business success. In this thesis, core competencies will encompass both.

### 2.3.2 Core Competencies in Resource-based View

In the resource-based view, resources are classified as tangible and intangible. According to Grant (1991) tangible resources include financial resources and physical resources such as plant, equipment, and stocks of raw materials. Intangible resources range from intellectual property rights like patents, trademarks and copyrights to the know-how of personnel, informal networks, organisational culture and a firm's reputation (Hall, 1992). However, the dividing line between the tangible and intangible is often unclear and how

they are classified can vary from one writer to another. Nevertheless, agreement on the relative importance of the two types of resources has been achieved in spite of the problems over classification. Although it is clear that both types of resources are required for any business to operate, resource-based theorists argue that intangible resources are the most likely source of competitive advantage, because they are less visible and, therefore, difficult to understand and imitate (Hall, 1992). Consequently, the importance of intangible concepts, such as know-how (Teece, 1980), corporate culture (Barney, 1986) and reputation (Aaker, 1989) is widely recognised in work adopting the resource-based view. Hall (1992) advanced a model to identify the intangible assets which produce competitive advantage and the placement of each asset in a framework of four generic capabilities - regulatory, positional, functional and cultural - although a lack of clear boundary in the classification between functional and cultural capabilities might result in difficulties in its further application. Whether or not these intangible resources have the potential to become core competencies depends on how difficult they are for competitors to acquire and how valuable they are to the firm as a basis for competitive advantage. As Day (1994) says:

“when they are rare, difficult to imitate, non-substitutable and they allow a firm to exploit opportunities or neutralise threats, then they can be considered core competencies and serve as the basis of an organisation's sustained competitive advantage.”

(p. 41)

Therefore, the concept of 'core competency' was developed in the resource-based view to indicate the need for the resources unique, inimitable and universally applied in different markets, and evaluate the firm's strategies. However, the questions raised thereafter are what resources meet these measures for core competencies and how core competencies could be developed. The search for the answers to these questions has led to widespread recognition of the importance of managing knowledge.

### 2.3.3 Core Competencies in Knowledge-based View

In the knowledge-based view, knowledge is conceived to be the most important intangible resource. Competencies or capabilities are viewed as '*sets of knowledge that differentiate a company strategically*' (Junior and Child, 1999). The real challenge facing the firm, therefore, is to identify and develop the knowledge underpinning core capabilities.

There are many categories of knowledge, which are identified as comprising the distinctive capabilities. But according to Hall (1992) most analyses have listed aspects of employee know-how and aspects of organisational culture as key intangible assets. Nonaka's (1991) illustration on tacit knowledge explained the possible reason for this:

“There are two dimensions to tacit knowledge. The first is the technical dimension, which encompasses the kind of informal personal skills or crafts often referred to as “know-how”. The second is the cognitive dimension. It consists of beliefs, ideals, values, schemata, and mental model, which are deeply ingrained in us and which we often take for granted. While difficult to articulate, this cognitive dimension of tacit knowledge shapes the way we perceive the world.”

(p. 98)

Unlike explicit knowledge, tacit knowledge is difficult to capture and copy (Polanyi, 1962; Popper, 1972). Hence, it is a powerful source of competitive advantage (Boisot, 1995a; 1995b; 1998; Grant, 1996a; Leonard and Sensiper, 1998; Nonaka et al., 2000; Sveiby and Lloyd, 1987; von Krogh et al., 2000) and, according to Prahalad and Hamel (1990), is directly linked to core competency. However, as tacit knowledge is originated in people's heads there is the debate in the literature about whether tacit knowledge should or can be shared. Some<sup>14</sup> express the view that knowledge is of no great value unless it is shared. They further claim that individual tacit knowledge is mobile, hence, needs to be



transmitted into collective know-how. They argue that the core competency of the firm lies in its collective tacit knowledge. Others (e.g. Boisot, 1995a; 2002) hold that diffused tacit knowledge tends to *'leak away'* and core competencies are not sustainable and become diluted. Nevertheless, the latter view is under attack by a number of scholars' research (e.g. Junior and Child, 1999; McEvily, 1999; Spender, 1998). Junior and Child (1999) argue:

“when the firm's advantage is based on collective knowledge the strategic problems will be of less intensity, as nobody alone can 'take the knowledge to home', nor it is easy for competitors to imitate this knowledge, putting together a high performing team, for example.”

(p. 4)

They further state that collective know-how is more difficult to circulate and transfer, and the more it is embedded in the work practice, the less relevant is the absence of one or some of the members of this collective. Wal-Mart's success (Stalk et al., 1992) in its distinctive capability's building adds effective evidence to this point. Another example showing the strength of embedded knowledge comes from Toyota's higher quality products over GM's although they had the same standard system (Inkpen, 1998). Moreover, McEvily's (1999) research on knowledge attributes underpinning key capabilities provides additional support to this point through addressing that increased complexity of collective know-how ensures its competent nature. The notion that collective tacit knowledge constitutes the organization's core competencies also mirrors the idea of *'communities of practice'* as *'competence centres'* or *'centres of excellence'* of the organization (Brown and Duguid, 1991; Easterby-Smith et al., 2000; Moore and Birkinshaw, 1998; Weick, 1979; Wenger, 1998). These groups of individuals, that develop collective knowledge and shared understanding of their working environment and working mechanisms, resolve problems

stemming from organizational power and hierarchy and increase the organization's responsiveness to environmental change.

However, by looking at the specialised, context-specific, distributed and intrinsic nature of tacit knowledge some researchers (Almeida et al., 2002; Clark, 1995; Day, 1994; Grant, 1996a; Polanyi, 1958; Tsoukas, 1996; von Hippel, 1994) question whether all types of personal tacit knowledge can be<sup>15</sup> or are necessarily transmitted into collective know-how. Building upon this perspective certain scholars argue that integrated streams of knowledge, created by combining many areas of specialised knowledge, is '*sticky*', not easily diffused to rival organisations, and is, thus, the essence of organisational capabilities (Day, 1994; Foss and Knudsen, 1996; Junior and Child, 1999; Prahalad and Hamel, 1990; von Hippel, 1994). Similarly, by looking at the more complex nature of local knowledge in the international setting, a number of scholars (e.g. Hu, 1995; Kogut, 1991; Makino and Delios, 1996; Martin and Beaumont, 1998; Tayeb, 1998; 1999) find that some specific knowledge cannot be learnt and embedded into organisational tacit knowledge base, which also calls for an integration mechanism for specialised knowledge. For example, Tayeb (1998), in her study on transfer of HRM practices between nations, and on subsidiary – parent company relationships, found that some management practices were deeply rooted in national culture and might not always be transferable. She went on to argue that those cultural-specific aspects of management practices involved complex human interactions with one another, and thus were areas where transfer might be rather problematic.

This thesis therefore proposes that core competencies (or core capabilities) are the combination of collective tacit knowledge and integrated specialised knowledge. This is further tested in field studies presented in Chapter 8. However, theorists have also concerned with how core competencies might be acquired.

## **2.4 Creation of Core Competencies: The Role of Knowledge Management**

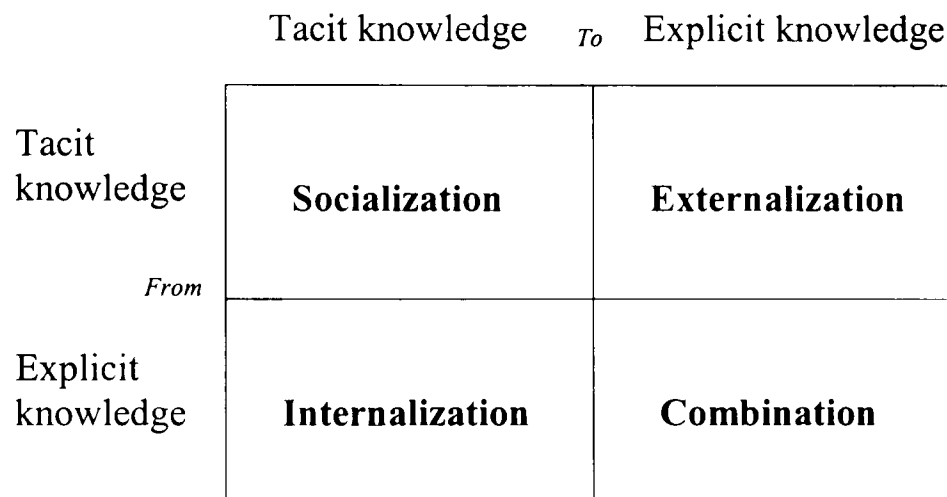
A wide range of knowledge management models were investigated for analysing key capabilities in the business and illustrating how knowledge flows or is appropriated in any system or population. As noted before, they were built on diverse views of knowledge. Some writers (e.g. Argyris and Schön, 1978; Boisot, 1987; Casey, 1993; Child, 2002; Demerest, 1997; Edmondson, 2002; Fiol and Lyles, 1985; March, 1991; Marquardt and Reynolds, 1994; Nonaka and Takeuchi, 1995; Senge, 1990) stress knowledge acquisition and collective learning, while others put greater emphasis on knowledge integration mechanisms such as internal business collaboration and group problem solving (Dougherty, 1992; Eisenhardt, 1989; Grant, 1996a; Spender, 2002), and strategic tools like alliances, licensing, mergers and acquisitions (Hamel and Prahalad, 1989) by depending their approach on the grounds of flexibility and speed. Having identified streams of knowledge underpinning the firm's core competencies, this section will focus upon exploring knowledge management strategies for creating both collective tacit knowledge and integrated specialised knowledge. The intention is to develop a conceptual framework for managing the firm's knowledge.

### **2.4.1 Creation of Collective Tacit Knowledge**

The means of facilitating the creation of collective tacit knowledge has been widely explored in the work of several writers (e.g. Argyris, 1994; Boisot, 1995; Crossan et al., 1999; Junior and Child, 1999; Easterby-Smith et al., 1999; Nonaka, 1991; O'Dell and Grayson, 1998; Senge, 1990), drawn upon insights gained from the perspective of organisational learning (Wong, 2000). Between them, Nonaka's (1991, 1994) SECI (Socialization, Externalisation, Combination, Internalisation) model (Figure 2.2), based on

Polanyi's (1966) distinction between articulated and tacit knowledge and focused on its tacit dimension, is probably the most cited theoretical work on knowledge creation. This model illustrates how to motivate knowledge creation through bold visions of products and strategies coupled with organisational cultures that promote sharing, transparency and proactive use of knowledge. In this model, the organization continuously creates collective tacit knowledge by converting personal, tacit knowledge of individuals into shared explicit knowledge and embedding the latter into business practice. In this knowledge conversion and transfer process, externalisation and internalisation processes are identified to be crucial, as both processes require high self-commitment important for the self-transcendence, which was identified as key determination of the knowledge creation process. The internalisation of newly created knowledge is the conversion of explicit knowledge into the organisation's tacit knowledge, which was identified as embedded collective know-how, part of organisational core competencies. One important contribution of this theoretical framework is that it sees this knowledge transmission process as a dynamic knowledge creation spiral, in which new insights are constantly created by knowledge recipients and managed to sustain the firm's competitive advantage, as knowledge recipients are perceived to be creative rather than passive, so that, the knowledge transfer process is not a one-way process. This is consistent with other scholars' arguments (e.g. Brown and Duguid, 2000; Clark and Salaman, 1998). The main constraint of this model, however, is that it is based on the assumption that all tacit knowledge can be eventually converted into explicit knowledge, hence, it ignores the notion that some specific tacit knowledge may be non-transferable (Boisot, 2002; Hu, 1995; Tayeb, 1998; 1999; Winter, 1987) or the transferring process may not meet the firm's requirement for efficiency (Athanasiou and Nigh, 2000; Grant, 1996a; Spender, 2002). In addition, in business planning process individuals often make sense of diffused explicit knowledge and directly create new individual tacit knowledge, especially

specialised knowledge. In this case, diffused explicit knowledge is utilised and converted into individual tacit knowledge rather than embedded into collective tacit knowledge. This individual tacit knowledge often immediately contributes to corporate decisions through well-designed integrating systems to form the basis of corporate integrated knowledge, the other part of organisational core competencies.



**Figure 2.2 Four Modes of Knowledge Conversion**

Source: Nonaka (1994, p.19)

### 2.4.2 Creation of Corporate Integrated Knowledge

The strategic means for facilitating specialised tacit knowledge integration has been investigated by a number of scholars (e.g. Grant, 1996a; Kogut and Zander, 1992; Spender, 2002). By questioning whether all types of personal tacit knowledge can be or are necessarily transferred into collective know-how, Grant (1996a) shed the light on the specialised nature of knowledge to argue that:

“transferring knowledge is not always an efficient approach to integrating knowledge. If production requires the integration of many people’s specialist knowledge, the key to efficiency is to achieve effective integration while minimising knowledge transfer through cross learning by organisational members.”

(p. 114)

In this context he pointed to four mechanisms for integrating specialised knowledge - rules and directives, sequencing, routines, group problem solving and decision-making. Rules and directives regulate the actions among specialists. Sequencing ensures that each specialist contributes independently in a pre-assigned time slot. Routines rely on an organizational business procedure system to reconcile complex patterns of individual behaviours and business interactions between specialists. Group problem solving and decision making provide a means by which specialised individuals coordinate to deal with complex problems and varied tasks. The smooth implementation of these mechanisms is contingent upon the existence of adequate common knowledge between specialists. Moreover, Grant and other researchers (Kogut, 2000; Kogut and Zander, 1996) also extend this knowledge integration perspective beyond the firm boundaries. They emphasise the role of relational networks in integrating external knowledge with internal knowledge. In addition, certain writers (Hamel and Prahalad, 1989; Teece, 2000) have increasingly looked into strategic alliances as an important means to integrate valuable external knowledge. However, the difficulties with this approach lie in its failure in recognising that the establishment of an effective knowledge integration mechanism often requires time-consuming and resource-committed efforts. Consider the high failure rate of joint ventures and rooted problems revealed from strategic alliances. Without painstaking change of organisational culture and the establishment of sound business relationships between different parties any attempt to integrate specialised knowledge will be in vain.

### 2.4.3 A Proposed Framework of Knowledge Management Process

Though there is a separation, even conflict, between knowledge transfer approach and knowledge integration perspective in the literature it is postulated that they are not exclusive but complementary because neither alone creates the full streams of critical knowledge that underpin the firm's core competencies. In order to test this idea, this study, built on the preceding models, proposes the following knowledge management model (Figure 2.3), in which the type of knowledge underpinning core competencies is clearly indicated and the processes through which firms can gain core competencies are illustrated. The model, as a starting point of this research, is used to indicate in general why and how knowledge should and can be managed to produce the firm's competitive advantage and provide ideas on how local knowledge could be utilised. Its key argument is then applied to China business context in Chapter 4 aiming at further developing a strategic management model for foreign investors to mitigate local knowledge disadvantage.

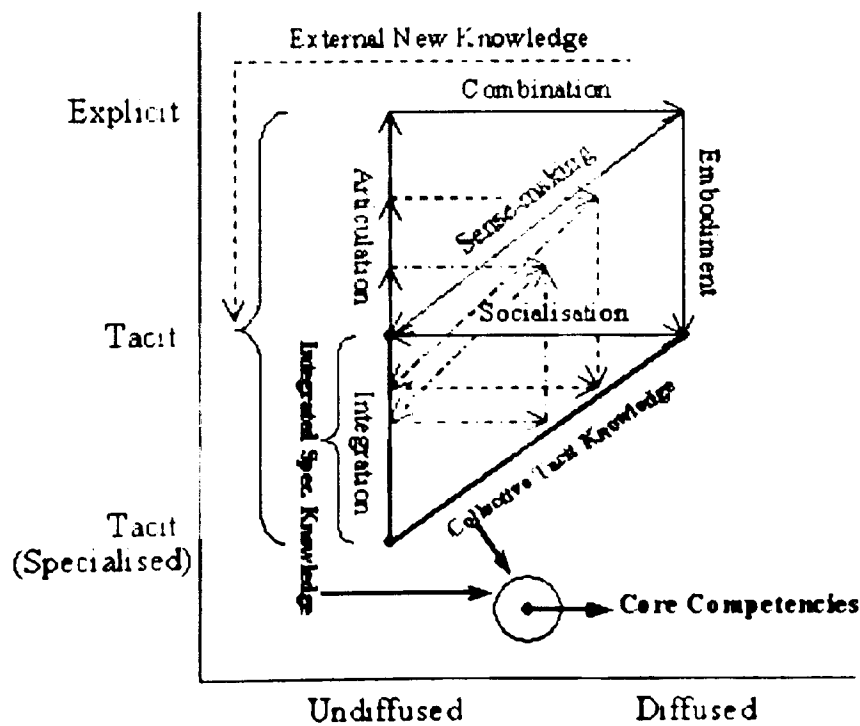


Figure 2.3 Proposed Knowledge Management Model

In this model, some transferable tacit knowledge is articulated into explicit knowledge and diffused into organisational explicit knowledge base for public use. Collective tacit knowledge is created when some corporate explicit knowledge is embedded into each individual's business behaviour or some individual tacit knowledge is directly diffused through internal socialised business activities, forming part of the core competencies of the firm. New individual tacit knowledge is created when corporate data is utilised through sense-making process during business decision-making at individual level. This category of knowledge asset can be further transferred into corporate knowledge when it is efficiently and economically transferable in the firm. Specialised tacit knowledge, which takes considerable time, and demands much resource to acquire or is non-transferable, is integrated into corporate specialised knowledge through wide scope business co-operation. Some integrated specialised knowledge can be transferred into corporate explicit and tacit knowledge through years' of close business interaction while some will still remain specialised knowledge due to its non-transferable nature which will need to be further integrated through long-term co-operation. The choice between knowledge integration and transfer made by the firm often depends on the nature of the tacit knowledge required and the specific business context. In a fast-moving business environment knowledge integration can be more relevant because of its flexibility and speed. However, for long-term transferable valuable specialised tacit knowledge the firm should focus its acquisition strategy on building it in-house and transferring it into collective wisdom in order to avoid over-dependence on the specialised knowledge holder. Therefore, the firm's overall strategy towards tacit knowledge is to transfer it into collective tacit knowledge to the greatest extent and integrate it when the nature of the knowledge, the business context and the firm resources limit knowledge transfer. The integrated specialised knowledge forms the rest of the firm's core competencies inimitable by its competitors and valuable in other markets. With corporate common explicit and tacit knowledge, specialised knowledge



holders often function as key decision contributors in the corporate decision-making system. Appropriate integration of these specialised business ideas can lead to better strategic decisions.

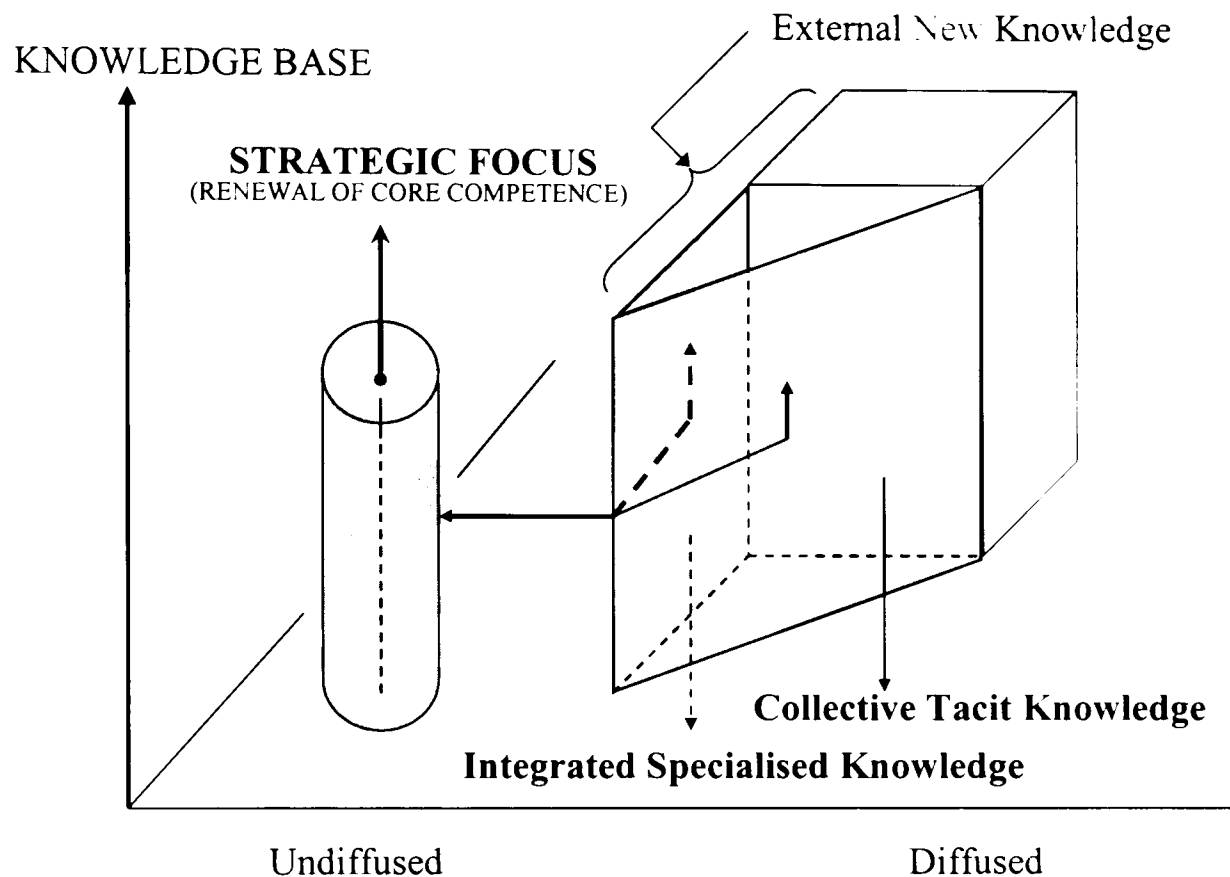
Because it takes time to acquire and develop both collective tacit knowledge and integrated knowledge it follows that firms that already possess a relevant set of these can gain competitive advantage over rivals (Grant, 1996a). The further question, however, is why some companies with established strengths in home market underperform in host markets.

## **2.5 Building a Strategy on Renewal of Core Competencies: Implications for the Multinational Firm's International Management Strategy**

Many businesses encounter insurmountable difficulties when operating in a new territory, and thus suffer considerable loss, for example, Disney in Europe<sup>16</sup>, Peugeot, BellSouth, and Japanese retailer Yaohan in China<sup>17</sup>, to name just a few. The lessons from these companies challenge existing perceptions about sustained competitive advantage. Can competitive advantage really be sustained? Consider the case of Disney, which has been widely cited. Its problems in Europe suggest that its core competencies developed in America met difficult challenges in a new business environment. It was noted in the early 1990s that core competencies could lead to core rigidities due to their dynamic, path dependent and embedded nature (e.g. Leonard-Barton, 1992). Day (1994) argues the ability of the firm to adapt to change is limited by its core resources due to the time and difficulties of their cultivation. In a similar vein, Nonaka et al (2000) asserted that routine knowledge assets might turn rigid hindering further knowledge creation due to excessive

exploitation of the existing knowledge. They further argue that knowledge management is a continuous process. The blurring boundaries between businesses in dynamic business environments suggest the need for new knowledge underpinning new capabilities. As other researchers (e.g. Chataway and Wield, 2000; Gertler, 2003; Nonaka et al, 2000) have noted, new knowledge can often lead to innovation. To gain new core competencies it is necessary to establish ways in which to link and incorporate external knowledge with local knowledge. Dyer and Nobeoka's (2000) study on Toyota's network learning further suggested that the firm's dynamic learning capability that creates competitive advantage needs to be extended beyond firm boundaries. Similarly, by looking at the global business environment, Inkpen (1998) points out that new knowledge provides the foundation for new skills, which in turn can lead to competitive success. Pascale (1984) also pointed out that unplanned action based on new knowledge, called 'emergent strategy' by Minzberg (1994), was often taken in response to unforeseen circumstances using the example of Honda's 50cc machines' success in America, which suggested that being responsive to fast changing environment will position a firm at the competitive edge. The competitive strategy, therefore, should focus on the determination how best to improve and renew the firm-specific knowledge, relative to the opportunities in the external environment.

Drawing from these arguments, a strategic focus model (Figure 2.4) as an incorporation of the proposed knowledge management model is proposed to emphasise the rationale between knowledge management and strategy and point towards the ways in which firms can reduce core rigidity and build new core competencies. This model is employed to indicate that the firm's existing core competencies may hamper its further business development in a new market, and suggest that the firm should build its strategy on renewal of its core competencies.



**Figure 2.4 Strategic Focus Model**

It is suggested in this model that, to avoid core rigidity resulting from excessive use of existing knowledge in the firm, external new knowledge should be constantly acquired as the firm's undiffused knowledge and combined, synthesised, and embedded into new corporate level tacit knowledge or integrated into corporate specialised knowledge. The type of new knowledge concerned ranges from explicit to tacit, transferable to non-transferable. The firm's core competencies are constantly renewed through new knowledge flow and integration into corporate knowledge base, indicating the theme of the corporate strategic focus. The challenge facing managers, hence, is to continuously focus on the creation of knowledge underpinning core competencies, and to leverage new knowledge into new core competencies.

This strategic focus model implies that the firm's competitive advantage developed in its home market does not secure its further success in a host market. Rather, the firm's

superior business performance in a new market is determined by its ability to constantly exploit new knowledge and renew its core competencies. This suggests that the multinational firm should build its international management strategy on exploiting the full value of local knowledge and developing location-based new ownership advantage.

## **2.6 Summary**

In this chapter, we have shown the complexity of the concept of knowledge and argued that the firm's knowledge management initiatives should assume a wide definition of knowledge in order to exploit its full value. It has clarified the concept of core competency and identified the knowledge underpinning the firm's core competencies. It has also found that the firm's core competencies rest on its collective tacit knowledge and integrated specialised knowledge. It has therefore proposed a knowledge management model in which some transferable tacit knowledge is articulated and diffused into corporate explicit knowledge base. Corporate data is then further embedded into corporate tacit knowledge base or utilised through sense-making by individuals to create new individual transferable tacit knowledge or specialised knowledge. Specialised tacit knowledge is integrated into corporate specialised tacit knowledge for fuller utilisation. In addition, corporate tacit knowledge is also created through direct diffusion of individual tacit knowledge and some specialised knowledge can be transferred during integration process. Core competencies are created through these particular knowledge management processes. To further understand how core rigidity resulting from excessive use of existing knowledge can be avoided we have further proposed a strategic focus model which illustrates how core competencies can be constantly renewed to increase the firm's responsiveness to the changing business environment. Constant acquisition, transfer and integration of external

new knowledge are crucial to ensure constant renewal of the firm's core competencies, which further explicates the firm's business strategy in the ever-changing business environment, implying that the multinational firm should build its international management strategy on exploiting the full value of local knowledge in its host markets.

## **2.7 Conclusion**

This chapter clarifies the type of knowledge underpinning core competencies, resolves the knowledge transfer-or-integration contradiction revealed by previous studies, provides a means to constantly build and renew organisational core competencies, and explicates the firm's business strategy. The main features of the proposed knowledge management model and its incorporated strategic focus model are as follows:

- Greater emphasis on the creation of organisational knowledge rather than individual knowledge.
- Better illustration on the rationale between knowledge management and distinctive capabilities.
- Deeper consideration of the impact of the business environment on strategic knowledge management.

Although to some degree these models should enrich our conceptual understanding of knowledge management strategy, the constraints should not be neglected.

First, it does not consider what implementation problems it might encounter, especially executive commitment and the large-scale change required. Knowledge management is

difficult even for world-leading companies (Birkinshaw, 2001; Gupta and Govindarajan, 2000a; 2000b). To understand why knowledge flows in certain conditions and not in others, and what facilitate knowledge integration, is crucial to exploiting knowledge as a potential source of wealth. Though some concepts have been proposed to facilitate previous models few were developed in a general context. For example, Nonaka (1998) developed the concept of 'ba', a shared space, to facilitate the knowledge creation process within the firm in the Japanese business context. He established four types of ba that correspond to the four stages of the SECI model. Each ba supports a particular conversion process and thereby each ba spreads up the process of knowledge creation. Inkpen (1998), by studying strategic alliances in America, suggested that knowledge valuation, searching knowledge connections between learning parties, relatedness of knowledge and cultural alignment between both sides are essential. Despite providing some useful insights in specific contexts whether these can be fully adopted in other cultural contexts is unclear. Management conditions differ significantly cross cultures. It is the aim of Chapter 4, to further research the management conditions in the China business context.

Second, it only covers selected views about knowledge management, though, the building of core competencies may actually involve theories beyond the subject boundaries of knowledge management, such as organisational behaviour and human resource management (Pucik, 1988). As some scholars (e.g. Easterby-Smith, 1997; Eisenhardt and Santos, 2002) noted that the field of organisational learning and knowledge management was multidisciplinary. Wider employment of management theories would certainly deepen our understanding of knowledge management issues concerned in this model. It is the purpose of Chapter 4 and the empirical study that follows in Chapter 8 to observe how specific tools of organisational behaviour and human resource management such as corporate culture are used to facilitate knowledge management initiatives.

Third, it does not consider the constraints of tangible assets impose upon the acquisition of intangible assets. Firms may often find that they have limited tangible resources to deploy a systemised knowledge management strategy that is not immediately cost-effective. It is the aim of Chapter 8 to investigate how managers make balanced decisions on this issue.

Finally, it also de-emphasises the difficulties in measuring knowledge in firms. Due to the non-quantifiable nature of knowledge firms often find it difficult to envisage a knowledge management plan and set up implementation criteria. It is also the aim of Chapter 8 to show these difficulties and illuminate possible solutions.

## Notes

<sup>1</sup> The industrial organization view of the firm was proposed by Bain (1959), Ansoff (1965), and Andrews (1971), and developed by Porter (1980; 1985). It was also studied by others such as McGahan and Porter (1997) and Nelson (1991).

<sup>2</sup> Following the seminal work of Penrose (1959) a large number of resource-based theorists turned to internal competence/capability-based approach, see, for example, Barney (1991; 1996), Collis and Montgomery (1995), Conner and Prahalad (2002), Decarolis and Deeds (1999), Dierickx and Cool (1989), Grant (1991), Gupta and Govindarajan (2000a), Itami (1987), Kogut and Zander (1992), Mahoney and Pandian (1992), Peteraf (1993), Prahalad and Hamel (1990), Russo and Fouts (1997), Spender (1994), Teece (1984), Wernerfelt (1984), Winter (1987).

<sup>3</sup> See, for example, Russo and Fouts (1997).

<sup>4</sup> The industrial organization view of the firm has received criticism from many writers such as Connor (1991), McGahan and Porter (1997), Rumelt (1991).

<sup>5</sup> In 1959, Penrose first explained the firm's growth as a learning process. In 1969, Drucker described knowledge as the crucial resource of the economy. Since then, a number of writers claimed that we have entered the age of knowledge economy, see, for example, Bell (1973) and Castells (1996). Knowledge-based view appeared and knowledge management studies have received significant attention since early 1990s, see, for example, Blackler (1995), Boisot (1995a), Decarolis and Deeds (1999), Drucker (1992), Grant (1996a), Hamel (2000), Hedlund (1994), Leonard-Barton (1995), Nonaka (1994), Prusak (1997), von Krogh and Roos (1995; 1996).

<sup>6</sup> See, for example, Lane and Lubatkin (1998), Lord and Ranft (2000), Nonaka (1991, 1994; 2002), Szulanski (1996).

<sup>7</sup> By knowledge transfer we mean knowledge is moved from one place to another.

<sup>8</sup> This is a key inquiry raised by Eisenhardt and Santos (2002).

<sup>9</sup> According to Denton (1998), it first appeared in Bacon, F. (1597) *Meditations Sacre*.

<sup>10</sup> This is Plato's original definition of knowledge, see, for example, in Polanyi (1962), Audi (1998), Moser et al. (1998).

<sup>11</sup> This is also revealed from other works such as Collins (1993), Leonard-Barton (1995) and Spender (1996b; 2002).

<sup>12</sup> See, for example, Blackler (1995), Cook and Brown (1999), Galunic and Rodan (1998), Spender (1996b), von Krogh et al. (1998).

<sup>13</sup> See, for example, Cook and Brown (1999), Galunic and Rodan, (1998), Grant (1996a), Hu (1995), Hu and Warner (2002), Kogut (1991), Spender (1996b), Nahapiet and Ghoshal (1998).

<sup>14</sup> See, for example, Argyris (1994), DeCarolis and Dees (1999), Nonaka (1991), Nonaka et al (2000), Senge (1990), Teece (2000).

<sup>15</sup> Certain other writers also emphasise the tacit nature of knowledge and question its transferability. For example, Alvesson (1993, p.1001) illustrates 'cultural, interpersonal, somatic' knowledge and 'creative skills'; Clark and Greatbatch (2002, p.152) stress management guru's 'analytical ability'; Legge (2002, p.75) emphasises 'scarce expertise'.

<sup>16</sup> See, for example, Brannen and Wilson (1996).

<sup>17</sup> See, for example, Clifford et al. (1997) and Yan (1998).



## Chapter Three

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### China: The Business Setting for Multinationals

#### 3.1 Introduction

China, as a business setting for multinational corporations, is unique. This chapter discusses its economic, industrial, political, and cultural context within which foreign investors operate. The purpose of this chapter is to provide the contextual knowledge to Chapter 4, which follows.

#### 3.2 Country Profile

Located in East Asia, on the western shore of the Pacific Ocean, the People's Republic of China (PRC) has a land area of about 9.6 million square kilometres, and is the third-largest country in the world, next only to Russia and Canada. For centuries China stood as a leading civilization, outpacing the rest of the world in the arts and sciences. But in the 19th and early 20th centuries, China was beset by civil unrest, military defeats, and foreign occupation. After World War II, the Communists under Mao Zedong established a socialist system that isolated the country from capitalist economies. After 1978, his successor Deng Xiaoping gradually introduced market-oriented reforms and decentralized economic decision-making. China has emerged in recent years as one of the world's leading powers, and become a place of the first choice for foreign investors.

### 3.3 China's Economic Development and Foreign Investment

#### 3.3.1 An Overview of China's Economy

Since the initiation of economic reforms in 1979, China has become one of the world's fastest growing economies. From 1979-1999, China's GDP grew at an average annual rate of 9.7% (see Table 3.1). It maintained robust growth amid the Asian financial crisis and the recent global economic downturn. The average rate of GDP growth in recent three years (from 2000 to 2002) stood at around 7.6%. Some economists have speculated that China could become the world's largest economy at some point in the near future.

**Table 3.1. China's Average Annual Real GDP Growth Rates: 1960-2002**

Time Period	Average Annual % Growth
1960-1978 (pre-reform)	5.3
1979-1999 (post-reform)	9.7
1990	3.8
1991	9.3
1992	14.2
1993	13.5
1994	12.7
1995	10.5
1996	9.7
1997	8.8
1998	7.8
1999	7.1
2000	8.0
2001	7.3
2002	7.4

Source: Bank of China

Economists generally attribute much of China's rapid economic growth to China's economic reforms and its 'open-door' policy. Economic reforms led to higher efficiency in the economy, which boosted output and increased resources for additional investment in the economy.

### **3.3.2 Economic Reforms**

Prior to 1979, China maintained a centrally planned economy. A large share of the country's economic output was directed and controlled by the state, which set production goals, controlled prices, and allocated resources throughout most of the economy. Private enterprises and foreign invested firms were nearly non-existent. A central goal of the Chinese government was to make China's economy relatively self-sufficient. Foreign trade was generally limited to obtaining only those goods that could not be made or obtained in China. The government policies kept the Chinese economy relatively stagnant and inefficient, mainly because there were few profit incentives for firms and farmers, competition was virtually nonexistent, and price and production controls caused widespread distortions in the economy. Chinese living standards were substantially lower than those of many other developing countries.

Since 1979, China has launched several economic reforms. The central government has initiated price and ownership incentives for farmers, which have enabled them to sell a portion of their crops on the free market. In addition, the government has established special economic zones and opened up cities for the purpose of attracting foreign investment, boosting exports, and importing high technology products into China. Additional reforms followed in stages that sought to decentralize economic policymaking in several economic sectors, especially trade. Economic control of various enterprises has been given to provincial and local governments, which have been allowed to operate and compete on free market principles, rather than under the direction and guidance of state planning. Moreover, state price controls on a wide range of products have been gradually eliminated. The result of China economic reforms has been a quadrupling of GDP since 1978, making China one of the world's fastest growing economies.

### 3.3.3 Foreign Investment in China

China's encouragement of foreign investment has been largely successful. Since 1994, China has been the second largest recipient of foreign direct investment (FDI) in the world after the United States. When the year of 2001 saw a worldwide slump in direct foreign investment, China absorbed a direct investment of 46.8 billion in the US dollars, a rise of 15 percent as against the previous year (World Investment Report 2002). In 2002, the country reported record high FDI of US\$ 52.7 billion – the highest in the world (see Table 3.2). China's entry into the WTO has further enhanced its smartness in attracting foreign investors and China has become a place of the first choice for transnational investors from the US and Japan and some other countries. According to MOFTEC (Ministry of Foreign Trade and Economic Cooperation), more than 400 out of 500 world powers have made their investment in China, and over 200 of them have set up research and development organizations (People's Daily, 9 September 2002). By the end of July 2002, China had 408,551 foreign-funded companies, with total contracted foreign funds of 799.65 billion U.S. dollars, and funds in use totalling 424.77 billion U.S. dollars (op cit).

The transnational corporations have almost entered all industrial sectors in China while the sectors find no signs of them are those in service industry or those not yet open to foreign investment. Their branches had taken up some 23 percent in the total added value of the Chinese industry, some 18 percent of taxation and 48 percent of total exportation (Agencies, 26 August 2003). The UN experts in economy are of the opinion that along with China's entry into the WTO it can be expected that China will keep on a steady increase in touting for foreign capital in the years to come (World Investment Report 2002).

**Table 3.2 FDI Inflows and Global Share**

(Billions of dollars and percentage)

	1985-1995	1997	1998	1999	2000	2001	2002
China	11.7 (6.45%)	44.2 (9.25%)	43.8 (6.30%)	40.3 (3.70%)	40.8 (2.73%)	46.8 (6.37%)	52.7 (9.88%)
USA	44.4 (24.54%)	103.4 (21.63%)	174.4 (25.12%)	283.4 (26.04%)	300.9 (20.17%)	124.4 (16.93%)	44.0 (8.24%)
S.E. Asia	29.8 (16.48%)	96.3 (20.15%)	86.3 (12.42%)	100.0 (9.19%)	131.1 (8.79%)	94.4 (12.84%)	-
Developing Countries	50.9 (28.11%)	191.0 (39.96%)	187.6 (27.02%)	225.1 (20.69%)	237.9 (15.95%)	204.8 (27.86%)	-
World	181.1	478.1	694.5	1088.3	1491.9	735.1	534.0

Source: Bank of China

China's investment climate has changed dramatically in more than 20 years of reform and opening. In the early 1980's, China restricted foreign investments to export-oriented operations and required foreign investors to form joint venture partnerships with Chinese firms in order to enter the market. Since the early 1990's, however, China has allowed foreign investors to manufacture and sell a wide variety of goods on the domestic market. In the mid-1990's, China authorized the establishment of wholly foreign-owned enterprises (WFOEs), now the preferred form of foreign direct investment.

In order to further attract foreign funds, China has been improving the country's foreign investment environment by enhancing its services to foreign investors. Such services include efficient and transparent government services, reform of administrative approval systems and sound legal and business environments (People's Daily, 7 August 2002). The government is also gradually lifting China's services sectors and paying more attention to high-tech industries. According to China's promises upon its WTO entry, the country will open the sectors of commerce, finance, insurance and tourism wider to foreign investors and further improve its investment environment.

It is noticeable that multinational corporations are adjusting their investment structures in China by shifting their R&D centres and regional headquarters to China and making inroads into industries that used to be investment taboos before China's entry to the WTO. China's cheap labour is no longer the only consideration of global investors. An increasing number of foreign investors are starting to notice China's huge potential for technological development. While multinational corporations are introducing more manufacturing technologies into China, they have started to develop China as a hotbed of new products and technologies. An increasing number of multinational corporations are also moving their regional headquarters to China, to coordinate their businesses in China and nearby countries and regions.

### **3.4 China's Industrial Structure**

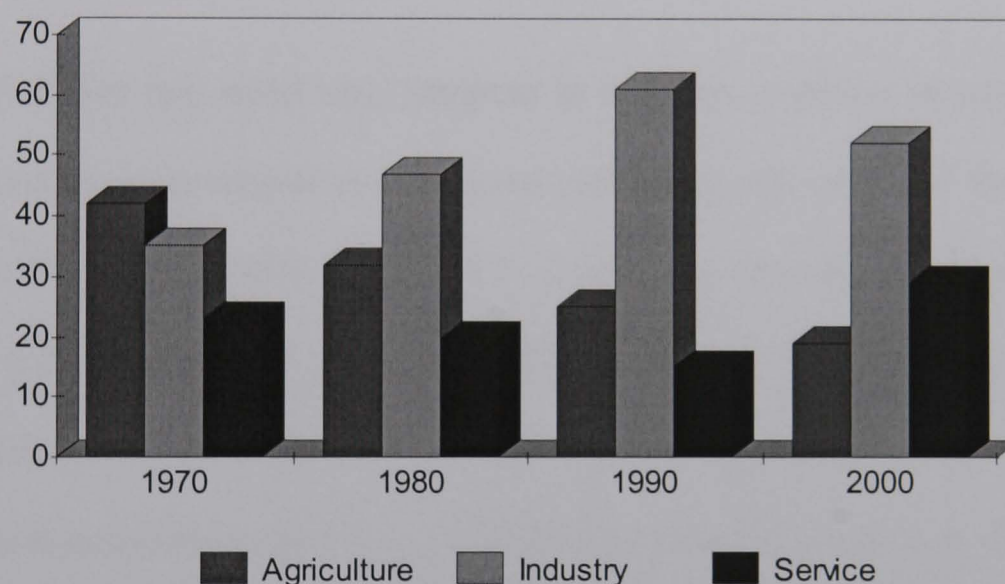
Before 1979, China's economy had a weak foundation in agriculture, and the ratio between industries was unbalanced. Since 1979, the policies of reform and opening to the outside world have enabled China's industry to enter a stage of great innovation and development.

On the one hand, China has pursued agricultural reforms, dismantling the commune system and introducing a house-based system that has provided peasants greater decision-making in agricultural activities. The government has also encouraged non-agricultural activities such as village enterprises in rural areas.

On the other hand, China has adopted a series of policies and measures giving priority to the development of light industry, expanding the import of top-quality consumer goods, strengthening the construction of basic industry and facilities, and devoting major efforts to

developing tertiary industry, so as to make China's economic structure more coordinated, optimised and balanced. The relations between different industries and within industries in terms of proportion have clearly been improved; the proportion of primary industry has declined, while that of the secondary and tertiary industries has grown; the growth of the overall national economy was driven formerly by the primary and secondary industries, but now it is being driven by the secondary and tertiary industries (see Figure 3.1).

**Figure 3.1 Sector Contribution to GDP (%)**



Note: Figures are calculated as a percentage of GDP. Source: China Statistics Bureau.

In addition, China's industrial structure has been altered fundamentally by the major shifts in enterprise ownership since 1979. SOEs, which dominated its national economy before the reform era, now account for only less than 28 percent of industrial output (Child and Tse, 2001). A wide range of enterprises with a variety of ownership and governance structures have been dramatically increasing. These include foreign invested corporations, private firms, urban and rural collective enterprises, and other contracted businesses.

The reform of state industrial enterprises, especially large and medium-sized enterprises, is still the constant focus of China's economic system reform. Strategic reorganization has been carried out in large and medium-sized enterprises to transform them into standard companies. In recent years a large number of enterprise groups have been set up through annexation during the re-organization of enterprises, such as the China Petroleum and Natural Gas Group, Shanghai Baoshan Iron and Steel Group, and some household appliance industrial groups, for instance, Changhong, Haier, Konka, Kelon and TCL. The Legend and Founder of Beijing University groups are prominent in the micro-computer industry. These groups take part not only in domestic but also international competition.

Though China has made rapid progress in industry, irrational structure within industries and unbalanced development in regional economies still exist. On the one hand, much of China's economy remains controlled by large State Owned Enterprises (SOE's), many of which are still inefficient and unprofitable. But local and provincial governments are often reluctant to close them for fear of social unrest and loss of influence. Local authorities also lack the resources to replace the social services (housing, health, etc) that have traditionally been provided by the SOEs. Continuing closures have resulted in unprecedented labour unrest in some of the industrial cities of the Northeast. Restructuring the state enterprise sector and modernizing the banking system remain major hurdles. On the other hand, the Chinese government's emphasis on guiding FDI into manufacturing has led to over-capacity of that sector, while leaving China's service sector highly underdeveloped.



### **3.5 The Government Structure and its Political Framework**

At present, China is divided into 23 provinces, 5 autonomous regions, 4 municipalities directly under the Central Government, and 2 special administrative regions (see table 3.3).

**Table 3.3 China's Provinces, Autonomous Regions, Centrally Administered Municipalities and Special Administrative Regions**

Name	Seat of Government	Area (100,000sqkm)	Population (100,000)
Beijing Municipality	Beijing	0.168	125.7
Tianjin Municipality	Tianjin	0.113	95.9
Hebei Province	Shijiazhuang	1.900	661.4
Shanxi Province	Taiyuan	1.560	320.4
Inner Mongolia Autonomous Region	Hohhot	11.830	236.2
Liaoning Province	Shenyang	1.457	417.1
Jilin Province	Changchun	1.870	265.8
Heilongjiang Province	Harbin	4.690	379.2
Shanghai Municipality	Shanghai	0.062	147.4
Jiangsu Province	Nanjing	1.026	721.3
Zhejiang Province	Hangzhou	1.018	447.5
Anhui Province	Hefei	1.390	623.7
Fujian Province	Fuzhou	1.200	331.6
Jiangxi Province	Nanchang	1.666	423.1
Shandong Province	Jinan	1.530	888.3
Henan Province	Zhengzhou	1.670	938.7
Hubei Province	Wuhan	1.874	593.8
Hunan Province	Changsha	2.100	653.2
Guangdong Province	Guangzhou	1.860	727.0
Guangxi Autonomous Region	Nanning	2.363	471.3
Hainan Province	Haikou	0.340	76.2
Chongqing Municipality	Chongqing	0.820	307.5
Sichuan Province	Chengdu	4.880	855.0
Guizhou Province	Guiyang	1.700	371.0
Yunnan Province	Kunming	3.940	419.2
Tibet Autonomous Region	Lhasa	12.200	25.6
Shaanxi Province	Xi'an	2.050	361.8
Gansu Province	Lanzhou	4.500	254.3
Qinghai Province	Xining	7.200	51.0
Ningxia Autonomous Region	Yinchuan	0.664	54.3
Xinjiang Autonomous Region	Urumqi	16.000	177.4
Hong Kong Special Administrative Region	Hong Kong	0.01092	68.4 (in mid 1999)
Macao Special Administrative Region	Macao	0.00024	4.3
Taiwan Province*	-	0.360	217.4 (at the end of 1997)

\* It is out of CCP control.

Source: China Statistics Bureau

The administrative system consists of three tiers - provincial-level units (provinces, autonomous regions, and centrally governed special municipalities); middle-level units (autonomous prefectures, counties, autonomous counties, cities, and municipal districts); and basic level (townships and villages).

Municipalities are directly under the Central Government and large cities are subdivided into districts and counties; autonomous prefectures are subdivided into counties, autonomous counties, and cities. Autonomous regions, autonomous prefectures, and autonomous counties are all autonomous national minority areas. The Constitution specifically empowers the state to establish special administrative regions when necessary. A special administrative region is a local administrative area directly under the Central Government.

The Chinese Government has always been subordinate to the Chinese Communist Party (CCP); its role is to implement party policies. The primary organs of state power are the National People's Congress (NPC), the President (the head of state), and the State Council. Members of the State Council include the premier (the head of government), a variable number of vice premiers, five state councillors (protocol equivalents of vice premiers but with narrower portfolios), and 29 ministers and heads of State Council commissions.

The NCP meets annually for about 2 weeks to review and approve major new policy directions, laws, the budget, and major personnel changes. These initiatives are presented to the NPC for consideration by the State Council after previous endorsement by the Communist Party's Central Committee. Although the NPC generally approves State Council policy and personnel recommendations, various NPC committees hold active debate in closed sessions, and changes may be made to accommodate alternate views.

When the NPC is not in session, its permanent organ, the Standing Committee, exercises state power.

Chinese president and vice president are elected by the NPC, the Chinese parliament. Elections were last held in March 2003 (next to be held mid-March 2008). The premier is nominated by the president, confirmed by the NPC. The CCP has dominated both the NPC and the State Council, the executive arm of government since 1949. Most candidates for the NPC are communist party members though eight other small parties controlled by CCP are allowed to compete for places. The CCP's Political Bureau serves as the centre of power, the policy maker in China. At present, Hu Jintao, the current president, holds the post of CCP secretary. But Jiang Zemin, the former president, has retained considerable political influence. He has kept his post as head of the powerful Central Military Commission and his allies make up much of the Standing Committee.

The political processes are guided by party Constitution and state Constitution, both promulgated in 1982; constitutions stress principle of democratic centralism, under which representative organs of both party and state are elected by lower bodies and they in turn elect their administrative arms at corresponding levels. Within representative and executive bodies minority must abide by decisions of majority; lower bodies obey orders of higher level organs. The NPC approves CCP policies and programs. Reforms implemented in early 1980s allowed more serious review and deliberations concerning government programs in NPC. State Council serves as equivalent of cabinet; key members also hold positions in important party organs.

The rate of economic change hasn't been matched by political reform, with the CCP retaining its monopoly on power. Nevertheless, in periods of relative liberalization, the

influence of people and organizations outside the formal party structure has tended to increase, particularly in the economic realm. This phenomenon is most apparent today in the rapidly developing coastal region. However, still, in all important government, economic, and cultural institutions in China, party committees work to see that party and state policy guidance is followed and that non-party members do not create autonomous organizations that could challenge party rule.

China's media are tightly controlled by the country's leadership. They also attempt to restrict access to foreign news providers by jamming radio broadcasts and blocking access to web sites.

### **3.6 Chinese Society and Culture**

The history of China dates back some 3,300 years. Modern archaeological studies provide evidence of still more ancient origins in a culture that flourished between 2500 and 2000 B.C. in what is now central China and the lower Huang He (Yellow River) Valley of north China (China 2002, 2003). Centuries of migration and development brought about a distinctive system of writing, philosophy, art, and educational organization that came to be recognizable as Chinese civilization.

#### **3.6.1 Population**

With a population officially just under 1.3 billion and an estimated growth rate of about 1% (op cit), China is very concerned about its population growth and has attempted with mixed results to implement a strict family planning policy.

### **3.6.2 Ethnic Groups**

China is multiethnic; but the largest ethnic group - the Han Chinese - dominates the politics, government, and economy. The Han Chinese constitute about 91.9% of the total population (op cit). The remaining 8.1% are Zhuang, Manchu, Hui, Miao, Uygur, Yi, Mongolian, Tibetan, Buyi, Korean, and other ethnic minorities. In the mid-1980s the state recognized 55 minority nationalities, some with as few as 1,1000 members (op cit).

Official policy recognizes the multiethnic nature of the Chinese state, within which all "nationalities" are formally equal. Minority nationalities are guaranteed special representation in the NPC and the Chinese People's Political Consultative Conference (op cit). Areas where minorities form the majority of the population may be designated "autonomous" counties, prefectures, or regions, subject to the authority of the central government in Beijing rather than to provincial or sub-provincial administrations. It is expected that local administrations in such regions will be staffed at least in part by minority nationals and that application of national policies will take into account local circumstances and special needs (op cit). In the early 1980s, for example, minority peoples were exempted from the strict limitations on the number of children per family dictated to the Han population.

### **3.6.3 Language**

There are seven major Chinese dialects and many sub dialects. Mandarin, the predominant dialect, is spoken by over 70% of the population (op cit). It is taught in all schools and is the medium of government. About two-thirds of the Han ethnic group are native speakers of Mandarin; the rest, concentrated in southwest and southeast China, speak one of the six

other major Chinese dialects (op cit). Non-Chinese languages spoken widely by ethnic minorities include Mongolian, Tibetan, Uygur and other Turkic languages (in Xinjiang), and Korean (in the Northeast).

Chinese is written with ideographs that represent meanings rather than sounds, and so written Chinese does not reflect the speech of its author. Han Chinese speak seven or eight mutually unintelligible dialects, each of which has many local sub-dialects. The disjunction between written and spoken Chinese means that written Chinese can be read among Han population, although they may not understand each other's speech. There is no specifically Cantonese (Guangzhou dialect) or Shanghainese (Shanghai dialect) literature because the local speech of a region cannot be directly or easily represented in writing. Educated Chinese tend to regard the written ideographs as primary, and they regard the seven or eight spoken Han Chinese dialects as simply variant ways of pronouncing the same ideographs.

#### **3.6.4 Religion**

Religion plays a significant part in the life of many Chinese. Buddhism is most widely practiced. Traditional Taoism also is practiced. Official figures indicate there are 18 million Muslims, 4 million Catholics, and 10 million Protestants (op cit); unofficial estimates are much higher.

While the Chinese constitution affirms religious toleration, the Chinese Government places restrictions on religious practice outside officially recognized organizations. However, unauthorized churches have sprung up in many parts of the country and unofficial religious practice is flourishing. In some regions authorities have tried to control activities of these

unregistered churches. In other regions, registered and unregistered groups are treated similarly by authorities.

### **3.6.5 Education**

Shortly after the founding of the PRC, the Chinese government took education as a matter of primary importance, and made enhancing the cultural quality of the people the basis of the construction of the nation. Before 1949, China had a population of nearly 500 million, of whom 80 percent were illiterate (op cit). Proceeding from reforming the educational system, the Chinese government made an overall plan and adjusted its educational policies, with the result that the number of students increased rapidly. Currently, 91 percent of the country has instituted compulsory primary education, nearly 99 percent of school-age children are enrolled in schools, the dropout rate has decreased and the illiteracy rate of young and middle-aged people has declined to less than seven percent (op cit). Since the initiation of the reform and opening policies in 1978, marked by the restoration of the higher-education examination system, China's education got on the road to accelerated development. As one of the priorities of China's economic and social development, education is a matter of great concern to the government.

### **3.6.6 Ethical Values**

The culture of traditional China encompasses diverse and competing philosophies, including Taoism, Buddhism, Legalism, and a host of local 'little traditions'. Nevertheless, Confucianism is the most clearly identified as the foundation of China's great cultural tradition, and Confucian values still provide the basis for the norms of Chinese administrative and interpersonal behaviour.



Confucius, also called Kong Zi, was the most influencing philosopher in the Chinese history. He believed that each person should act according to prescribed relationships in order to maintain social order. "Let the ruler be a ruler and the subject a subject," he said, but he added that to rule properly a king must be virtuous. To Confucius, the functions of government and social stratification were facts of life to be sustained by ethical values.

Confucianism, therefore, is primarily concerned with social order. It reflects the Chinese aspiration toward a conflict-free, mutual-respect, hierarchical, and mutual-dependent social relations.

Confucianism was taught in the academies and tested in the imperial civil service examinations. These values are distinctive for their emphasis on society and public administration and for their wide diffusion throughout Chinese society.

Confucianism flourished before 1949 but was attacked during the Communist Consolidation and Great Cultural Revolution eras (1949-1976) because it was conflict with Maoist/Leninist communist doctrine. However, The Post-reform Era (1979-present) saw a movement back to acceptance of Confucian values. These traditional values have clearly shaped much of contemporary Chinese life. The belief in rule by an educated and functionally unspecialised elite, the value placed on learning and propagating an orthodox ideology that focuses on society and government, and the stress on hierarchy and the pre-eminent role of the state were all carried over from traditional society.

### **3.6.7 Social Stratification**

Traditional thought accepted social stratification as natural and considered most social groups to be organized on hierarchical principles. In the ideal Confucian scheme of social stratification, scholars were at the highest level of society, followed by farmers, then by artisans, with merchants and soldiers in last place.

However, following Deng Xiaoping's pragmatic slogan, "to be rich is glorious", individuals with enormous wealth have had more political influence and gained higher social status.

## **3.7 Summary**

This chapter discusses the economic, industrial, political, social, and cultural background of China. China is the most populous country in the world, with a continuous cultural stretching back more than 3300 years. Its dramatic economic development and structural changes are remarkable. However, its social and cultural background, as well as its political system, are complex.

This chapter provided background knowledge about the business context in which foreign investors operate. Based on this understanding, Chapter 4 will introduce the general knowledge management framework developed in Chapter 2 into China context in order to advance a theoretical local knowledge management model for multinational corporations in China.

## **Chapter Four**

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### **Strategic Management of China Local Knowledge: A Theoretical Model**

“A firm that invests abroad has an ownership advantage that is transferred across borders, but as a consequence of investing abroad the firm has the disadvantage of being foreign (Hymer 1976). This disadvantage stems from a lack of local knowledge of social, political, and economic conditions in the host country (Beamish 1984).”

*(Makino and Delios, 1996, p.906)*

“Global success rests on the ability to listen and learn in locations far from the home base.”

*(Kanter and Dretler, 1998, p.62)*

#### **4.1 Introduction**

This chapter introduces the key argument developed in Chapter 2 to the China business setting and develops a theoretical model about exploiting China local knowledge.

Previous literature suggests that disadvantages of foreignness, renamed ‘liabilities of foreignness’ by Zaheer (1995), can greatly impede decision-making and threaten performance.<sup>1</sup> The central claim in this research stream is that local knowledge disadvantage is the major challenge faced by foreign investors. As Tayeb (1988, 1992) has stressed, multinational firms have to respond to their environmental changes if they are to succeed and survive on the international scene. The underperformance of multinationals in

China market shown from previous research<sup>2</sup> (e.g. Imamura, 1999; Lubman, 2000) strongly suggests that a lack of in-depth understanding of this dynamic market resulted in inappropriate China strategies, and further hindered multinationals' ability to better utilize their established global resources. China is a nation where great potential and uncertainty co-exist. To fully reap the business opportunities and overcome local knowledge disadvantages demands a long-term well-established local knowledge management system.

Despite its wide recognition and rich theoretical heritage, relatively little research has been devoted to the question of how local knowledge disadvantage can be mitigated. There is some literature on knowledge transfer from parent companies to host markets, most about technology. Much less has been written about how multinational corporations actually tap the power of local knowledge (Tsang, 2002). Certain scholars (for example, Lord and Ranft, 2000; Makino and Delios, 1996; Tayeb, 1998; Tsang, 2002) have addressed a reverse knowledge diffusion approach to developing competitive advantage from local knowledge. However, such studies are relatively fewer, and rarely conducted in the Chinese business context. The reason for this imbalance may stem from the over-emphasis upon the role of the multinational firm in transferring firm-specific advantages gained in its home market at low cost, thereby offsetting its 'liabilities of foreignness' (Buckley and Casson, 1976; Caves, 1982; Dunning, 1977; Hennart, 1982; Zaheer, 1995). However, as noted in Chapter 2, this contention can hardly explain why some multinational firms with established home-based strengths underperform in their host markets, like Disney in France, for example (Brannen and Wilson, 1996). With regard to China local knowledge management little research has been done so far. Studies on organisational learning in China are generally limited to the simple acknowledgement of the importance of managing local knowledge and who expatriate managers could learn from leaving the means through which multinationals could manage the learning process almost untouched. Moreover,

Despite the recognition of tacitness of local knowledge (Lord and Ranft, 2000; Tayeb, 1998; 1999), past studies on local knowledge management solely focuses on knowledge transfer approach. Is knowledge transfer an optimal choice for tapping the power of local knowledge? Furthermore, the scope for local knowledge management has not yet been determined. Who are the main local knowledge holders? What unit of analysis is appropriate to address local knowledge management issue? Past studies solely focus on learning effects from joint ventures (Child and Markoczy, 1993; Inkpen, 1998; Makino and Delios, 1996; Si and Bruton, 1999; Tsang, 2002) or internal knowledge transfer, knowledge flow within the multinational firm (Lord and Ranft, 2000; Martin and Beaumont, 1998; Tayeb, 1998). Other local knowledge sources (Lee, 1999) essential to international business conduct were overlooked. However, in order to develop local competitive advantage it is crucial for the multinational firm to explore strategies towards full exploitation of local knowledge sources. In addition, studies exploring knowledge management models paid little attention to the human factors hindering effective implementation of the management initiatives, especially in an international business context where cultural issues prevail (Joynt and Warner, 2002; Warner, 2003; Tayeb, 1992; 1996). In the case of China, how do local knowledge holders differ from those in the west? Both Hofstede and Bond's (1988) study and Lang's (1998) work suggest that the cultural features of local Chinese affect local business conduct. Do the cultural differences therefore impede local knowledge management process? Could those factors be managed and how? The answers to these questions should be instructive to successfully exploit the full value of local knowledge.

In an attempt to redress the deficiencies in the literature, this chapter will firstly examine the nature of China local knowledge and explains its role in international business operation. It will argue that China local knowledge, by nature, differs significantly from

global knowledge transferred to China market, and it is its very nature that determines its critical importance to international business performance. Secondly, it will propose the concept of and identify local knowledge holders in order to determine the scope of local knowledge management. Finally, it will propose a strategic management model of China local knowledge by introducing the key argument of the general framework of knowledge management developed in Chapter 2 into the China business context. It will argue that conventional knowledge transfer approach may not fit China's situation. It will also particularly emphasise the impacts of human factors upon local knowledge management initiatives and implementation processes by analysing the main historical and cultural features of local knowledge holders, and suggest management strategies for overcoming associated barriers. More specifically, it will illustrate how external local knowledge could be acquired and integrated into the multinationals' knowledge base and how individual knowledge could be utilized for making strategic decisions. It will propose that multi-layered knowledge platforms and common knowledge need to be established and developed in order for knowledge holders to meet positively. It will also discuss whether a 'pull and push' system could be employed to resolve the barriers rooted in local knowledge holders.

## **4.2 The Nature of China Local Knowledge**

The concept of '*local knowledge*' (Inkpen, 1995) in the business context is not widely explored and well developed. It was interchangeably used with '*local market knowledge*' (Inkpen and Beamish, 1997; Lord and Ranft, 2000) and '*market-specific knowledge*' (Johanson and Vahlne, 1977; Petersen and Pedersen, 2002). Lord and Ranft (2000) defined it as '*knowledge that is specific to a host country regarding its language, culture,*

*politics, society, and economy*' (p. 573). Emphasising the complex nature and wide scope of local knowledge Makino and Delios (1996) gave local knowledge a more explicit explanation:

“Local knowledge includes information and know-how about the local economy, politics, culture, and business customs of a region; information on local demands and tastes; and information on ways to access the local labour force, distribution channels, infrastructure, raw materials, and other factors required for the conduct of business in a region.”

(p. 907)

This research did not pre-specify the definition of local knowledge in advance in order not to delimit the interviewees' own responses valuable and applicable to the concept development. However, it does adopt the distinction between tacit and explicit knowledge widely used in the field of knowledge management. Yet, as noted in Chapter 2, it does not distinguish knowledge into these two categories in the same manner as some researchers (e.g. Boisot, 1995a; Nonaka et al, 2000) did. Rather, following Polanyi (1962) and Fiddis' (1998) view of knowledge, local knowledge is considered to be a spectrum, where much of it falls in between tacit and explicit knowledge.

Some researchers (Eriksson et al., 1997; Lord and Ranft, 2000; Johanson and Vahlne, 1977; Li, 1994; Makino and Delios, 1996, Tayeb, 1998; 1999) have found that certain forms of local knowledge cannot be treated as a public good which is readily transferable within the firm. Local knowledge in a specific country or region may have a higher tacit nature than in other countries or regions, making it more difficult to capture. For example, Tayeb (1998; 1999), in her studies about multinational firms in Scotland, has found that the cross-cultural transfer of multinationals' HRM practices is largely constrained by their context-specific external as well as internal factors in international markets. Moreover,

even relatively explicit forms of market knowledge can be difficult to obtain in some host countries due to inefficient information infrastructure (Lord and Ranft, 2000). Furthermore, some existing explicit forms of market knowledge may not be reliable, or soon become redundant, due to rapidly changing political and economic conditions (Lord and Ranft, 2000). Hence, the nature of local knowledge between countries can differ, further suggesting that local knowledge management needs to be locally adapted.

China is unique in terms of its economic structure and growth rate, political system, long history and diverse culture (Cannon and Jenkins, 1990), size and population. The dramatic pace of economic reforms has led to a dynamic and complex economic structure (Child and Tse, 2001) characterised by the co-existence of state-owned, collective, private, foreign invested, contracted, and their mixtures. Business behaviour, human perceptions, individual needs in one of them can be greatly different from those in another. More important, the composition of this structure has been constantly changing with China's fast economic growth and its long-committed in-depth economic and social reforms<sup>3</sup>. Consequently, to ensure successful transition from a planned-economy to market economy without putting vital national industries at risks government has been taking an important role in control on foreign business operation and development. The existing laws and regulations have been constantly refined and adjusted (Child, 1994), leading to ambiguities or lack of transparency as side effects. On top of that, new laws often do not lead to greater business certainty (op cit). Rather, they may create new areas of ambiguity which are subject to differing interpretations (Lee, 1999). Adding to the complexity of this business environment is the fact that the Chinese culture is as diverse as the whole of Europe (Lord, 2001). Chinese people naturally identify with each other through combinations of language, dialect, generation, region, and educational and professional affiliation, which can present real difficulties for understanding Chinese as a whole



(Fairbank, 1987). Even those similarities they share are challenges for foreigners to understand. For example, the specific perception of Chinese on contracts as a symbol of the beginning of a relationship between two sides rather than binding agreement confuses many foreign managers (Lee, 1999). Inter-partner conflicts and misunderstanding of each other due to societal differences in work attitudes, motivational structures, interpersonal norms, and negotiation patterns between foreigners and Chinese often lead to low performance (Shenkar, 1990; Wang, 1998). Gamble (2000) observed that:

“these differences are not abstract phenomena. Rather, they are ‘embodied’ in the patina of daily actions and decisions, in everyday conversations, habits, values, prejudices, ideals, preconceptions, notions of ‘common sense’, and so forth.”

(p. 896)

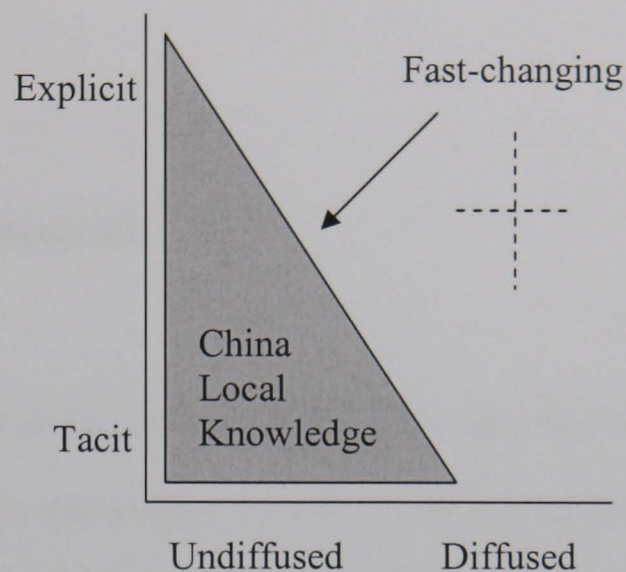
The embedded and specialised nature of this cultural knowledge implies particular difficulties in its articulation. In addition, the complexity of China market is compounded by significant regional differences due to its huge size and variably developed economic infrastructure (Dahlman and Aubert, 2001). Market penetration by foreign firms, motivated by the plentiful supply of cheaper labour in the interior regions and government support for projects that improve conditions there, not only requires good understanding of cross-regional cultural issues but also demands adequate local knowledge of the particular region’s main characteristics in terms of regional policies, local business operators, distribution networks, density and centrality of local customers, local purchasing capacity and so on. Regional governmental bodies or companies may not follow what is designed by the central government or headquarters in Beijing<sup>4</sup>. Thus, there is the saying ‘*policies on the top and countermeasures down below.*’ The geographical reach and inefficient administration system of major Chinese companies often make consistent business activities practically impossible (Lord, 2001). The under-developed regional distribution

system and geographical disparity between regional potential purchasers can incur extremely high regional marketing costs (Campbell, 1986). Although this has been undergoing dramatic change owing to the high economic growth rate it will take a long time to be cost-effective. Successful firms in certain sectors build geographic strongholds, which allow synergies in distribution as well as economies of scale, by realising that firms may have limited resources and local understanding of the country as a whole (Heracleous, 2001). Therefore, the tacit nature of local knowledge is increased by the complexity of China's business environment because of its dynamic economic structure, government influence, diverse culture, great regional differences, size and population.

Moreover, China's historical and political background, under-developed communication infrastructure, vast administrative bureaucracy, and the distinctive Chinese attitude toward information of all kinds determine the undiffused (Boisot and Child, 1996; Croll, 1993; Dahlman and Aubert, 2001) and unreliable nature of local explicit knowledge. Wen (2001) further observed that official Chinese statistics are not fully reliable<sup>5</sup>. Multinationals often find it difficult to envisage strategic plans due to difficulties in obtaining accurate figures. Compiling and publishing statistical data with an eye toward political advantage represent an old problem that originated in the planned economy. People at different levels have been cooking the books to maximise individual benefits. China's poor communication within the huge Chinese bureaucracy and inefficient information infrastructure result in a lack of data or information (Lee, 1999).

Therefore, unlike global knowledge transferred to China market which is fully codified, widely available and controllable, China local knowledge is highly tacit, undiffused and fast-changing as depicted in Figure 4.1. Some embedded tacit cultural knowledge may not be transferable. The shaded area represents China local knowledge base as a whole. It

indicates that most local knowledge required is tacit and undiffused. In addition, local knowledge changes in all directions with China's fast development in all areas.



**Figure 4.1 The Nature of China Local Knowledge**

In light of the above, we enquire:

*Question 1: Is China local knowledge highly tacit, undiffused and fast-changing? Whether is it totally transferable?*

If so, this very intrinsic and difficult-to-control nature of local knowledge should determine its significant impact upon the international business performance in China. Based on these arguments it is also enquired that:

*Question 2: Does local knowledge have greater impact upon the multinational firm's business performance in China than global knowledge transferred to that market?*

If the answer is affirmative, the immediate task of the management of multinationals will be not only to recruit a knowledgeable workforce but also, more important, to increase the visibility and utilisation of local knowledge for effective strategic decisions. To fulfil this objective fully understanding of local knowledge holders is required.

### **4.3 Local Knowledge Sources**

The concept of knowledge holder is here proposed to facilitate identifying the scope of local knowledge sources and determining the unit of analysis for this study. By knowledge holder we mean an individual or a collective group of people or an organised body who possess certain knowledge. Knowledge holders may exist within one organisation or outside an organisation or even across organisations or industries. Key local knowledge holders in China include people far beyond the scope of those involved in business transactions. In addition to the role of expatriates and local staff as crucial local knowledge holders, local business partners, customers, suppliers and officials are also identified as great sources of local knowledge (Gamble, 2000; Lee, 1999). Gamble (2000) stresses that expatriates' local and international experience, especially in transitional economies or Asian countries, is crucial to multinationals' business operation. Lee (1999, p.41) illustrated the crucial role of local staff as an excellent source of knowledge about Chinese business operations, *'They know how to deal with many operational problems that foreign managers may consider major disasters'*. Other researchers (Beamish and Wang, 1989; Inkpen and Crossan, 1995; Lee, 1999; Yan and Child, 2002) emphasised the importance of joint venture partners as local knowledge providers regarding domestic market and environment, sources of raw materials, and contacts with government authorities, local suppliers, and labour unions. Crane (2000) and Wong and Maher (1997)



suggest that local distributors are the first source of local knowledge of China market. Others claim that local authorities are the best source of local knowledge about policy changes (Clegg et al, 1996; Lee, 1999). Lee (op cit) found, in her empirical study on organisational learning in China, that network members possessed great degree of best local practices, suggesting that local knowledge holders include people far beyond the scope of those involved in business transactions. She further suggested that foreign investors needed to establish relationships with a variety of individuals and organisations because of China's more complex administrative system, size, and difference in industry structure. This suggests that a wider range of local knowledge holders and scope of China local knowledge management is required for further study. These knowledge holders are depicted in Figure 4.2 in peripherals in descending order in accordance with the degrees of their business interactions with the multinational firm.



**Figure 4.2 Local Knowledge Holders**

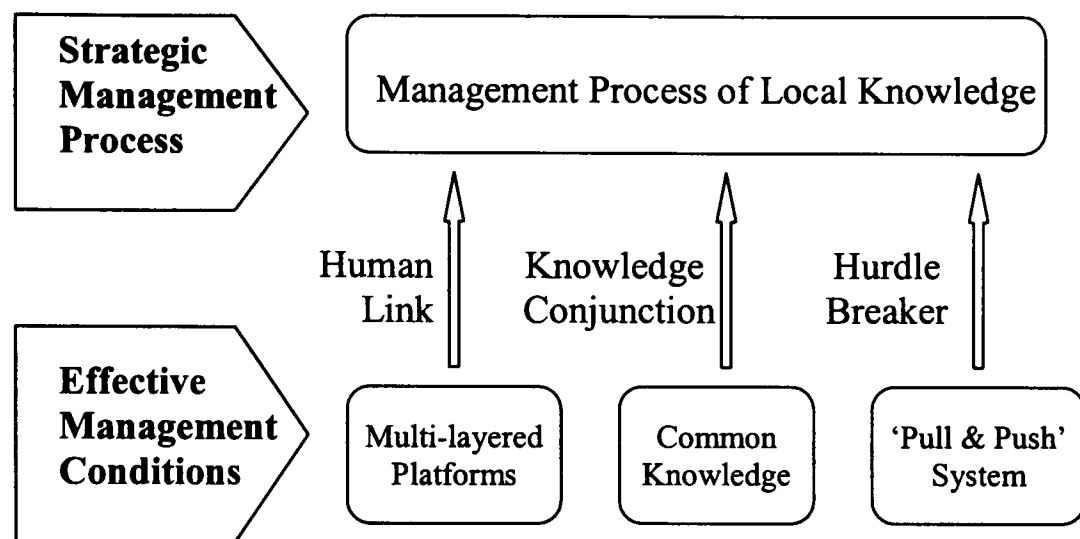
We therefore are interested to find out:

*Question 3: Whether do key local knowledge holders in China business environment include people far beyond the scope of those involved in business transactions?*

If they do, this very dispersed nature of local knowledge sources will suggest that conventional studies on local knowledge management that solely focus on learning effects from joint ventures or international knowledge transfer are limited. The study of local knowledge management should therefore assume wider unit of analysis which includes main local knowledge holders in a host market.

#### **4.4 The Management Model of China Local Knowledge**

As discussed above China local knowledge is highly tacit, undiffused, and fast-changing; some local knowledge may not even be transferable. To understand how multinationals can manage the visibility of China market in such a dynamic business environment we propose a model of local knowledge management which encompasses two strategic efforts (see Figure 4.3): (1) the design of local knowledge management process responding to the nature of China local knowledge and the scope of local knowledge holders; (2) the creation of conditions under which the proposed management process can be effectively implemented. The former suggests the strategic direction of China local knowledge management while the latter indicates its strategic focus.



**Figure 4.3 Model of Local Knowledge Management**

#### 4.4.1 Management Process of Local Knowledge

The notion of local knowledge disadvantage, a central claim of Hymer (1976), has intrigued a number of authors that have viewed internationalisation as a dynamic process of organisational learning (Barkema et al., 1996; Inkpen, 1998; Inkpen and Beamish, 1997; Johanson and Vahlne, 1977; Lord and Ranft, 2000; Petersen and Pedersen, 2002). However, few have explored the particular learning mechanism employed. Inkpen's (1998) work examined learning effects from joint ventures. Lord and Ranft (2000) investigated the extent and determinants of internal local knowledge transfer. Other local knowledge sources essential to international business conduct, as illustrated above in China business context, were relatively neglected. In addition, it has been observed that transferring local knowledge is often problematic because of its intrinsic nature (Lord and Ranft, 2000). Yet, there is a scarcity of insights on an alternative strategy.

In recent years a wide range of knowledge management models have been investigated for analysing key capabilities and illustrating how knowledge flows or is appropriated in a

given system or population. Nevertheless, few have been developed for the purpose of managing the more intrinsic and dynamic local knowledge in an international business setting. Building on the key argument of the general framework developed in Chapter 2, and drawing on the arguments on the nature of China local knowledge and the scope of local knowledge holders, a model of the strategic management process of China local knowledge management is now proposed (Figure 4.4). In this process, undiffused explicit local knowledge is constantly acquired externally through socialised activities and diffused internally into corporate explicit knowledge through built-in knowledge diffusion systems. Some transferable tacit local knowledge is constantly acquired externally through socialised activities and then codified and diffused into corporate explicit knowledge base for public use through articulation and diffusion. Corporate members create new individual tacit knowledge from time to time through making sense of this explicit knowledge base during business decision-making. Corporate tacit knowledge is created when corporate explicit knowledge is embedded into each individual's business behaviour, or some individual tacit knowledge is directly diffused through internal socialised business activities. The new individual knowledge created through sense-making process can then be further transferred into corporate knowledge when it is efficiently and economically transferable in the firm. Specialised tacit knowledge, which takes considerable time, and demands considerable resource to acquire, or non-transferable, is integrated into corporate specialised local knowledge externally through acquisition and co-operation and internally through recruitment and co-operation. Some integrated specialised knowledge can be transferred into corporate explicit and tacit knowledge through years' of close business interaction while some will remain specialised in nature and needs to be further integrated. The corporate-level explicit local knowledge can be accessed by each relevant individual of the multinational firm to make sense of corporate data for decision-making. With corporate explicit and tacit knowledge specialised local knowledge holders often function



as key decision contributors in the corporate decision-making system. Appropriate integration of these specialised business ideas can lead to effective corporate strategic decisions.

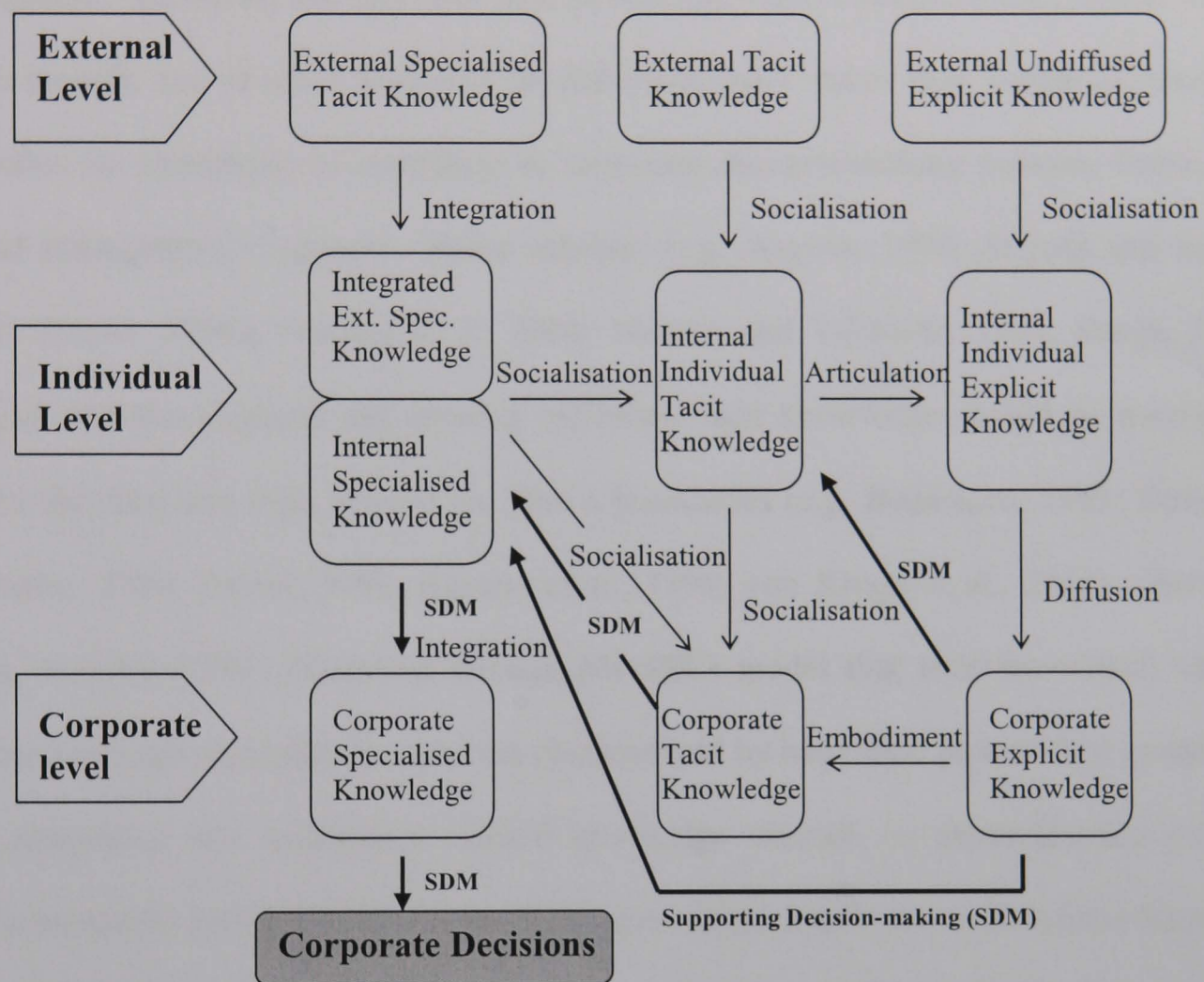


Figure 4.4 Local Knowledge Management Process

There is a rich body of literature on the acquisition of external tacit knowledge. It is described as a socialisation process characterised by individual physical contact (Davenport and Prusak, 1998; Nonaka and Takeuchi, 1995; Polanyi, 1966). However, the undiffused nature of China explicit local knowledge implies that it is also difficult for foreign firms to acquire explicit environmental knowledge without individual physical contact, suggesting the need for a socialisation process for acquiring external undiffused explicit knowledge about China market. Luo's (2000) study also suggests that undiffused

information becomes more fluid in the presence of *guanxi* (personal relationship built through socialisation).

The central importance of tacit knowledge for corporate competitive advantage is widely recognised. However, the fact that tacit knowledge often resides in individuals, and is more mobile, and is often perceived as individual asset rather than corporate resource, indicates its limitations to contribute to corporate decision-making process, hence, has raised management's concern. Some scholars (e.g. Argyris, 1994; Argyris and Schon, 1996; Boisot, 1995a; Nonaka et al, 2000; Nonaka and Takeuchi, 1995; Senge, 1990) suggest that the acquired and existing individual tacit knowledge should be transferred across the firm and even beyond the firm's boundaries (e.g. Badaracco, 1991; Dyer and Nobeoka, 2000; Hamel, 1992; Khanna et al., 1998; von Krogh et al., 2001). Between them, Nonaka (1991) illustrated through his SECI model that tacit knowledge can be diffused through a socialisation process characterised by individual face-to-face interaction and articulated into undiffused explicit knowledge through an externalisation process characterised by collective face-to-face interaction. This undiffused explicit knowledge can be further diffused into collective explicit knowledge through what is termed a combination process. The latter can be embedded into collective tacit knowledge through internalisation. One important contribution of this theoretical framework is that it sees this knowledge transmission process as a dynamic knowledge creation spiral, in which new insights are constantly created by knowledge recipients, and managed in order to sustain the firm's competitive advantage. However, as noted in Chapter 2, the main constraint of this approach is that it is based on the assumption that all tacit knowledge can be eventually converted into explicit knowledge, which ignores the notion that some specific tacit knowledge may be non-transferable (Boisot, 2002), or that the transferring process may not meet all the firm's requirements for efficiency (Grant, 1996a; Spender, 2002).

Furthermore, during business planning process individuals often make sense of diffused explicit knowledge and directly create new individual tacit knowledge, especially specialised knowledge. In this case, diffused explicit knowledge is utilised and converted into individual tacit knowledge rather than embedded into collective tacit knowledge. This individual tacit knowledge often immediately contributes to corporate decisions through a well-designed integrating system to form the basis of corporate integrated knowledge. In addition, this framework also assumes active participation of knowledge holders, which is often empirically problematic (McKinlay, 2002), in cross-cultural business setting in particular (Simonin, 1999).

By questioning whether all types of personal tacit knowledge are transferable and necessarily integrated into collective know-how Grant (1996a) shed light on the specialised nature of knowledge to argue that transferring knowledge is not always an efficient approach to integrating knowledge. In this context he pointed to four mechanisms for integrating specialised knowledge – rules and directives, sequencing, routines, group problem solving and decision making. This model broadly illustrates knowledge integration mechanism as business collaborative activities, as it is submitted that corporate business operations are a business collaboration process; certain mechanisms identified by Grant are considered to be management conditions. This contention is empirically tested then in Chapter 8.

Similarly, by looking at the more complex nature of local knowledge in the international setting some researchers (Bartlett and Ghoshal, 1989; Lord and Ranft, 2000; Makiro and Delios, 1996; Tayeb, 1996; 1998; 1999) find that certain specific knowledge cannot always be learnt, and also requires personal experience, which itself calls for an integration mechanism.

In China, the complex and highly tacit nature of local knowledge implies real difficulties in local tacit knowledge transfer. In addition, the fast-changing nature of local knowledge might make knowledge transfer ineffective. Therefore, tacit knowledge transfer may not always be a suitable approach to local tacit knowledge management, although it is advisable to transfer tacit knowledge where possible as the firm can make its local operations more transparent as a result. Non-transferable tacit knowledge and some specialised knowledge that takes considerable time and requires rich resources to acquire both call for an effective integration approach. Thus, we suggest that some tacit knowledge is diffused through internal social activities and codified through an articulation process. The codified local knowledge can be further diffused through the multinational's built-in dissemination system for decision-making. While some specialised tacit knowledge is integrated through wide scope co-operation, acquisition, and recruitment depending on its transferability, difficulties in the transfer process, urgent level of need, and the multinational's existing resources. Effective integration of local tacit knowledge requires that business decisions are made by local knowledge holders, suggesting the need for decentralised decision-making and a strong sense of accountability and responsibility among local knowledge holders.

Based upon these analyses we enquire that:

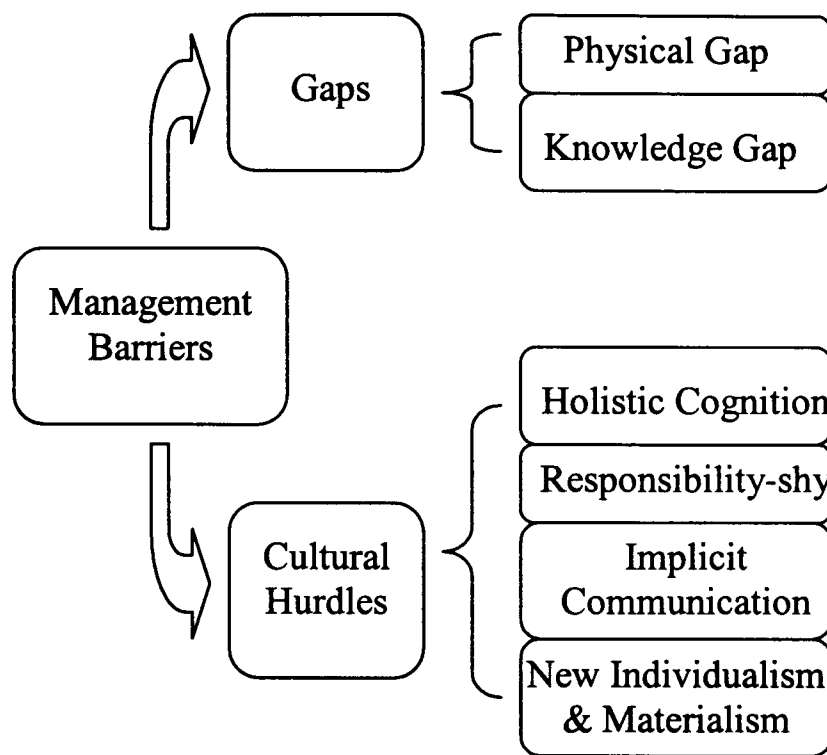
*Question 4: Whether does the multinational firm employ a local knowledge management mechanism that emphasises complementary use of knowledge transfer approach and knowledge integration perspective? In detail, does its local knowledge management process involve the following sub-processes?*

- *External undiffused explicit knowledge is constantly acquired through socialised activities, synthesised and diffused into corporate explicit knowledge base through an in-built diffusion system;*
- *Some external tacit knowledge is constantly acquired at the individual level, and codified and diffused into corporate explicit knowledge base;*
- *The corporate explicit knowledge is then constantly utilised by corporate members either to be embodied as corporate tacit knowledge or to create new individual tacit knowledge;*
- *Specialised knowledge both external and internal is integrated into corporate specialised knowledge base through wide scope collaboration.*

If it does, however, to effectively implement this proposed local knowledge management process, it will be crucial for multinationals to fully understand the management barriers and conditions under which the associated hurdles can be overcome.

#### **4.4.2 Local Knowledge Management Barriers**

One problem with existing knowledge management models is that they neglect implementation barriers, human factors in particular. Previous studies suggest human related factors often affect the ability of both foreign and host sides to communicate and co-operate (e.g. Goodall and Warner, 2003; Scullion, 1995; Tayeb, 1988; 1992; 1996). It can be argued that certain key features of Chinese local knowledge holders have strong negative impacts on local knowledge communication. These are summarised in Figure 4.5.



**Figure 4.5 Management Barriers**

First, the wide scope of China local knowledge, the size of the country, and scale of most multinationals' business all increase the scope of knowledge communication and widen the distance between communicators. Therefore, in addition to normal mental and non-mental gaps there are still huge physical gaps between knowledge holders and seekers in China market. This feature certainly serves as a physical barrier for local knowledge communication. Thus, it is necessary for multinationals to establish connections linking local knowledge holders and seekers.

Second, most local knowledge holders only have limited understanding of wider world businesses (Warner, 1991; 1992; Braun and Warner, 2002). It is also a truth that most foreigners have limited understanding of China and the Chinese. China's former closed-door policy, different economic system and attitude toward influence of external information isolated China from the rest of the world, and limited its international exposure, along with the long absence of business studies in local universities and undiffused nature of external knowledge. Facing the hurdles of the language, diverse



culture, rapid economic and political changes, deficient information system, size and population foreigners feel the local Chinese are naturally difficult to communicate with (Lang, 1998). Although the situation has been changing rapidly in recent years the huge knowledge gaps between Chinese and foreigners still exist and serve as the leading communication barrier in Sino-foreign business. Firms that make every effort to bridge these gaps could certainly have advantages in getting to know the local market better than their competitors.

Third, certain researchers (e.g. Bond, 1996; Hofstede and Bond, 1988; Lang, 1998; Pun et al, 2000; Redding, 1990) found that the Chinese cultural system has promoted a concrete and synthetic view of the world, differing radically from the cognition of Western people. Their holistic cognition, enabling them to see the 'big picture' of problems, is found to have advantages over the inductive thinking practiced by Westerners (Hofstede and Bond, 1988). In addition to their concrete and holistic way of thinking, the Chinese also have a reality-accepting attitude towards problems, which is not always logical in Westerners' eyes (e.g. Lang, 1998; Pun et al, 2000). These three aspects suggest they often develop a networked view of the problem trying to identify all linked aspects to 'encircle' the issue, aiming at elaborating practical solutions that fit into the given environment rather than finding more optimal answers (Lang, 1998, p.41). However, the difficulty of this approach is that the Chinese synthetic thinking process of solving problems is highly tacit, and hence lacks logic in Western terms, being difficult to capture and less acceptable. In addition, because the Chinese approach is more time-consuming when identifying problems (Lang, 1998) the resulting ideas are not likely to be generated during brainstorming process of company meetings or teamwork. Moreover, the local Chinese view of the world, coupled with poor business experience in international settings, often leads to short-term plans, which they develop in a step-by-step manner, as opposed to long-term decisions engaged

by westerners such as Europeans (Lang, 1998). Relational as opposed to rational decision-making is often preferred by Chinese managers aiming at keeping a balance between different interests (Easterby-Smith et al., 1995; Lang, 1998; Pun et al, 2000). In fact, while Western management adheres to plans, standards and fixed principles, Chinese executives tend to adopt a more flexible (or loose) approach since some western practices and thinking are perceived inappropriate or naïve in the China business context (Yang, 1998). Their thinking differences require more mutual dialogues for better understanding and mutual-involved decision making that will enable local knowledge flow and integration.

Fourth, Lang's (1998) intercultural management studies in Sino-European joint ventures show that Chinese shy away from responsibilities due to traditional reasons<sup>6</sup>, indicating that local knowledge has a limited chance to be fully utilised in multinationals' China business operations. Vertically, they have strong sense of power distance determining their preference for hierarchical communication during solving interdepartmental problems (e.g. Lang, 1998; Pun, et al, 2000; Redding, 1990). Horizontally, their interpersonal communication is characterised by seeking consensus and common goals and adopting harmony-seeking style (Lang, 1998). Individual Chinese managers may not want to bear the responsibility for their proposals when drafting up plans. This passive and responsibility-shy attitude may stem from the political and economic turmoil of the Cultural Revolution (Lang, 1998) as well as traditional Chinese culture. However, the fact that most Chinese pursue higher status in their business life (Lang, 1998) indicates that assisting one's acquisition of power is perceived as face giving, which further motivating pursuing responsibilities. In addition, both Billett's (1996) and Huber's (1991) work suggests that decentralised power system facilitates individual competence contribution.



Fifth, some researchers (e.g. Bond, 1996; Hofstede and Bond, 1988; Redding, 1990) have found that the Chinese culture is characterised by implicit communication. Lang (1998) stated that the search for harmony in the Chinese society through the maintenance of 'face', a dominant regulator of social life, has been the greatest barrier for Chinese to bring issues to public discussion and state disagreement with others. It is perceived impolite to disagree, question, and challenge their superiors. And also it is a loss of face to ask any 'low-level' questions. Therefore, understanding face-giving and face-saving mechanism is crucial in order to build trust in this low-trust culture, break the face barrier, and motivate local knowledge holders' involvement in knowledge sharing.

Finally, China's traditional strong individualistic (Ralston et al., 1999) and materialistic culture, which has sometimes been hidden behind a veil of familism and Communist collectivism (Lang, 1998), does not just hinder effective cooperation as it does in most western countries but reduces loyalty and commitment. Consequently, high employee turnover and self-serving behaviours are not uncommon. On top of that, in a face-oriented culture<sup>7</sup>, some Chinese communicate differently from those Europeans who traditionally are individualistic (Lang, 1998). Unlike those Europeans who tend to be aggressive and articulate, preferring to bring issues 'out into the open', Chinese may prefer to take an implicit approach to interpersonal communication (Lang, op cit) although they all usually assess their employees individually and hold them personally accountable for wrong behaviour (Lang, op cit). Moreover, due to their individualism and their strong belief that 'knowledge is power' Chinese have a long history of hoarding knowledge. Furthermore, in 'waking up' from China's former closed-door policy and ten years' absence of a normal educational system, some Chinese realised the importance of knowledge more than any other nationalities in the world<sup>8</sup> and this obviously adds more difficulties to knowledge sharing. An adapted corporate culture compensating this psychological feature and a

business philosophy of mutual benefit practiced in other individualistic cultural societies are necessities to improve the situation.

Based on these analyses, the next research question is derived as:

*Question 5: Whether do Chinese local knowledge holders possess certain specific features that can have strong negative impacts on local knowledge flow and integration, namely, physical and knowledge gaps, synthetic view of the world, implicit communication, responsibility-shy attitude, and emerging materialism and individualism?*

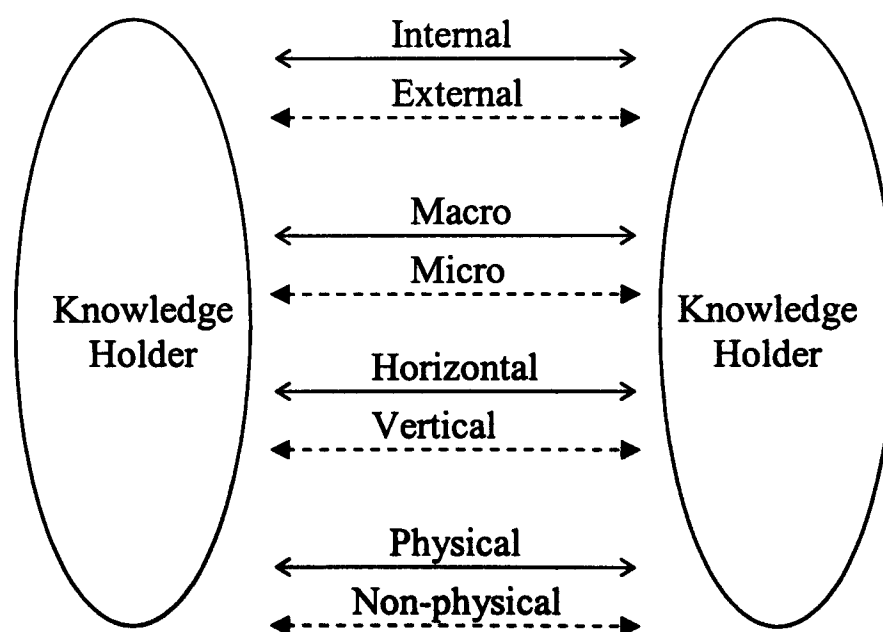
If they do, any local knowledge management system in the China context should aim at creating the conditions under which the huge gaps between knowledge holders and seekers can be effectively bridged and knowledge communication barriers can be strategically resolved.

#### **4.4.3 Local Knowledge Flow and Integration Conditions**

In order to explore how knowledge flow and integration barriers can be broken I propose three strategic conditions of local knowledge management: *Multi-layered knowledge platforms* serving as links connecting knowledge holders, *common knowledge* serving as knowledge conjunction ensuring knowledge holders meet in a positive condition, and a *'pull and push' system* serving as strategic means to break rooted human barriers that hinder effective knowledge flow and integration.

#### 4.4.3.1 Multi-layered knowledge platforms

Multinationals should establish multi-layered knowledge platforms (see Figure 4.6) in their business structure and routine in order for knowledge holders to interact. These multi-layered platforms are designed to meet the strategic direction of China local knowledge management. The main function of these platforms is to link different knowledge holders internally and externally, physically and/or non-physically, and vertically and horizontally at both macro and micro levels. At macro level they draw knowledge holders close to the multinational firm. While at micro level they are designed to suit individual needs. Vertically they facilitate bottom-up knowledge flow and integration, and horizontally they allow inter- and cross-functional cooperation. Internally they promote ultimate use of shared resources and built-in collaboration and interaction systems. Externally, they emphasise wide scope of network activities, relationships and business contacts.



**Figure 4.6 Multi-layered Knowledge Platforms**

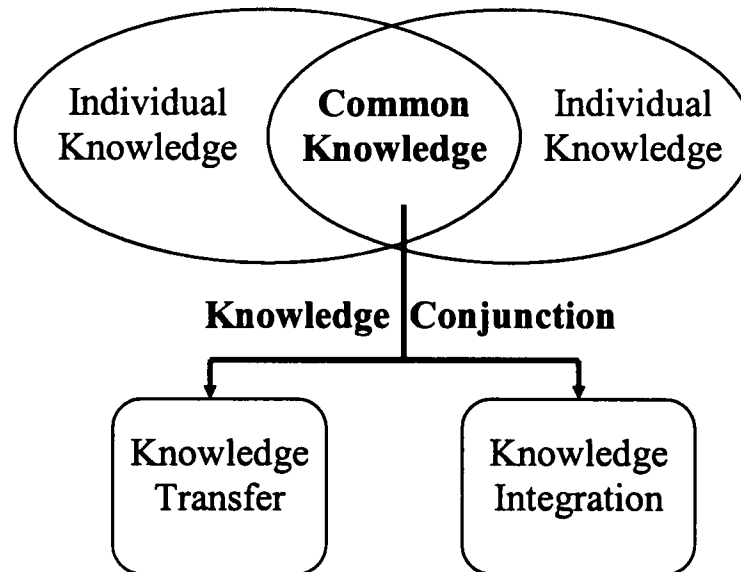
The proposition of the concept of knowledge platform is based on the non-mental dimension of 'ba', non-mental shared space and time, adopted by Nonaka (1998) and Nonaka et al (2000) to facilitate knowledge transfer and the concept of knowledge connection proposed by Inkpen (1998) to facilitate effective tacit knowledge acquisition between international alliances. In considering the crucial need to integrate tacit knowledge in China market we also considered the mechanisms of teamwork and taskforce pointed by Grant (1997) in order to create chance for specialised knowledge holders to work together. However, Grant's (1997) unit of analysis is unfortunately limited to the firm. In the case of China, where the scope of local knowledge holders includes people far beyond business transactions, its limitations become apparent. As compensation we will address wide business co-operation and acquisition at macro and external levels as part of the layers of knowledge platforms that will facilitate external specialised tacit knowledge integration into its existing specialised corporate local knowledge base. These multi-layered knowledge platforms ensure local knowledge holders bridge non-mental gaps and have maximum chance to meet for local knowledge flow and integration. Therefore, it is enquired that:

*Question 6: Can multilayered knowledge platforms (internal-external, macro-micro, horizontal-vertical, physical-non-physical) be established in the multinational firm to bridge the physical gaps between local knowledge holders and seekers?*

#### **4.4.3.2 Common knowledge**

Multinationals should develop common knowledge serving as knowledge conjunction between knowledge holders and seekers in order to bridge their huge knowledge gaps and allow different knowledge meets under a positive condition (see Figure 4.7). The

knowledge conjunctions can be built through enhancing both local knowledge holders' knowledge and global expertise' knowledge at both individual and corporate levels. The means for developing common knowledge can be knowledge transfer such as training at different levels and/or knowledge integration such as job design.



**Figure 4.7 The Function of Common Knowledge**

The proposition of this concept is based on Grant's (1996a) definition and illustration on common knowledge, an efficient tool to enhance knowledge '*absorptive capacity*' (Cohen and Levinthal (1990):

“At its most simple, common knowledge comprises those elements of knowledge common to all organisational members: the intersection of their individual knowledge sets. The importance of common knowledge is that it permits individuals to share and integrate aspects of knowledge which are not common between them.”

(Grant, 1996a, p. 115)

It has some similarities with Nonaka et al's (2000) '*dialoguing "ba"*', the mental dimension of '*ba*', Lam's (2000) '*shared understanding*', Athanassiou and Nigh's (2000)

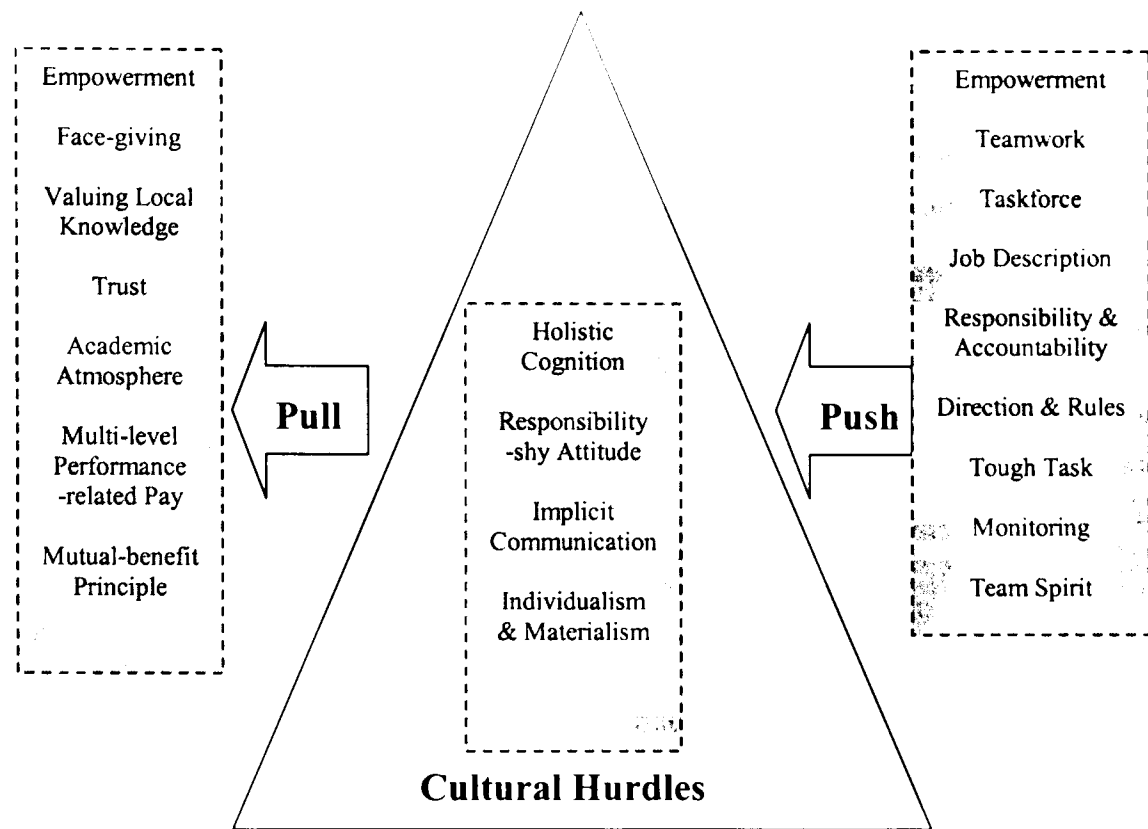
'*common understanding*', Child and Rodrigues' (2002) '*common national or technical language*', and the concept of '*relatedness of knowledge*' addressed by Inkpen (1998) and Markides and Williamson (1996) and Lord and Ranft (2000). However, Grant's (1996a) unit of analysis is based on the firm while Nonaka et.al's (2000) analysis goes beyond the firm's boundaries. By extending the concept to international strategic alliances and overseas' operation Inkpen (1998) and Lord and Ranft's (2000) illustration revealed the crucial importance, complexity and difficulties of its application in international settings, where people involved naturally share limited languages, commonalities, background, common sense, literature and so on. In the case of China, where huge knowledge gaps are identified between Chinese local knowledge holders and global business professionals, the development of common knowledge serving as knowledge conjunction between knowledge holders and seekers is crucial to effective knowledge communication. Thus, we enquire that:

*Question 7: Can common knowledge significantly facilitate local knowledge transfer and integration?*

#### **4.4.3.3 A 'pull and push' system**

To break the cultural hurdles of local knowledge holders for effective knowledge communication a well-tuned 'pull and push' system (see Figure 4.8) is required by multinationals' China businesses. In this system, local thinking has greatest chance to contribute to multinationals' strategic decisions. In this regard, multilevel teamwork and task force participated by local knowledge holders, both external and internal, and empowerment through which knowledge holders have the chance to make decisions directly can be effective means to meet this cultural feature. Secondly, local knowledge

holders will be pushed and pulled to take responsibilities in this system. In considering the fact that most Chinese pursue higher status in their business life (Lang, 1998) multinationals should make the greatest effort to assist local knowledge holders' acquisition of power perceived as face giving, and hence motivate taking responsibilities. In addition, explicit and detailed job description will help local knowledge holders understand their responsibilities. Thirdly, this system should give full consideration to the Chinese face culture and promote explicit communication. On the one hand, understanding face-giving and face-saving mechanism is crucial in order to build trust in this low-trust culture, break the face barrier, and motivate local knowledge holders' involvement in knowledge sharing and integration. On the other hand, an embedded learning culture with strong emphasis on accountability, valuing local knowledge, trust (Dodgson, 1993), and promoting academic atmosphere as compensation means to tackle low trust and implicit cultural features of local knowledge holders, will motivate articulation of tacit knowledge. In addition, rules, directions, tough task assignment and empowerment will all exert pressure for local knowledge holders to share and utilise their ideas. Factors such as detailed reporting requirement, well-prepared and directed meetings and seminars, well-monitored team and individual work may ensure more contribution from the local knowledge holders involved. Fourthly, to compensate for the new materialism and individualism feature of local knowledge holders this system should include a motivation system in which both individual and collective performance will be considered in its performance-related pay system. Moreover, the principle of mutual benefit in business should be considered as an important motivation factor to local knowledge flow and integration in order to meet new materialism. In addition, a corporate culture which promotes collaborative spirit will weaken individualism.



**Figure 4.8 A 'Pull and Push' System**

Drawing from these arguments, it is enquired that:

*Question 8: Can a 'Pull and Push' system, which involves strategic means such as empowerment, explicit job description, rules and directions, tough task assignments, mutual-benefit policy and a learning culture with an emphasis upon trust, collaborative spirit, accountability and academic attitude towards business issues, be employed to break through the cultural hurdles that hinder local knowledge management in China market?*



## **4.5 Summary**

Having examined the nature of China local knowledge and the scope of local knowledge holders it is found that, unlike global knowledge transferred to China, local knowledge in this dynamic market is highly tacit, undiffused and fast-changing; some local knowledge may even be non-transferable. It was argued that local knowledge might have greater impact upon the multinational firm's performance than global knowledge transferred to China market owing to its intrinsic and fast-changing nature. We have identified the main local knowledge holders in China and found that the scope of local knowledge sources extends beyond business transactions. Based on this understanding a process model of local knowledge management is proposed in which external undiffused explicit knowledge is constantly acquired through socialised activities, synthesised and diffused through built-in diffusion system, and some external tacit knowledge is constantly acquired and internal individual tacit local knowledge is codified and diffused into corporate explicit knowledge base for effective decision making, while specialised local tacit knowledge is integrated into specialised corporate tacit knowledge base for fuller utilisation. To further understand how this process can be implemented we have identified key knowledge communication barriers by analysing the main features of local knowledge holders and investigated means for breaking associated communication hurdles. We found that Chinese local knowledge holders had huge physical and knowledge gaps with global business specialists and they might also share some cultural features serving as rooted human hurdles for effective local knowledge flow and integration. Therefore, the second element of our proposed management model of local knowledge encompasses three conditions under which communication barriers can be resolved. These conditions include multi-layered knowledge platforms on which local knowledge holders are given the maximum chance to meet, common knowledge serving as knowledge conjunction to allow knowledge holders

and seekers to meet positively and a 'pull and push' system in which rooted human hurdles are overcome.

## **4.6 Conclusion**

The key arguments and the model developed and presented in this chapter will not be directly tested in the field study. Rather, as it is argued in Chapter 5, in order to avoid biased response, they will be compared with a practical model which will emerge from the findings of the study. The main contribution of this model will be six fold if it can be found consistent with the practical model: First, it will fill in a gap in the unexplored conceptual territory of strategic management of China local knowledge. The model developed in this chapter offers concrete propositions about how to effectively and efficiently manage local knowledge for better China business decisions and performance, and explicitly indicates a main theme of the multinational firm's effective China strategy. Second, it will suggest that the over-emphasis upon the role of the multinational firm in transferring home-based knowledge to host markets at low costs, thereby, offsetting 'liabilities of foreignness' is problematic, as it may overlook the nature of local knowledge and underestimate its impact upon the firm's business performance. Third, it will suggest that conventional studies on local knowledge management that solely focus on learning effects from joint ventures or internal knowledge transfer can be limited by pointing out that local knowledge sources in China market may be very dispersed. Fourth, it will indicate that a knowledge transfer approach, which was over emphasised in local knowledge management literature, may be limited. The argument has been that knowledge transfer may not be an optimal choice of exploiting China local knowledge; to realise its full value knowledge integration should be employed as compensation. Fifth, it will

provide insights into the argument on management strategies towards tacit knowledge between Nonaka et al (2000), who maintains that tacit knowledge should be transferred in order for its full value to be realised, and Grant (1996a), who argues that some specialised tacit knowledge needs to be integrated to achieve efficiency. The predicted nature of local knowledge (very intrinsic and fast-changing) will suggest that a knowledge transfer approach may not respond to China's situation. Finally, this proposed framework will identify the management barriers hindering local knowledge management and the management conditions under which individual knowledge flows and is integrated into multinationals' global knowledge base in China business context. It may suggest that human factors, which were conventionally overlooked in knowledge management research, can have an important role to play in implementing knowledge management initiatives.

Although to some degree the establishment of this model might enrich the existing literature, it has similar constraints to those identified in the general framework outlined in Chapter 2. Nevertheless, certain constraints will be re-addressed in the empirical chapters which follow. This model serves as a good starting point for further empirical research, which follows. Moreover, this model should also be useful because it provides theoretical insights into organisational local knowledge creation that can be utilised beyond China business context, particularly those emerging economies in which foreign investors face similar issues. For example, the Chinese and Indian markets may have much in common; the cultural traits of Chinese are substantially similar with those of Indians (see, for instance, Tayeb, 1987; 1988). The strategic propositions of the local knowledge management model developed in this chapter might be useful in the latter business setting.

## Notes

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<sup>1</sup> See, for example, Buckley and Casson (1976), Hennart (1982), Hymer (1976), Lord and Ranft (2000), Mezas (2002), Miller and Parkhe (2002), Sethi and Guisinger (2002), Zaheer (1995).

<sup>2</sup> Also see China Economic Weekly (2000) and China Pulse (2000).

<sup>3</sup> This was supported by a number of recent work, for example, Child and Warner (2003).

<sup>4</sup> This was called 'regionalism' by Huffman (2003).

<sup>5</sup> This was further revealed from latter work, for example, Studwell (2003).

<sup>6</sup> This was echoed by Ritchie's (2003) recent illustration of accountability and responsibility from social economic point of view in the case of China.

<sup>7</sup> This can be found in most cultural studies, for example, in recent work of Child and Warner (2003).

<sup>8</sup> This was supported by latter work like Redding (2002).

## **Chapter Five**

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### **Methodology: On-site Investigation**

#### **5.1 Introduction**

Previous studies on local knowledge management strategy have focused upon a knowledge acquisition and transfer approach. Other competing knowledge management strategies and implementation issues have not been fully explored. The theoretical model developed in the previous chapter considerably redresses these imbalances to better explain performance differences between multinational firms in China. In order to test to what extent the theory model is consistent with practice it seeks to explain and explore further insights into the key research problem the researcher undertook a longitudinal field study. This chapter considers the rationale behind the research strategies deployed and describes the methodological steps taken. It will define the nature of the research problem and clarify exactly what is to be sought from the empirical work. It will subsequently discuss how this problem can be addressed by connecting chosen theories paradigms to particular strategies of inquiry. It then will describe the detailed design of the field research, covering the methods of data collection, choice of populations and instruments used, elaborate how it was adapted to the nature of the problem and the research context, and specify how the two critical issues of representation and legislation were addressed. It will finally highlight the main validating procedures employed and assess its advantages and limitations. It argues that an important contribution of this study is the use of qualitative multi-methods that allows greater understanding of the research problem.

## 5.2 The Research Objective

The primary objective of this research is to address the gap in the understanding of the causes and forces that explain performance differences between multinational firms in China. By emphasising the role of local knowledge in assisting in the multinational firm's smooth operation in the dynamic China market, the theory advanced in Chapter 4 consists of a series of arguments summarised in specific hypotheses and exploratory questions.

More specifically, we need firstly to *examine* the *concept* of *local knowledge* and its *nature* in order to *discover whether* and *why* it is a key source of competitive advantage in China market. Secondly, we need to *identify* local knowledge holders in order to *determine* who should be managed. Thirdly, we need to *discover* what management *process* and *mechanisms* are employed to develop competitive advantage from local knowledge sources. Fourthly, we need to *identify* the *context-specific features* of the main *local knowledge holders* and *examine whether* and *in what way* they may hinder local knowledge *management process*. Fifthly, we need to *investigate how* the management obstacles can be overcome to ensure successful *implementation* of local knowledge management *initiatives*. Finally, we need to *find out whether* superior business performance is attributed to full exploitation of local knowledge, that is, to *determine* whether there is a *causal relationship* between local knowledge exploitation strategies and the multinational firm's business performance in a *China business setting*. Since there is very limited understanding of these critical issues thus far, these questions are truly *exploratory* in nature. It is the purpose of next section to discuss how a unique field strategy emerges in the face of the characteristics of these issues and the specific research context.

### 5.3 Strategy of Inquiry: The Choice of a Qualitative Approach

Knowledge management as a new subject has not been studied in various ways that consider a variety of possibilities. Though research approaches in social sciences range broadly, from longitudinal ethnographic studies with a predominant focus on observations to in-depth interview methodologies and one-shot questionnaire approaches, previous studies on knowledge management strategies have often relied upon theoretical deduction and survey approach. Though the deductive method is a useful '*method of getting knowledge*', empirically established data have more claim to be called 'knowledge' than does a conclusion arrived at deductively (Simon, 1969, p.274). This is not to ignore the usefulness of deduction. Rather, as Simon (1969) advised, we should not limit ourselves to its use, and then neglect other empirical methods. This study therefore aims at combining theoretical deduction and empirical research. However, the question is: what empirical approaches are best suited for exploring the specific research problem of this study? The purpose of this section is to consider all possibilities in addressing that specific research problem and explain the choice of a qualitative approach.

Empirical research approaches in social sciences range widely. However, they are not readily classified. Nevertheless, there has been a broad divide between research based on the science model and research which derives from ethnographic commitments. The former was often labelled as '*quantitative*' research or '*survey*' whilst the latter was often termed '*qualitative*' (as opposed to '*quantitative*') research (e.g. Filstead, 1970; Schwartz and Jacobs, 1979; Taylor and Bogdan, 1984) or '*field research*' (as opposed to '*survey*') (e.g. Burgess, 1982; Singleton and Straits, 1999). Although the dividing line between these approaches are not completely clear the distinction between qualitative and quantitative approaches has been widely adopted (e.g. Bryman, 1988; Denzin and Lincoln,

2000; Miles and Huberman, 1994; Morse, 1994; Silverman, 2001; Strauss, 1987). According to Denzin and Lincoln (2000, p.3), unlike quantitative techniques that emphasise *measurement between variables at a single point in time*, qualitative approaches stress 'the *qualities of entities and processes and meanings that are not experimentally examined or measured in terms of quantity, amount, intensity, or frequency*'. They are used to seek answers to questions that stress '*how social experience is created and given meaning*' rather than for *descriptive and explanatory* purposes. They stress the *socially constructed nature* of reality and the *value-laden nature* of inquiry rather than scientific *preciseness* of information. Qualitative inquiry involves intensive interaction between the researcher and the informants in a limited number of settings and may therefore lead to '*observer bias*' (Simon, 1969, p.88) and '*observer-caused effects*' (Simon, 1969, p.91), whereas quantitative research relies on detached and inferential materials where may be susceptible to '*reactivity*' (Singleton and Straits, 1999, p.247), which introduces systematic measurement error. Qualitative inquiry aims to achieve *depth* therefore may lack of generalisability, whereas quantitative research targets gaining *breadth*, and hence may not completely understand the context. The criteria for choosing a research strategy are therefore determined by the characteristics of the research questions and the specific situations of the research project.

One significant feature of the research questions is that knowledge and knowledge management processes and strategies we seek to explore are *difficult to measure, to define, and to articulate*. Knowledge and knowledge management practices are deeply *embedded* in daily business behaviours, and are often used unnoticed. Though knowledge management as a subject, which is intentionally studied, is new, knowledge management practices have long been exercised in organisations and societies. People take them for granted, as they are not labelled in terms of knowledge management. Informants may



simply '*lack of knowledge by subject*' (Simon, 1969, p.100). This *soft* nature of the research topic itself indicates the potential inappropriateness of a quantitative approach, which relies on *hard measures* and *numeric forms* to find things out. Not only would it pose difficulties in designing a structured questionnaire but also in describing management phenomena as an answer to research questions. Consequently, informants may not be able to answer the question in the way the researcher intends. As a result, the researcher may only get limited knowledge from the informants. This is an important limitation of a wholly survey based approach to exploring knowledge management issues, as used in other studies.

A second feature of the research questions is that *local knowledge* is a *social context-specific* concept. It is about the understanding of a *social* as well as *organisational construct and behaviour*. Its management involves *complex and interrelated social phenomena*. It is necessary to find out *how* local knowledge *flew* among populations and systems and *how* it became *embedded* into individual as well as *social settings*; *how* it was utilised through *socially-organised* business activities; *how* its carriers *interacted* within and *beyond* organisational boundaries; and *how* the *social and business setting* in which it was exploited influenced the management process. In other words, I needed not only to investigate the intended management process but also the *context-specific* management barriers and management conditions under which that management process was then *implemented*. The implementation process involved *people* - *how they acted, thought, and felt*, and *how they interacted* with one another. I also investigated *relations* within and among *social groups*, and into *how* the groups adapted to changes. Without this *social context* there would be no local knowledge. To explore these *socially inter-related and human-centred* issue of implementation, qualitative approaches, best suited to investigate

*social dynamic situations*, were considered more appropriate (Hall and Hall, 1996; Singleton and Straits, 1999).

A third feature of the research questions is that they are concerned with the local knowledge management *process*. I needed to look into the *whole* management system in which local knowledge was best utilised for effective business decision-making, and how the multinational firm *interacted* with its business environment over time. The management phenomena I intended to investigate were not isolated scenarios that occurred at a *single point in time*, rather, they were *holistic* and *dynamic* and should be studied simultaneously and as a *whole*. The search for understanding of the *whole dynamic picture* of local knowledge management *process* called for qualitative approaches that emphasise 'the *qualities* of entities and *processes* and *meanings*', which are *not quantifiable* (Denzin and Lincoln, 2000, p.3).

A fourth feature of the research questions is that they are *exploratory* in nature. The purpose of this study is to fill in a gap in the unexplored conceptual territory of how to develop competitive advantage from local knowledge in China market. The intention is to understand the causes and forces that explain performance differences between multinational firms in China. So far there is limited understanding of local knowledge, its role in the multinational firm's business conduct, and its management. With regard to China local knowledge and its management relatively little research has been done thus far. The research questions were set to understand the *meaning* of personal perceptions and business actions that convey knowledge, and the *rationale* behind them. They concerned the *implicit theories* about international business conduct. They were set to develop an *empirical model* of managing local knowledge in the Chinese business setting. The *exploratory* nature of these research questions called for qualitative approaches by which a

set of *rich data* could be gained to ensure the *concept* and *theoretical model development* (Silverman, 2001; Singleton and Straits, 1999).

A fifth feature of the research questions is that they aim to investigate competitive strategies deployed by multinational firms, of which companies try to make *secret* in order to avoid any *best practice* spill-over. The questions I intended to ask were about the *power* of the people and organisations, *knowledge*, and its utilisation, a *people-manipulated technique*. Would people always tell the *truth*? Would people be committed to answer such a *sensitive* and complicated question? With these questions in mind I doubted that a quantitative approach alone would secure qualified data gathering. It could even result in an extremely low response rate or limited control over the choice of informants. Qualitative methods, however, offered the researcher the opportunities to build up rapport with informants, and thus, enable her to elicit true answers to such sensitive questions. This is a useful approach to finding things out particularly in China, a Guanxi (relationship) society, which put constraints on the way in which the researcher conducted her study. It responded to the nature of doing research in China. This was made apparent during my field study. The country president of a leading bank who was willing to meet me in person was not available in the time slot offered and refused to answer a one-shot questionnaire. Instead he stated his willingness to have a research meeting in the future. Therefore, qualitative approaches served as the prerequisite to overcome the obstacle of '*cover-up*' (Simon, 1969, p.104).

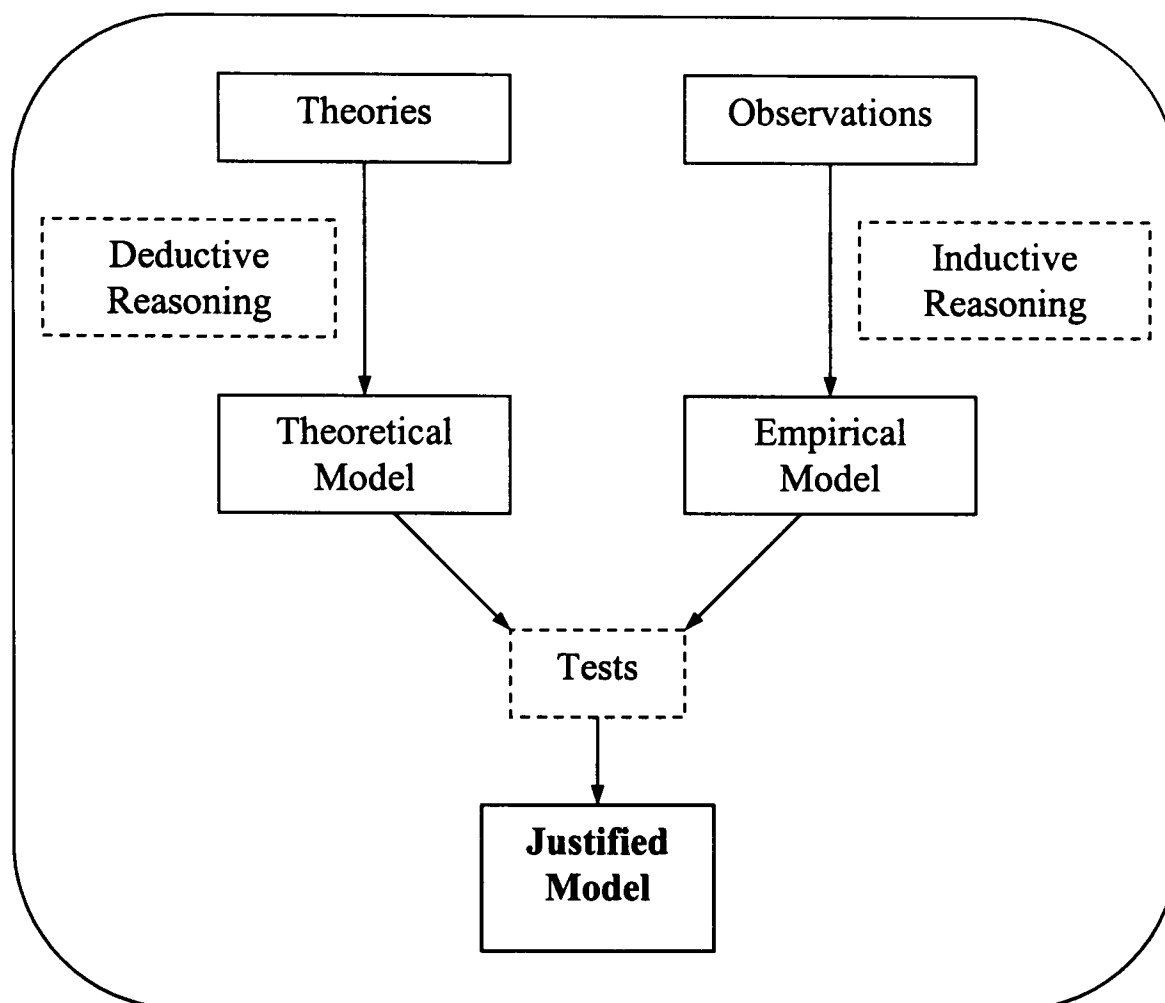
A final feature of the research questions is that they involve finding cause-and-effect relationships between local knowledge management strategies and the multinational firm's business performance in China. However, according to Singleton and Straits (1999), the criteria for inferring cause-and-effect relationships cannot be established easily by

quantitative techniques since variables are measured at a single point in time. Similarly, Simon (1969, p.69) alerted that “*the decision whether or not to call a relationship ‘causal’ is indeed a delicate matter*”. Simon went on to argue that neither quantitative techniques nor other formal reasoning methods could guarantee that an observed relationship was causal. Yet, the value-laden qualitative techniques would allow the complicated and detailed richness of such phenomenon to emerge.

Therefore, the nature of the research questions strongly called for qualitative approaches towards addressing this specific issue. Although undertaking qualitative studies in international settings is costly and time-consuming wholly quantitative techniques may not fully explore all the local knowledge management issues concerned.

#### **5.4 Primary Research Design: An Exploratory Multi-method Study**

Many qualitative studies either rely on field exploratory investigation to build ‘*grounded theory*’ (Glaser and Strauss, 1967) or adopt a testing out approach (Philips and Pugh, 1992), that is, to develop qualitative hypotheses and directly subject them to an empirical test. The former neglects the role of theoretical deduction in forging new insights, whereas the latter can bring preconceived perceptions into the field study, and therefore build ‘*observer bias*’ (Simon, 1969, p.88) and ‘*observer-caused-effects*’ (Simon, 1969, p.91) in. To avoid these drawbacks I employed a research process depicted in Figure 5.1.

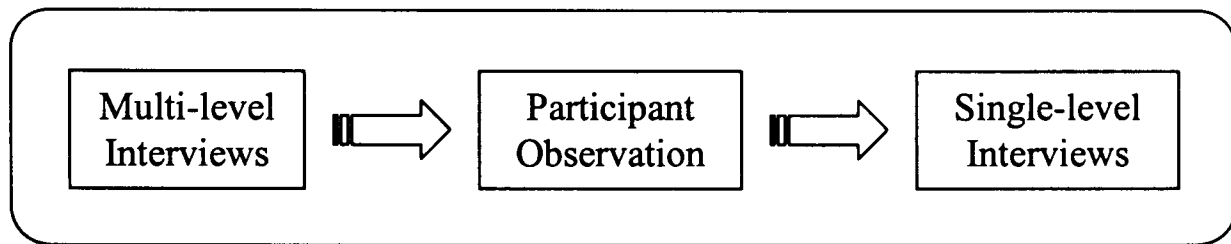


**Figure 5.1 The Research Process**

In this research process, I first advanced a theoretical model (presented in Chapter 3) drawing from a knowledge management framework (developed in Chapter 2) and a variety of disciplines. Yet, I did not carry it into the field directly in order to alleviate '*observer bias*' (Simon, 1969, p.88) and '*observer-caused-effects*' (Simon, 1969, p.91). Rather, an empirical model was developed by analysing empirical evidence gathered through real cases. Instead of imposing my categories and conceptions upon respondents within the research sites to gather data, I allowed key concepts and theoretical arguments to emerge from the real world. I then compared the two models to examine to what extent the key argument put forward in the theoretical model had been tested and to what extent the empirical model stood. The lack of a priori knowledge of the topic under study suggests that singular reliance upon theoretical deduction or a qualitative testing out can sometimes risk becoming misleading.

A multi-method qualitative approach was chosen for carrying out the empirical study. It was adopted in response to the requirements of the research questions and the specific research context. This design consisted of three major research phases (Figure 5.2) moving from a *first stage* of multi-level in-depth interviews with 17 Chinese managers in different positions among 4 Chinese organisations to a *second stage* of field observation on 2 Chinese projects involving 6 European companies, and then, to a *final stage* of single-level in-depth interviews with elite managers of 11 European multinationals. Each phase was designed to uncover certain specific aspects of the research questions. Phase one was designed to examine the concept and the nature of China local knowledge. Since the theoretical model was based upon the assumption that local knowledge was a key source of competitive advantage in China market it was therefore critical to empirically test such proposition. A second purpose of this phase was to identify local knowledge holders in order to specify the unit of analysis for further study. A third purpose was to explore their perceptions on their foreign interactive firms or rivals in China business operation and competition. Though these aspects of the research question were also further investigated during the two phases of study followed in order to foster credibility through *triangulation*, the basic concept of local knowledge and the scope of local knowledge holders emerged from this phase. Phase two was designed to specifically observe whether there was a causal relationship between exploiting local knowledge and the multinational firm's business performance, although it was also used to investigate other sub-questions and generate key arguments on local knowledge management issues. Phase three was designed to focus on key research topics revealed in phase two broadly investigating main management processes and key management strategies. It aimed to develop a relatively generalisable empirical model of managing China local knowledge. For this purpose, the researcher rejected the choice of multi-level interviews within one or two companies although it was clear that the breath was gained at the expense of depth.

A formal pilot study was not conducted because my first stage multi-level interviews were intended to serve similar purpose.



**Figure 5.2 The Research Design**

The aim of deploying such multi-method approach was to increase validity. I recognised that different methodologies were likely to illuminate different facets of the question. Triangulation was seen as an important way of increasing credibility. A number of writers on ethnographic methodology agree that triangulation is a major way of validating qualitative research (Silverman, 2001). As Denzin and Lincoln (1994) commented:

“Qualitative research is inherently multimethod in focus ... However, the use of multiple methods, or triangulation, reflects an attempt to secure an in-depth understanding of the phenomenon in question. Objective reality can never be captured. Triangulation is not a tool or a strategy of validation, but an alternative to validation ... The combination of multiple methods, empirical materials, perspectives and observers in a single study is best understood, then, as a strategy that adds rigor, breadth, and depth to any investigation ...”

(p. 2)

### **5.4.1 Sampling**

In this exploratory multi-method study the unit of analysis consisted of the multinational firm and its interactive entities in China market. To conduct business in China market the multinational firm not only directly interacts with business partners, but also deals with



diversified external relations. This unit of analysis however was not pre-determined. Rather, it was identified in the field. As Singleton and Straits (1999) pointed out, one reason it is important to identify accurately the unit of analysis is that confusion over units may result in false or misleading conclusions about research findings. To draw conclusions about how the multinational firm develops competitive advantage from local knowledge on the basis of information about how it learns from its joint ventures or how it transfers internal knowledge, while ignoring other possible knowledge sources, might bias further enquiry.

The sample of multi-level interview study was composed of 3 Chinese companies with foreign companies as their main suppliers and/or competitors and 1 Chinese research institute acting as the information and research centre in its industry. One case, headquartered in Beijing, was a diversified private business group that had a foreign joint venture as its competitor in its core business, the garment sector. The second case, headquartered in Nanjing, was another private business group in the food manufacturing sector, whose business tended to be vertically integrated and was considered to be a business 'miracle' by local government and multinationals in the food sector. It had both wholly owned and joint venture foreign competitors and numerous other multinationals as its suppliers. The other firm, located in Tianjin, was in the petrol-chemical sector. It had a major purchasing department for its development projects and multinational suppliers. My purpose to include this state-owned conglomerate in this study was to investigate whether purchasing behaviour when interacting with multinationals was any different from others for state-owned firms were still some multinationals' main customers and partners. Selection of these companies was based on degree of business interaction between the company and the multinational firm, business scope and accessibility. I sought to include those that had intensive business interactions with foreign companies, that had freedom to



control and manage their businesses, that had large scale business activities, that outplayed their foreign counterparts in their sectors, which were accessible as well. The inclusion of the research institute, located in Beijing, was based on the need for expert judgement about local industry knowledge because local research organisations had served as the key source and disseminators of knowledge in each industry.

The sample of field observation study involved 2 Chinese firms and 6 European companies in a single sector. It was two business projects of the Chinese firms created this unique possibility: one was a purchasing (in bidding form) project of a well-known Chinese firm in the meat processing sector, and the other was a bidding project for equipping a new factory of another diversified Chinese firm. The six European multinationals involved originated from Germany, Denmark and Spain in machinery, packaging material and food additives. They were all present in China for more than three years. This field observation was undertaken in late March 2001 in Beijing, where the first initiatives of the projects were envisaged, and in May 2001 in Frankfurt, where agreements were made. I joined both the two projects as a participant. The choice of field observation was based on an emerging opportunity in March 2001 when I had multi-level interviews with Chinese managers in Beijing. Taylor and Bogdan (1984) describe the ideal setting for participant observation as one that is directly related to the researcher's interests, easily accessible, and allows for the development of immediate rapport with informants. This ideal was realised in my field study. On the one hand, the two bidding projects involved 6 European companies that would certainly make every effort to win projects. On the other hand, the Chinese side, two local companies, would certainly choose any products they needed in the available time frame. Both deals would certainly be agreed during two international fairs held in Beijing and Frankfurt. The issue what differentiated the winners from losers in the bidding projects and how people actually made things happen, which I was interested,

surfaced. Secondly, I had a direct professional stake in this setting. One Chinese company was my former client and I had close relationships with most of the managers there. This company had also participated in my first stage multi-level interview study. The other Chinese company sought my assistance in its bidding process as it was new to that industry. I also had some relationships with five of the European companies involved. Therefore, the required rapport was already present to permit clear observation. Thirdly, there was secured funding for my trip to Germany. The only drawback of selecting this observation setting was my over-familiarity with it, which might have created observer variability. However, as Lofland and Lofland (1984) suggested, I had to start where I was. For this reason I was very keenly aware of my observer role.

The sample of single-level interview study consisted of 11 European multinationals in 10 sectors with China representative offices or business subsidiaries formed between late 1970s and 1998. One withdrawing multinational firm was intentionally invited to avoid bias interpretation on the causal relationship I intended to investigate. The business scope of the European multinationals ranged from one business subsidiary to 27 companies in China. Four had more than 10 enterprises. Ten had more than two subsidiaries. They originated from 6 different European countries. Selection of these companies was based on the multinational firm's business scale, sector in which it operated, country of origin, years' of presence in China, and access. Before selection a variety of commercial organisations, such as China Desk, European Chambers, European Embassies, were contacted to gain lists of European companies operating in China, resulting in lists of companies from 9 different European countries. However, some had merged or been acquired or diverted, and others claimed to be truly international. Consequently, it was difficult to determine how much country of origin mattered. Therefore, country of origin was not a strict selection criterion. From these lists I selected those that had headquarters,

and/or regional headquarters, and/or key business activities in Beijing/Tianjin area. The consideration behind such location choice was that I could obtain the resources required for the study, such as communication facilities, and reduce the costs of accessing sites from a Beijing base. A second consideration was that Beijing/Tianjin area was in the central position of North China and it was also the political centre of China, so most European companies had headquarters or regional headquarters in this area to oversee their overall businesses. A third consideration was that those companies that had headquarters in the North often operated further across China. They were sources of business knowledge of the entire country, not just Beijing or Tianjin alone. This choice therefore would not result in significant systematic bias. Based on this selected list of European companies a random sample of 84 companies spread evenly across 14 sectors<sup>1</sup> was further selected in terms of business scale and number of subsidiaries<sup>2</sup> (see Table 5.1). Personal relations as well as direct contacts were then used to negotiate access. The response was 17 letters, faxes and emails, 13 expressing willingness to assist, 2 explaining their unavailability during the limited time frame, one suggesting it was an unsuitable participant because its real operation had not yet started, and one claiming that they were 100% localised staff, and not really suitable case. Of these companies two finally withdrew due to time constraint. One of them chose to have email interview in Feb. 2002.

**Table 5.1 Sample of Single-level Interviews**

	1*	2	3	4	5	6	7	8	9	10	11	12	13	14	Total
2-**	2	2	2	2	2	2	2	2	2	2	2	2	2	2	28
2-9	2	2	2	2	2	2	2	2	2	2	2	2	2	2	28
10+	2	2	2	2	2	2	2	2	2	2	2	2	2	2	28
Total	6	6	6	6	6	6	6	6	6	6	6	6	6	6	84

\* Code of sector

\*\* Number of subsidiaries

The methods adopted and sample features are summarised in Table 5.2.

**Table 5.2 Research Methods and Companies Participated**

Companies	Research Methods	Business Sectors	Data
<i>Chinese companies</i>	<i>Multi-level Interviews</i>		
C1	7	Diversified	Info C1a-g
C2	7	Food Manufacturing	Info C2a-g
C3	2	Petrol Chemical	Info C3a-b
C4	1	Research Centre	Info C4
<i>Local projects</i>	<i>Field Observation</i>		
C5		Diversified	Info C5
C2		Food Manufacturing	Info FO C2
<i>European Companies</i>			
M1		Food Machinery	Info M1
M2		Food Machinery	Info M2
M3		Chemical Material	Info M3
M4		Chemical Ingredients	Info M4
M5		Chemical Ingredients	Info M5
M6		Food Packaging	Info M6
<i>European Companies</i>	<i>Face-to-face Interviews</i>		
M7	1	Building Material	Info M7
M8	1	Electronics	Info M8
M9	1	Automobile and Insurance	Info M9
M10	1	Engineering	Info M10
M11	1	Pharmaceutical	Info M11
M12	1	Power Equipment	Info M12
M13	1	Power	Info M13
M14	1	Industrial Gas	Info M14
M15	1	Bank and Commercial Service	Info M15
M16	1	Telecom. Equipments	Info M16
M17	1	Pharmaceutical	Info M17
M18	<i>E-mail Interview</i>	Packaging Material	Info M18

The samples, particularly those for first stage multi-level interviews and second stage field observation, were not randomly selected because of access difficulties which were more prominent in the China context. The Chinese value personal relationship (Guanxi) more than any other societies.

#### **5.4.2 Selection of Informants**

Informants were chosen stage by stage, considering the content of the inquiry, and the specific research setting. Four general criteria were adapted from Tremblay's (1982, p.100) criteria of 'ideal' informants. An informant should be the richest source of knowledge desired; his professional role should expose him continuously to the kind of information being sought; he should be willing and able to communicate his knowledge; he should communicate his knowledge in an objective manner. Though these criteria of eligibility could hardly be determined in advance most were met as a result of personal contacts and explicit communication.

The informants for the first phase of the study were composed of 14 Chinese managers at three levels - top, middle and frontline managers – from two private-owned Chinese companies with foreign suppliers and/or competitors; 2 purchasing managers from a Chinese state-owned conglomerate with foreign suppliers; and one director of a Chinese research centre that oversaw and monitored its industry. Since access to these companies was all via personal contacts it was possible to match potential informants against the selection criteria. For example, in interviewing the president of Chinese company 1, he called four of his senior and middle managers to join our discussion on certain specific issues where they might have more expert knowledge. At Chinese company 2, 3 out of 7 managers interviewed were my former business partners. They kindly arranged my

research meetings with other managers. The reason to select managers at different levels was that they each had specific understanding of local business knowledge as they were in charge of different matters of the business and therefore interacted with different internal and external entities. The two purchasing managers of Chinese company 3 had intensive day-to-day interactions with both national and international suppliers. They were in a better position to comment on the relationship between their purchasing decisions and suppliers' local knowledge base. The director of Chinese company 4 that oversaw its industry was an invaluable source of local industry knowledge. Through this selection of several different sources, I was able to piece together a multi-faceted concept of China local knowledge, and to get a fuller picture of its nature.

The informants for the second phase of the study consisted of all staff involved in the two bidding projects. Most were senior and middle managers. These people were, of course, not chosen. But they were certainly best source of knowledge desired as they directly involved in those projects from the very beginning.

The informants for the final phase of the study involved 8 senior expatriate managers and 3 local middle managers. Because the research meetings were single-level interviews I clearly indicated my willingness to meet either the president of the multinational firm who had access to all information required or a president-recommended knowledgeable senior manager or middle manager. Although these single-level interviews might lead to a somewhat one-sided view of the issues concerned elite managers were indeed in a better position to talk about company strategies. This was confirmed during my interview with a middle manager of multinational 13, who said, *'some of your questions are concerned with company strategies that I might not be in the best position to answer. But I'll answer as much as I can.'* The three middle managers involved were good compensation to the eight

research meetings with senior expatriate managers. Furthermore, certain informants have been involved in China business from the outset in a variety of senior positions. For example, the country president of multinational 11 was formerly general manager of its key business. In addition, elite managers are perceived as the most open to assert their own opinions and capable of dealing with probing questions (Welch et al., 2002). These further suggested their suitability as the informants. Apart from these factors I clearly stated that the purpose of the research meetings was to gain objective views of the issues concerned in my corresponding letters.

### **5.4.3 Data Collection**

Qualitative data for this study were gathered through a combination of multi-level face-to-face interviews, participant observation, single-level face-to-face interviews, and document analysis. This data collection strategy echoes Simon's (1969) view:

“One must avoid limiting oneself to a narrow choice of methods. ... Several methods together may provide better and cheaper answers than any single method can.”

(p. 188)

Similarly, Bulmer (1993) pointed out that each of the commonly used means of collecting data, such as interview, group discussions, direct observation, participant-observation and documentation (Ghauri et al, 1995; Yin, 1994), had particular advantages and disadvantages and no one source could be judged necessarily superior to another. As a result, different methods were chosen to elicit different perspectives on a single issue or to investigate different aspects of the research question. Such a triangulation strategy for collecting qualitative data fully considers the content of the research questions and the

research setting in which relevant data were collected and avoided partial view of the issue investigated.

#### ***5.4.3.1 Multi-level interview data***

Realising that face-to-face interviews solely with expatriate managers might bias the understanding of China local knowledge and knowledge holder issues the research started from an in-depth exploration on Chinese perspectives by cooperating with four local Chinese organisations. Seventeen face-to-face interviews with one director of a Chinese research centre and people of different positions - top, middle and frontline staff, from three Chinese firms that have foreign joint ventures as their competitors or suppliers were conducted on-site in Beijing and Tianjin in March and April 2001 to explore the concept and the nature of local knowledge, cultural features of main local knowledge holders, and their perception of foreign rivals or suppliers. Five managers in Chinese company 2 who were based in Nanjing flew to Beijing for an international fair in Beijing in March 2001 and were interviewed in Beijing instead of Nanjing. I began by interviewing Chinese informants for two reasons. On the one hand, I realised that local Chinese managers were the richest source of local knowledge in the business setting. I could hardly believe that foreign managers had better understanding of local knowledge issues. In order to allow the concept of local knowledge, a socially embedded intangible factor, to emerge it was crucial to start from the Chinese. On the other hand, I had ready access to these informants. By taking this advantage I could gain value-laden data on the basic concept my thesis was based upon at lower cost in a less time-consuming way.

The interviews were designed to yield in-depth data. They ranged from one to four hours in length. The longest interviews were undertaken with middle managers who used



concrete examples to illustrate certain phenomenon while the shortest were often done with frontline managers whose jobs tended to be more focused on specific areas. The interviews were loosely structured. I simply brought out four questions: (1) What is local knowledge? (2) What are its characteristics? (3) Who has it? (4) Is it important to you and your interactive bodies or individuals? Informants were required to answer them with personal experience in a way that they were comfortable with. They could answer them in different orders and discuss them freely. They could also use non-verbal expression. For example, one manager of Chinese company 1 used chopsticks on the dining table to depict the management model of that company as she could not fully express it verbally. They could lead the topic to a specific point that they wanted to emphasise. The four broad questions were all open-ended, which provided few restrictions on the content and allowed myself to go further depth to probe relative issues. This was quite suitable especially because I was viewed as an *'old friend'* and often invited to dine and spend other time which allowed the opportunity to ask more specific questions to get deeper knowledge of the targeted issues. These interviews provided data which gave valuable expression to the informants' views about the local business context and local thought processes that were intangible and hence not directly observable.

Some writers argue that data collection strategy must always take into account what is actually viable within the context. Bulmer and Warwick (1993) alerted that many assumptions formed in the developed economies might not be tenable in developing countries. Similarly, a number of China researchers call for a China-adapted approach. For example, Shenkar (1994) identified a variety of research issues in China context, such as Chinese reluctant attitude towards participation, secrecy and a suspicion of questions, wording difficulties and political influence. Furthermore it was made clear in Shenkar's study that the recording of interviews would be regarded as intrusive. People were very

reluctant to disclose any verbal information and written material. I specifically discussed these issues with the informants. Their view was that China was under dramatic change. Some of these issues were much less apparent such as political influence. Access through personal contacts avoided certain problems. Additionally, my research topic was not related to any sensitive political issues. However, three aspects are worth note. One was that Chinese managers still had a distinct perception of the concept of time, which may favour researchers. A researcher could contact those managers without fearing time constraints as Chinese managers did not value privacy as much as Westerners. I undertook my research meeting with the president of Chinese company 1 on a Sunday, with its middle managers in late afternoon, and meetings went on until 10pm. A second aspect was that a researcher could save time in communication as written communication was not expected. In this study, a mobile phone was the only efficient communication facility. A third aspect was that recordings were still not acceptable. It was not just a matter of intrusion, as perceived by a number of writers, rather, it was perceived as lack of loyalty. As one manager said, *'I know you are not going to sell us'*. As a result, none of the interviews with Chinese managers were recorded. In return, I gained more critical views of the issues because they would then disclose more sensitive information and perceptions. In addition, all interviewees were promised confidentiality in research meetings in order to ensure the validity of the discussed issues. However, I took detailed daily notes on all non-recorded interviews.

#### ***5.4.3.2 Field observation data***

In order to pose the question, whether local knowledge is the key source of competitive advantage, and understand *how* foreign managers, local Chinese staff, Chinese customers, competitors and other peer companies interacted in live business activities, field

observation on business interaction process involving six European firms and two Chinese firms in a single sector was undertaken by following two bidding projects in Beijing and Frankfurt.

The observation process lasted 7 days, four days in Beijing in March 2001 and 3 days in Frankfurt in May 2001. As noted earlier my role there was an inside participant. My observer role was concealed, therefore, informants felt comfortable with my presence when discussing issues and expressing ideas. To guard against forgetting, field notes were written up at the end of each day. But I wrote down crucial events and critical discussions more immediately in a visitor seat around corners. The primary source of data was the words and actions of the people I observed. As a participant I had access to the broadest range of data through being involved in discussions. To elicit information from informants I often used intentional statements based on background knowledge of the setting such as '*what do you think about his injector?*'. Therefore, the interviews undertaken during field observation were unstructured and context-specific, and sometimes they were about technical features of the company products as well as customer expectations. I also found although I was an insider I could not always follow every event however. For example, managers of Chinese company 5 were taken to Amsterdam for a day visit by a customer. I could not follow them but intentionally asked questions upon their return. There was also extreme situations where observation opportunities were missed. For example, Chinese customers were intensively invited to restaurants in Frankfurt in evenings, when I returned home, but I still sought information about this the next day.

The strong point to observe these cases was that this opportunity allowed me to collect 'real' information on the key issue concerned. If local knowledge was a true source of competitive advantage how was it exploited to win business deals? Did the companies win

because of superior utilisation of local knowledge? In what way this was realised? A true picture, though not vivid enough, of local knowledge management activities emerged from the field, which was so critical to my further investigation. The only disadvantage was what I noticed earlier that I was over-familiar with the research setting being observed, which might have increased observer bias, though I was keenly aware of this point during observation.

#### ***5.4.3.3 Single-level interview data***

To explore the means for managing local knowledge, and obtain a full variety of evidence and generalise main issues, I consolidated ten main questions for further face-to-face onsite interviews with elite managers from the eleven European multinationals in 10 sectors- pharmaceutical, telecom equipment, power, electronic automation, automobile, bank, building material, management service, commercial service, and technology service. They were all conducted in Beijing and Tianjin in November and December 2001. Seven interviews were undertaken in English and 4 in Chinese.

To ensure interview efficiency I explained and communicated the research objectives and main issues in advance and devoted time to each specific case' business background before each interview. The interviews were scheduled to last two hours, and indeed averaged about two hours, not including informal discussions in a few cases during lunch time. Before the interviews the interviewer worked out ten questions, but was free to modify them and the order depending on the context during the interview process. The way in which questions were brought out could also be changed. Some explanations or introductions to a topic or a question were made during these interviews. Some specific questions which seemed inappropriate with particular interviewees were left out, where the

interviewer acquired enough information before the interviews. The questions were designed to be open-ended, which provided no restrictions on the content and allowed interviewer to go further depth to probe relative issues about the topic of this research. In a few cases I was invited to have lunch with the informants hence had more time to elicit related issues.

Recordings were made in all interviews with management from European multinationals with permission from the interviewees. However, in one case the informant showed specific concern on the use of a dictation machine. He asked, *'What is this information for? Are you recording now?'* This suggests that some informants, even expatriate managers, do consider tape-recording as intrusive, not only Chinese. Consequently, I had to re-explain my purpose, and he kindly agreed with its use. The promise of confidentiality also proved to be very useful. For example, one informant concerned, *'are you going to write down all companies' names? I prefer not to show my company and my own names in your thesis if it would not affect the quality of your thesis'*. Similarly, another informant required, *'please keep the secret for me'*. The reason for this concern was often not because they feared of best practice spill-over. Rather, they feared that their openness would affect their companies' reputation. As one manager confirmed, *'we do not know what would be the result. So better not to show our names'*. The results showed that the anonymity of the discussions did encourage them to personally open up. The informants showed considerable commitment and frankness in discussions. For example, one manager commented on their knowledge of local customers, *'we do not know our customers; we do not know them at all'*.

#### 5.4.3.4 Archival data

Secondary data were sought both prior to each interview and afterwards. The purpose to retrieve these data is three fold. First, the interview time was limited, and some interviewees suggested the researcher use company files as detailed hard data on certain topics such as business background, so we could use the interview time focusing upon the qualitative issues which were not documented. Second, I had the opportunity to clarify the validity of this secondary data. For example, I had read of the reasons of Multinational 17's first joint venture dissolution. I had the chance to clarify that the secondary data were greatly biased in my interviewing. Third, I used secondary data to bring out issues almost in all cases. For instance, I used information from a local newspaper on Multinational 10's success in bidding for a Shell project to discover the concrete reasons for its success. I also used information provided by friends who knew those companies to probe further issues which were difficult to gain through formal interviews. Using these secondary data as dialoguing media I was therefore able to discuss the research questions in-depth and gain more evidence about the issue. Although many researchers use secondary data as a means of validating empirical data I found that the source of secondary data were not as reliable as those writers perceived. For example, two managers commented, *'every company, particularly the giant ones, uses consulting companies to fashion the wording of their dissemination materials. This information, however, does not reflect any truth'* (Info M10; Info M12). Thus, I used secondary data that I clarified in my field investigation but I did not use them for the purpose of validating my empirical data.

Qualitative data, gathered from these interviews, field observation, and second documentation, guided my understanding and interpretations of the findings. It was through a combination of qualitative methods that I was able to gain a clearer sense of

local knowledge management. Although the qualitative results might only provide inferences about the universes of the multinational firms headquartered in Beijing, the results pointed to wider local knowledge management trends occurring across China because most of them operated everywhere in China, and one was headquartered in Shanghai, regional-headquartered in Beijing.

#### **5.4.4 Data Analysis**

The 17 multi-level interviews, 7 days' field observation, 11 single-level interviews, 1 email interview, and the secondary data gained from these companies resulted in ample data in English and Chinese. All narrative data were first translated and/or converted into processed data before analysis.

Undertaking live research on knowledge management is challenging. The intangible nature of knowledge and knowledge management practices posed significant difficulties in coding and analysing process. It also implied the less usefulness of the currently available qualitative software programmes to content analyse the data. In such circumstances, '*content analysis*', a qualitative technique (Berelson, 1952; Simon, 1969, p.278), in which the various responses to the question are grouped into a logical and orderly set of discrete categories, was used to measure the immeasurable manually. Empirical data were classified through examining equivalent themes and their patterns to represent the ideas or concepts to be measured. I searched for patterns in data and for ideas that helped explain their existence. To do this the data were first coded by categorizing words. I created these codes not by copying preconceived theoretical concepts adopted in my theoretical model, but by employing original terms used by informants. Here let me use two examples to elaborate the coding process:

One example is the way in which I classified the concept of local knowledge. I put all answers regarding the concept of local knowledge together and read the data line-by-line to look for nouns such as policy, culture, administration, industry, economy etc. I then categorised them into such. I further read these categories to compare their individual content and looked for similarities. They were then finally categorised into knowledge of administration, knowledge of economic and industrial structure, and knowledge of culture and cognition.

The other example is the way in which the nature of China local knowledge was identified. I put all answers regarding the concept of local knowledge together again and read line-by-line for adjectives such as tacit, fast-moving, available, reliable, changing, not sure, subject to interpretation, inconsistent etc. I then classified them into these categories. They were read repeatedly to find similarities in meaning and finally defined as highly tacit, undiffused and fast-changing. These concepts were often defined by employing the original words used by informants. For example, one participant used the word, tacit, exactly the same as was used in the theoretical model. Other words like knowledge penetration, knowledge blend were all emergent terms used by informants. I did use 'knowledge integration' to take the place of 'knowledge utilisation by collaboration' as they referred to the same thing but the former was more concise. But such borrowed terms used in coding process were only a few. Comparing and contrasting between data were the key tools used in coding process.

Hence, coding helped gain a new perspective on the empirical data, before being translated into formulated empirical arguments and refined into an empirical model.



This data analytic strategy is similar with '*grounded theory*' coding (Charmaz, 2000; Glaser and Strauss, 1967;), which allows theoretical ideas to emerge from the field in the course of the study using loosely structured research designs, used by grounded theorists. The value of this approach rests on its relatively more objective use of empirical data because it does not require data to fit into the preconceived standardized codes used by quantitative and some qualitative research.

#### **5.4.5 Follow-up Review**

Upon completion of data analyses (Feb. 2003) a company report was sent to each informant of the 11 multinational corporations, with whom I had single-level interviews, for critical feedback to double check whether the quotations I used were correct and offensive, whether I had misinterpreted any information provided, and whether they could offer more insights. Reports were sent to these rather than all informants for three reasons. One was that most local Chinese would not necessarily like documented communication. A second reason was that local Chinese, particularly those working for local companies, had been cautious about written confirmation. A third reason was that those companies involved in field observation were not informed about my role as an observer.

The response rate was judged not high enough because of the wide-spread SARS in Beijing area. Additionally, the data analysis and writing of the report lasted about a year's time, and I did not expect my informants to remember what they exactly said a year ago. However, still I received valuable confirmation from 4 informants and comment from 1 non-informant manager who had considerable working experience in one case company. Three expatriate managers interviewed had left China by the time reports were sent. No

criticism or challenged views from any informants was received. However, it was difficult to judge whether they all agreed with the results.

#### **5.4.6 Structure and Timing of the Fieldwork**

An explicit structure and timing of the fieldwork was summarised in Table 5.3.

**Table 5.3 Structure and Timing of the Fieldwork**

<i>Time period</i>	<i>Activities</i>
October 2000	<p><i>First field trip (Beijing/Tianjin area, China)</i></p> <ul style="list-style-type: none"> <li>▪ Preliminary contacts with multi-level interview organisations;</li> <li>▪ Gathering sources of sample for single-level interviews.</li> </ul>
Nov. 2000 – Feb. 2001	<ul style="list-style-type: none"> <li>▪ Gathering sources of sample for single-level interviews</li> <li>▪ Preparation for multi-level interviews</li> </ul>
March 2001 - April 2001	<p><i>Second field trip (Beijing/Tianjin area, China)</i></p> <ul style="list-style-type: none"> <li>▪ Undertaking 17 multi-level interviews with Chinese managers of 4 Chinese organisations on site in Beijing and Jianjin; <b>(First phase)</b></li> <li>▪ Negotiating access to two bidding projects involving 6 European companies and two Chinese companies.</li> <li>▪ Undertaking 4 days' participant observation by following two bidding projects in Beijing;</li> <li>▪ Gathering sources of sample for single-level interviews.</li> </ul>
May 2001	<p><i>Third field trip (Frankfurt, Germany)</i></p> <ul style="list-style-type: none"> <li>▪ Undertaking 3 days' field observation involving 6 European companies and two Chinese companies by following two Chinese bidding projects in Frankfurt. <b>(Second phase)</b></li> </ul>
June 2001 – Oct. 2001	<ul style="list-style-type: none"> <li>▪ Analysing first and second phase empirical data;</li> <li>▪ Consolidating key interview questions;</li> <li>▪ Selection of single-level interview sample;</li> <li>▪ Negotiating access to sample European companies;</li> <li>▪ Communicating the research topic;</li> <li>▪ Scheduling research meetings.</li> </ul>
Nov. 2001 – Dec. 2001	<p><i>Fourth field trip (Beijing/Tianjin area, China)</i></p> <ul style="list-style-type: none"> <li>▪ Undertaking 11 single-level interviews with elite managers of 11 European multinationals in Beijing and Tianjin. <b>(Third phase)</b></li> </ul>
Feb. 2002	<ul style="list-style-type: none"> <li>▪ Undertaking 1 email interview.</li> </ul>
Jan. 2002 – Dec. 2002	<ul style="list-style-type: none"> <li>▪ Analysing third phase empirical data;</li> <li>▪ Comparing and contrasting all empirical and secondary data.</li> <li>▪ Writing up thesis and empirical report to participated European multinationals.</li> </ul>
Feb. 2003	<ul style="list-style-type: none"> <li>▪ Sending empirical report to elite interviewees for validation.</li> </ul>

## 5.5 Validating Procedures

A number of measures were taken to ensure the validity of this study.

Firstly, the social research strategy of ‘triangulation’ was adopted to increase validity. The research used both theoretical deduction and grounded theory building, which were adopted separately in existing knowledge management studies. It also deployed multiple empirical methods, through which I gathered qualitative data from a variety of data sources, in order to add one layer of data to another to build a confirmatory edifice. I linked verbal expression to behaviour by combining in-depth interviewing with field observation. I also linked views of local experts to perspectives of foreign managers by interviewing both sides. Additionally, I collected data from Chinese managers in a variety of positions by undertaking multi-level interviews. The value of incorporating these techniques was that they secured an in-depth understanding of the research question and ensured that the meaning was discovered consistently. As Hall and Hall (1996) argued:

“Triangulation, using evidence from different sources, different methods of investigation ..., is seen as an important way of fostering credibility. Most writers on ethnographic methodology agree that triangulation is the major way of validating qualitative research. Silverman too agrees that the use of multiple methods increases validity ... ”

(p. 210).

Secondly, I offered guarantees of anonymity and confidentiality to free informants’ minds of apprehensions so that interviewees could be more open towards the issues discussed. I guaranteed that the informants and their organisations would not be identified by name in the thesis and future publications. This was essential to overcome ‘*cover-up*’ obstacle (Simon, 1969, p.104). Simon suggests that ‘*deception*’ is sometimes employed as standard

practice in order to avoid knowledge spill over and lock out competition. To overcome the 'cover-up' obstacle to knowledge I also tried to access companies where I had a trust relationship already through networking within the sample frame. To establish a rapport was a major effort during each interview. These measures did have significant effect. Informants were frank and I did not observe any 'cover-up' obstacle during interviewing.

Thirdly, instead of using theoretical arguments as the basis of the research questions to prompt respondents' views and codifying data in terms of theoretical framework suggested by Yin (1994), I employed less preconceived research questions and interpretation of empirical data. I also declared in my pre-interview communications that interviewees would not be influenced by any particular pre-conceived ideas. This had some effect. Most informants did not ask my personal views when being interviewed. One middle manager indeed wanted to know the theoretical arguments and views of other companies contacted. She insisted, *'In this aspect we want to learn something from you. Other companies may have good practices that are not shared with others. We would like to know that.'* Consequently, the purpose of this study was again explained and I promised she would receive both theoretical and empirical results after the fieldwork. This was intended to avoid *'observer-caused effects'* (Simon, 1969, p.91). Measuring qualitative data often leads to the question of how the application of constructs can avoid subjective biases in measurement. In data analysis process I used grounded theory coding procedures in order to avoid bringing in pre-conceived views into the data interpretation process. The concept of local knowledge and local knowledge management strategies emerged on-site. This, to a great degree, avoided *'observer bias'* (Simon, 1969, p.88).

Fourthly, the approach taken here also avoided directly operationalising the constructs on which the theory was reliant through employing the instruments and mode of data

collection that emphasised capturing more basic, unstructured data from informants. The loosely structured interviews, participant observation and open-ended questions adopted in data collection process facilitated generating of a chain of value-laden evidence from the informants. Simon (1969) pointed out that:

“People like to please other people, and subjects in research studies are no exceptions. Interviewees often answer questions the way that they think the interviewer would like them to answer. ... such genial behaviour has a ruinous result unless the researcher does something about it.”

(p. 104)

I avoided this through loosely constructed data collection and adopting less preconceived measures noted above, which allow limited influence from the researcher.

Fifthly, to generalise key issues investigated I undertook in-depth interviews with elite managers from a randomly selected sample of 11 European multinationals in ten sectors. Such wide replication of case types provided a greater degree of confirmation than just a single case. The significant differences between those cases studied increased the validity of the generalisation (Yin, 1994). This was also considered to be effective in controlling ‘*observer variability*’ (Simon, 1969, p.84).

Sixthly, the fieldwork of this project lasted nearly a year. The key issues identified in the first and second phases’ of investigation were further explored in the third phase of the field study undertaken six months later. Yet the results did not show any particular inconsistency. As Robson (1993) argues, prolonged involvement with a project and persistent observation are ways in which credibility can be enhanced.

Finally, as I noted earlier in this chapter, I fed the identified empirical model of local knowledge management back to the elite managers interviewed in the third phase of the field study to test the appropriateness of my interpretation of the empirical data. Their feedback, though not from all, further confirmed the accuracy and comprehensiveness of the obtained results.

## 5.6 Conclusion

This chapter considered the rationale behind the research strategies deployed and described the methodological steps taken. The nature of the research problem was first defined in order to clarify the research objectives and further determine the best-suited empirical approaches. The detailed design of the field research, covering the methods of data collection, choice of populations and instruments used and validating procedures, has been described and assessed.

The developed methodology helped achieve the objectives. The qualitative multiple methods of data collection – a combination of multi-level interview, participant observation, and single-level interview – surfaced the *context-specific, hard-to-measure and difficult-to-articulate* concept of local knowledge, and its *entire socially-embedded management process* as well as the *difficult-to-identify human-related implementation barriers* and the *difficult-to-learn management strategies* for breaking those management obstacles from the insiders' perspective. I have shown that an important contribution of this study is the use of a qualitative multi-methods that allows greater understanding of a *little-known and difficult-to-explore* research problem.

However, the limitation of this research methodology should not be neglected. First, because the field research was carried out by the author, a single observer who interacted with a limited number of people in a limited number of settings, and despite the validating procedures employed during the course of the study, it is still, to a certain degree, dependent on the observational and interpretive skills of the researcher, for which reason systematic observer bias might still occur. According to Yin (1994, p.36) this can only be addressed by repeating the fieldwork by a latter investigator. However, the nature of this project could make replication impossible. In terms of design, fully documenting the process of research is essential for reliability. Second, certain anthropologists believe that field studies of less than several years' duration are likely to be misleadingly superficial. Though such views may not always be appropriate evidence from this study did show that a couple of hours' in-depth interviews with one informant from each European multinational firm, even those multi-level interviews with managers from Chinese organisations, were insufficient to guarantee bias-free research results. As the president of Chinese firm 1 said, 'to talk about local knowledge we need a few days' time. So we'll focus on the most important aspects of it.' Similarly, the managing director of Multinational 12 explained, '*I had a look at your questions. They require a few hours' of time to discuss in detail.*' Nevertheless, this could be addressed by further follow-up studies.



## **Notes**

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<sup>1</sup> These sectors include steel, oil, telecom, light industry, power, automobile, insurance, electronics, pharmaceutical, building and engineering, industrial material, bank and commercial service, retailing, mailing, shipping and other services.

<sup>2</sup> They were classified into three levels, less than 2, 2-9, 10+ subsidiaries.

## Chapter Six

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### Local Knowledge: The Key Source of Competitive Advantage in China Market

“It is easy to go for equipment and build factories in a country but without the environmental knowledge you would not be able to make any decisions on where to go and what to do.”\*

*(General Manager, Multinational 7, Interview, 7<sup>th</sup> Nov. 2001)*

“You can do nothing without local knowledge.”

*(North Asia Manager, Multinational 14, Interview, 7<sup>th</sup> Dec. 2001)*

“In our local market, we compete on local knowledge. We are very confident in dealing with our local people and local authorities. We have the best understanding of our workforce and our customers. We have the ability to bring every category of local knowledge together to best reap business opportunities. We set up a diversified business last year in one and half day, which could take multinationals one and half year’s time to do so. We knew how to do it, how to have the superiors’ greatest support without leaving them into an awkward position. This is art.”

*(President, Chinese Company 1, Interview, 15<sup>th</sup> April 2001)*

#### 6.1 Introduction

The assertion that local knowledge disadvantage impedes the multinational firm’s international performance is beyond debate. However, opinions vary about the strategies which might mitigate such a location-based disadvantage. Some scholars argue that

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\* Throughout this and the following chapters the data have been presented in the form of selected quotes. These quotes represent the views of the majority of the interviewees on the respective issues.

location-based disadvantage can be offset through importing home-based ownership advantage, superior technology in particular.<sup>1</sup> Others have argued that knowledge acquisition facilitates building up of local knowledge base, and thus leads to higher business performance<sup>2</sup>. However, the thesis of this study was not subjectively pre-determined. Rather, I collected views of working practitioners to empirically investigate to what extent local knowledge influences business performance and whether local knowledge disadvantage can be offset by advanced home-based expertise. This chapter presents the empirical answer to these questions. The research results are based on the analyses of the face-to-face interviews with managers and field observations described before.<sup>3</sup> It examines the concept and the nature of China local knowledge to show its significant differences from the global knowledge transferred. It argues that, unlike global knowledge transferred to China, local knowledge is highly tacit, undiffused and fast-evolving. Its intrinsic and fast-changing nature determines its greater impacts on the multinational firm's business performance. Drawing from the empirical evidence it concludes that local knowledge disadvantage cannot be offset by home-based advantage, so, the multinational firm's superior business performance is attributed to its unique approaches towards exploiting the value of local knowledge. The purpose of this chapter is to gauge the extent to which the key propositions on the nature of local knowledge and its role as the key source of competitive advantage in China market, proposed in Chapter 4, are tenable.

## **6.2 What is China Local Knowledge?**

Local knowledge is a relatively unexplored and under-developed concept. In order to deepen our understanding of such an intangible factor I empirically identified its scope,

classified its key components, and examined its nature. I did not pre-specify its definition in advance in order not to delimit the interviewees' response valuable and applicable to the concept development. However, I did adopt the distinction between tacit and explicit knowledge widely used in the area of knowledge management.

### **6.2.1 The scope of China local knowledge**

Consistent with the general view of local knowledge the empirical data show that, unlike global knowledge transferred to the China market, which is often technology and management procedures based, local knowledge has a wider scope. In content, it covers knowledge of the economy, culture, politics, skills base, society, and history, which is specific to the Chinese business setting. As the North Asia Manager of M14 described:

“Knowledge is not only a technological thing. It has a wide scope. We need every kind of knowledge. You have to have a basic understanding of the culture, the political situation, and the social economic situation. You have to know the history, both old and new. And then you need to know the legal framework that is relevant to the company laws, the trading laws and regional laws. Some may be illegal in another country. Then of course you need to know your competitors and your customers locally. For us we export very little. We produce locally and sell locally. So we must know the local customers, local competition, local market.”

(Info M14)

Using an explicit example, the president of C1 illustrated the importance of understanding the wide scope of local knowledge to China business operation:

“Local knowledge is about everything you need to know in the local market including even the weather. Let me give you an example. A few years' ago, our shirt business beat our main competitor, an American joint venture. They were forced to sell their products at 80 Yuan each and nobody wanted to buy, while our products were widely

accepted at 230 Yuan each. The main reason was that those Americans thought their thin and fine-knitted pure cotton shirts favoured by Americans also would be favoured by Chinese. But they were wrong. Beijing's summer is very hot and humid. Most people did not have air-conditioners at work. Actually a great number of local men favoured a kind of imported shirt made of thick rough-knitted pure cotton cloth at that time but the price was really high. I went to the only supplier who could produce that cloth in China and bought out all they produced that year. When our competitors turned to that supplier it was too late. We controlled all the material."

(Info C1a)

In nature, China local knowledge ranges from explicit information to tacit know-how, intuition, perception, and relationships. This is reflected from the following sentiments of the president of C1:

"We have plenty of news from different media. Some people know how to interpret them into useful information but some do not. You have to fully understand the situation in order to interpret a piece of information into business opportunities. Last year I learnt a piece of news saying that this sector was going to be streamlined due to the existing problems of the market stemming from lack of regulations. I knew if I could enter this sector and become a streamlined company I would be able to make money as we would be considered healthy even if we did not operate legally, because our government would not smack their own face,<sup>4</sup> and with failure of most small companies we would have good business. I got our license the next day and now we are the biggest company in this sector."

"Guanxi is crucial local knowledge. To some extent it can lock out your competitors. But the way to cultivate it is often not learnt because it is built on long-term trust between both sides. We members of the People's Congress from private businesses often dare to disagree with the government as they now need us. Therefore, we often have bargaining power with the government and influence their decisions. This is our real power as we sometimes use this collective power to support specific persons to come into power in order to pave the way for our own businesses. To some extent giant multinationals could cultivate guanxi as our government needs them too, especially in certain sectors. However, to what extent they could influence is not sure as none of their staff could be in such a position, which is really convenient for trust building.

Lobbing with Chinese is art. I told my managers ‘go and do everything you want for the company. I’ll back you and help you to clear the way ahead’.”

“In our local market, we compete on local knowledge. We are very confident in dealing with our local people and local authorities. We have the best understanding of our workforce and our customers. We have the ability to bring every category of local knowledge together to best reap business opportunities. We set up a diversified business last year in one and half day, which could take multinationals one and half year’s time to do so. We knew how to do it, how to have the superiors’ greatest support without leaving them into an awkward position. This is art.”

(Info C1a)

His sentiments also suggest that local knowledge is a socially embedded concept. The complex China business context therefore increases the scope of China local knowledge.

### **6.2.2 Classification of China Local Knowledge**

Despite the recognition among scholars on its wide scope,<sup>5</sup> there has been a lack of configuration of the concept of local knowledge because of its complexity and location-specific characteristics. In order to enhance our understanding of the concept of local knowledge and investigate how it influences local business operation this concept is classified into three main dimensions through field investigation - knowledge of administration, knowledge of industrial and economic structure, and knowledge of culture and cognition (Table 6.1).

**Table 6.1 Classification of China Local Knowledge**

<b>Categories of Local Knowledge</b>
Knowledge of administration
Knowledge of industrial and economic structure
Knowledge of culture and cognition

### ***6.2.2.1 Knowledge of administration***

The concept of knowledge of administration emerged from the field investigation. It refers to information and know-how about the specific local business administration system manipulated by local authorities. As China is in transition from a planned-economy to a market economy the government has sought control over foreign business. Such control however is not necessarily executed by clear rules, regulations and laws because existing laws and regulations have been constantly refined and adjusted, leading to ambiguities or lack of transparency as side effects. Aspects such as internal documents; inconsistency and misunderstanding between government hierarchies; inconsistency of written and application laws; contradictory new laws; regulations and administrative commands; negligent attitude towards laws; unclear regional protection and imposition of taxes and duties; unclear rules about business procedures in some sectors; and delay in the diffusion of new regulations and laws etc., were all mentioned as evidence by interviewed managers. Therefore, knowledge of administration includes not only documented regulations but, more important, the invisible rules and perceptions. In order to increase transparency of the administration issues the multinational firm needed to work with a variety of administrative bodies. As the general manager of M7 emphasised:

“You need to understand the labour law, understand the impacts of the differences of the state bureau’s regulations on foreign enterprises. For example, the foreign control bureaus in the building construction industry are piles of organisations. ... It is important in China market to maintain good relationship with bureaus at state and ministry level. They can be of great assistance. Any related issues can be clarified, secured, and then that is of great benefit. Also if you don’t maintain good relationship they can create problems. The power of the PSB, Public Security Bureau, is high. The Environmental Protection Authority is becoming much much more powerful, particularly with the manufacturing sector. Relations with them are important. ... So to work with several aspects is important.”

(Info M7)

Knowledge of administration also involves understanding of the piles of regional policies restricting foreign business development in certain areas. These policies were made to promote regional development and protect local pillar industries. As one senior president of M9 complained:

“In reality, automotive manufacturers in China are classified, according to an automotive classification which goes back to 1950s, into passenger cars, trucks, buses and so on. When China’s WTO membership was signed in the US and between EU and China I asked the EU commissioner to ask the Chinese to remove the classification. The Chinese said that it was not acceptable. So it means that if a company produce trucks it will not be allowed to produce passenger cars even if the trucks sector collapses and the passenger car sector booms. That is not a free market. ... You cannot have centrally planned rules and say you produce this there and this is another city and so on. The market demands market dictated production. If the market requires sports cars we should be able to produce it quickly to meet demand. ... We cannot have protection or imposition of taxes, duties or fees in provinces different from what is prescribed by the central government. This is one of our worries even after WTO. So a free market in line with taxes should apply all over China. We should avoid the provincial tax because there are 10 different taxes. But it will take some time.”

(Info M9)



Similarly, the managing director of M15 illustrated how difficult the protected local finance system was to its business operation in China:

“We have met a lot of difficulties. One difficulty is on the financial side due to the fact that RMB is not convertible with foreign currency. You need to get several approvals. The services of China banks are still far away from international standards. This always presents problems. If you have a credit card they have no overdraft facilities. A current account is impossible in China. This is very humble to the company because you cannot operate the company smoothly without an overdraft account. You always have an extremely high cash flow. You know you have money coming in next week but you cannot use it. There is a very difficult task regarding cash. Also the accounting standards are still not international ones. Reporting to the China tax authorities are still decades behind international ones. Very difficult tasks! ... I believe this is one of the obstacles China has to work on.”

(Info M15)

Therefore, local protection has been a critical issue faced by most foreign investors. They had to make sure they were operating safely in the ‘grey zone’ (Info M9). As the managing director of M15 explained:

“A lot of German companies, as well as those from the world, think they come to one country. That is wrong. Because China is not only as huge as more than one normal sized country it is also not legally one country. If you want to sell a product in Beijing you might have to pay additional tax, duty, whatever fees, than in other provinces in order to get your product sold. For example, the car industry is very much restricted. This kind of restrictions will fall within the next few years after WTO. ... But now you cannot sell a car produced in Tianjin to Shanghai. It is impossible. ... So China is the only country where we have central offices in two cities. We normally have one in other countries. A different market absolutely.”

(Info M15)

In addition, knowledge of administration involves understanding of the complexity of the implementation of regulations. The national laws and regulations issued by central

government were often inadequately implemented, ignored or misunderstood at regional level. As the country president of M11 put it:

“China WTO membership will have an impact on improving the situation but I do not look forward to it in 3-5 years. Its implementation will take a long time. It will be much longer than people like to think. There are so many laws that have to be changed, not only from the international level but also from the provincial level. People in many provinces have no idea about WTO. They put a lot of regional regulations to counter WTO. This will be a long education process until everybody will be on the same page. Now everybody is working on a different page. I do not see there will be a major change in next 3-5 years. It takes time to educate regulators as well as hospitals what is sector practice and what is not. ... So there is a lot to be done.”

(Info M11)

One senior president of M8 illustrated how laws were ignored by local organisations:

“Although China has many regulations the Chinese corporations who really obey them are rare. There is a lack of an effective supervision system. We can almost say that there is no supervision system. They wait until unexpected things happen.”

(Info M8)

This category of knowledge was perceived as difficult to acquire because of a lack of transparency in China. Yet, its impact upon foreign business operation was significant because there was no split of politics from business administration in this market. As the human resource director of M17 confirmed:

“This is also why sometimes we feel difficult. Some procedures are very complicated. We wish, China’s government also wishes, this could be globalised. But as a government they also need to protect themselves. This is normal. This is what a government should do. They cannot keep balanced. To each individual company this government influence seems too much. And this influence certainly impacts upon business operation. To us the direct problem we face is registration. Some products we want to produce globally at the same time. But this is difficult to be done in China. But

it is a very good product. ... We wish this could be improved. We also wish WTO membership could make things better. From a macro point of view it is better but in detail it is still different from other countries. In China price control seriously affects business. But the government has its own consideration. They wish to lower both the burden of individual and the government. But if they continue to cut 1/3 of the price of our products then we would have no profit. This certainly affects our operation.”

(Info M17)

Although multinationals all believed China WTO membership would eventually weaken governmental influence and improve the visibility of the market they understood that it would take considerable time given the present situation.

#### ***5.2.2.2 Knowledge of industrial and economic structure***

The concept of knowledge of the industrial and economic structure as an important facet of local knowledge also emerged from the field investigation. It includes information and know-how about the construction of China's economy, segmentation between sectors, composition of each sector, regional economic differences, corporate microstructure, corporate situations etc.

The construction of China's economy is unique because of its existing planned economic system, constant economic reform, and evolving foreign investment policies. The dramatic pace of economic reforms undertaken in recent years has led to a dynamic and complex economic structure characterised by co-existence of state-owned, collective, private, foreign invested, contracted, and their mixtures. More important, the composition of this structure has been constantly changing due to both continuing growth and reform process.

As the president of C2 explained:

“Things have been changing very fast, including our customers, competitors, suppliers and business partners alike. When I first started my business in 1987 there were very strict restrictions on private businesses. It was extremely difficult to get a business license. We had to ally with state-owned or collective businesses. State-owned businesses were protected. Collective businesses were encouraged. We dealt with them only. The situation was much improved after 1993. So there was a surge of contracted businesses during that period of time. They were private in nature but state-owned or collective in name. Then the policies were shifted to encourage foreign investment and private businesses. So you see now private businesses are everywhere and foreign suppliers dominate this sector. Nowadays, most profitable businesses are private in nature. A large proportion of state-owned ones were acquired or contracted by private companies, like the Nanjing company which we just acquired. Some bigger ones were acquired by foreign companies. So you see we now have collective, private and foreign competitors and suppliers. There are still some state-owned ones supported by the government but economic reform will eventually change the nature of ownership. Private, foreign and companies in the stock market will dominate the future of the China economy.”

(Info C2a)

Such dynamic construction of China economy resulted in complex composition of each sector that needed to be consolidated. This was reflected in the following sentiments:

“The infrastructure in the automobile sector should be in place because, in 2000, there were 2.4-2.5 million cars and vehicles, of which proximately 600,000 were passenger cars. These were manufactured by 130 companies. Some of them produced 50-100 vehicles. These companies will not survive. M9 (real name omitted) in the world manufactures 2.4 million passenger cars, one manufacturer for the entire world. Here 130 manufacturers produce 2.3 million trucks, buses and commercial vehicles. So that is the structure, and it is not easy, because again in some provinces, the smallest manufacturers only employ 60 people. ... This sector must follow market growth. In certain circumstances they must control the volume of the investment applications to increase synergy and so on.”

(Info M9)

“The China distribution system is not efficient. You’ve got 70,000 distributors. Then you’ve got 60,000 - 80,000 hospitals. I am not very sure about this. The distribution

part is extremely large. What do you really need to do? In the US you need 3 or 4 distributors. And I talked to CIBS when people had the discussion. My chairman said distribution cost in the US is about 4%. In China from producer to retailer outset is 25%. You need to consolidate this. ... There is so much inefficiency in the distribution. ... You must make improvement to make the distribution system cheaper.”

(Info M11)

Such complexity of China’s industrial economy, coupled with the problematic administration system, also resulted in a lack of economic order. As the country president of M11 commented:

“Competition is not entirely on the level ground because some companies use corruption. ... A lot of producers produce the same medicine. They have no knowledge of the products. They only produce pills and compete on price. What will happen is that we have no advantage to compete on price as we have a scientific background. For our medicines we have seminars and we teach the doctors how to use them and what is the background of our medicine. A lot of producers do not have these. They only compete on price. This is the major problem. You must consolidate this.”

(Info M11)

Moreover, the segmentation of sectors in China was somewhat different from that in other countries. Because that the administrative system was constructed in terms of the local classification of sectors, and the degree of government control over one sector could be significantly different from another, understanding such differences is considered essential in order to ensure that the multinational firm operates within the regulated zone (Info M9)<sup>6</sup>.

Therefore, at macro-level the multinational firm needed to understand how the Chinese economy was constructed (Info M16), how sectors were classified (Info M9), and what organisations there were in each sector (Info M7) in order to relate their businesses within

the economic framework and focus their strategy (Info M7, M8). As one senior president of M8 elaborated:

“If we look at the whole market, competition is very high. More than 1000 companies produce this product including foreign owned companies, domestic large and medium sized companies, and most are local, county even private ones. Their products’ quality, features, credibility, services are all different. If a company’s product has no fixed position in the market but has to compete blindly they can never be successful. So a company needs to have a clear strategy. ... Foreign companies are competing around the top area of the pyramid. The issue is how to penetrate down the pyramid. With economic growth our customer base will be bigger but market penetration down the pyramid is crucial as domestic firms are penetrating up the pyramid. It is not easy.”

(Info M8)

At micro-level it was necessary to understand the detailed structure of each relevant organisation in its industry such as each customer’s operation status, technical strength and specific needs in order to fudge how to best serve its customers. This category of knowledge significantly influenced key decisions. For example, the managing director of M15 confirmed the impact of customer knowledge upon local business decisions:

“Our business is absolutely customer driven. If their businesses are healthy we can expand our own business. They definitely influence our decision. Our business plan is fully driven by customers’ needs.”

(Info M15)

The respondent of M8 illustrated its application R&D activities driven by local customer knowledge:

“We have two fields of R&D, basic R&D and application R&D. We have application R&D in China. We have had basic R&D overseas for many years. But application to each market is very important. Not everything we designed overseas can be used in China. We need to adapt them to the China market. In China customers may have a

different operation manual issued by safety department. We need to meet this kind of requirements. Or sometimes we need to alter the design of one equipment to meet local specific needs.”

(Info M8)

The investment manager of M13 emphasised the importance to understand the Chinese management system:

“A firm needs to know the system, including the Chinese management model. As foreigners may not understand how state-owned firms are managed. Even firms in the stock market are completely different from those in Europe. You need to have a deep understanding of the specific system and its state-owned features otherwise doing business in China will be a waste of time and money.”

(Info M13)

Apart from the need to understand China industrial and economic structure at both macro and micro levels, understanding the significant economic differences across regions was also considered critical. Consistent with Lord's (2001) research finding all the interviewed managers considered that the geographical reach and inefficient administration system of major Chinese organisations often made consistent business activities practically impossible. Hence, there was the view that '*China is not one market*' (Info M1, M7, M8, M9, M11, M14, M15). An under-developed regional distribution system and geographical disparity between regional potential purchasers thus not only led to extremely high regional marketing cost but also called for adequate local knowledge about the specific region such as regional economic structure, living standards of local customers, local purchasing capacity and so forth (Info M13). As the investment manager of M13 explained:

“Even if the Electricity Bureau agrees the county level electricity department would not agree as if so they would incur a loss. They have to consider what local people can

afford as economic disparity across regions is huge. Even if the county level electricity department agrees the pricing authority would not agree as they would need to consider local affordability together with profitability of state-owned firms as people there need to survive under the present system. They are not balanced. ... I tell you what happened to our Hubei project. That project is situated near the bank of Yangzi river. When a shipment of the coal arrived we had an automatic delivery machinery to deliver the coal directly to the factory. Local farmers came to us and complained that this machinery occupied their land and now they had no land. What were we to do? 'You must use our vehicles and tools to deliver your coal. And you pay us according to the quantity of the coal we deliver for you. Otherwise we would damage your deliver system'. ... Our Changsha project also had this kind of stories. Once this project was approved everybody there knew and started to build things like houses. We had to give them money in order for them to remove those poor things. So you must understand regional economic differences."

(Info M13)

Hence, knowledge of industrial and economic structure was essential for the multinational firm to make effective business strategies, develop local customer base, and detect competitors' strategic plans (Info M7).

### ***5.2.2.3 Knowledge of culture and cognition***

The concept of knowledge of culture and cognition emerged from the field investigation as the third dimension of local knowledge. It concerns local cultural customs, perceptions, ways of thinking, and associated behaviours. Consistent with Gamble's (2000) contention the empirical data indicate significant cultural differences which impact upon business practices and differences in management style between Europeans and Chinese. As the North Asia Manager of M14 confirmed:

"There are some cultural conflicts when implementing the management system in China. Cultural problems occur between joint venture partners in many cases. They



also occur frequently between foreign managers and local staff. The worst problems between foreigners and local partners are those which come up when there is no prior awareness of the existence of cultural differences. Communication can fail completely and leave frustration and bitterness.”

(Info M14)

Section two in Chapter 8 will elaborate such cultural differences in more detail.<sup>7</sup> Apart from the findings presented in Chapter 8 there is much evidence showing significant differences between Chinese cultural customs and Western preferences. A typical example was that given by the sales manager of M6:

“Our former China manager is Scottish. He worked as the exporting manager for this German company for 14 years. He had considerable international experience. ... But he still had rather rigid working habits. He didn’t dine together with local business partners and customers as we Chinese share dishes and drink alcohol during lunch. So he was never really involved in networking in China. Chinese partners and customers also have different perceptions regarding time. They rarely turned up on time for meetings. He (the China manager) never waited for more than 15 minutes. ... This posed difficulties for us in managing customer relationships.”

(Info M6)

Another good example was that given by the business development manager of M10. He explained the differences of cultural customs between British and Chinese:

“The British are not as warm as Asian people. ... They have a cold culture. This has negative impact on their businesses. So Chinese say, ‘Ok. I can work with you but I do not feel comfortable’. We talked to British expatriates and they thought that was cultural difference and they could do nothing about it. So over the weekend we Chinese accompanied and entertained our partners but the British did not. They thought the weekend was the time for themselves and their families and they did not have any reason to get together with business partners. But Chinese staff would feel uncomfortable if they leave local partners alone. We have been working hard to

facilitate better mutual understanding but we did not work frontline, so sometimes it was difficult to take matters further.”

(Info M10)

As elaborated above China had a complicated economic structure. Consequently, business behaviour, human perceptions, and individual needs in one type of organisations can differ from those in another. A sales manager of M6 illustrated cultural differences between foreign clients and local clients, and how understanding these differences assisted in winning local deals:

“Chinese clients are much more emotional than Westerners. If you make your greatest efforts to communicate with them and build good relationship with them they normally consider buying some of your products. They are soft-hearted. But Westerners normally firmly refuse.”

(Info M6)

This is in line with the remarks of a purchasing managers from C3:

“In the petrochemical sector safety is very important. Our first purchasing criterion is quality. If the quality/price ratios of the products are similar we tend to buy from our *guanxihu* (suppliers with good relationship). Some sales people are very persistent. We may consider some of their products too. But the quality of their products must be acceptable.”

(Info C3b)

This category of knowledge dominates in local business conduct and interaction. It is embodied in social and business behaviours, which might be difficult for foreign managers to understand. As the respondent of M9 experienced:

“There is something that we do not understand. For instance, Italians are short tempered. They raise voice when things go wrong. But every time when we got upset

our Chinese partners laughed. ... The system that works in Italy does not work in China. Here we need a different approach, a local-adapted approach, to getting things done.”

(Info M9)

Awareness and appropriate utilisation of this knowledge often differentiate potential winners from losers in China market. As the respondent of M16 illustrated:

“One aspect in China is different. Let me put it in this way: it is different in Asia from that in Europe and US. That is of course the personal relations and contacts. And of course this is extremely important in China and that is why you consider yourself a new-comer even when you have been here for many years. It is fairly linked to your business process, your local networks, and winning the knowledge and trust from a number of individuals in your customers’ networks and the authority organisations you deal with. So it might be a progress which lasts a number of years until you really have the network that is required to do business in China in an efficient way. I think this is part of knowledge underestimated. ... The Americans consider themselves at the centre of gravity which means they expect everyone else to adopt their way of behaving. That is very short term and bound to fail. They do the same in Europe. You are coming to a new market, a new country and you are expected to adopt local habits and not enforce your habits to a new market. From this point of view I believe our style is well adapted to acquire local knowledge. I mean our country is small. We have developed over the years a number of fairly large and successful groups and all their businesses have been formed to base on export activities as their domestic market is so small. And our company is one of them. From the very beginning we have our mindset in line with the fact that we are visitors in all around the world and we have to adopt local habits in these countries. This awareness is attributed to our success all over the world.”

(Info M16)

### 6.3 The Nature of China Local Knowledge

The empirical results indicate that, unlike global knowledge transferred to the China market, which is relatively well-documented and widely available within the corporation, China local knowledge is undiffused, highly tacit and fast-evolving (Table 6.2).

**Table 6.2 The Nature of China Local Knowledge**

Categories of Knowledge	Nature of Knowledge		
Administration	Undiffused	Tacit	Fast-evolving
Industrial and economic structure	Undiffused		Fast-evolving
Culture and cognition	Undiffused	Highly tacit	Evolving

All managers interviewed shared the view that China lacked transparency, characterised by the undiffused and tacit nature of local knowledge. This posed significant difficulties in acquiring any local knowledge fudged essential for business operation. Internal documents, inconsistency between the written and application laws, inconsistency and misunderstanding between government hierarchies, contradictory new laws and administrative commands, negligent attitude towards laws, unclear regional protection and imposition of taxes and duties, unclear rules on the business procedure in some sectors, and delay in diffusion of new regulations and laws were repeatedly mentioned as evidence of undiffused and tacit nature of knowledge of administration. A good example was given by the general manager of M7:

“There is a lack of transparency. There is still an opinion that it is stupid to make it clear. The internal documents are optically clear. There is some misunderstanding in my view in government hierarchies like the Construction Bureau and the State Bureau of Building Material Industry. They both have functionalities on setting up businesses but they do not speak to each other. There is not a good relationship between them. The Construction Bureau maybe says you try to understand this and we have different

ones. They are confusing. There isn't a way to understand the real effect that they have. Adding to that, there is confusion when what the Customers Bureau says it is export related and could be considered export durable. The Tax Bureau may take a different view. There is no strong link between the Customers Bureau and the Tax Bureau. It is not just that the information isn't easy to get due to a lack of transparency. The fact is that some necessary information is not available. ... In certain areas when the Customers Bureau who measures foreign companies whether they are investing to the point and whether they are exporting the finished products, and so importing materials, they tend to talk to foreign companies. It was not non-changing regulations. They change when they do implement the regulations. In my experience they change more in the way when they handle contract laws and disagreements. So the Arbitration Commission will handle contract law issues. ... Yes, to acquire the knowledge is difficult. My experience working with the government If they are not sure you are not sure. There are a lot of internal documents."

(Info M7)

This is echoed by the sentiment of one senior president of M8:

"China lacks transparency. This is for sure. It is not only reflected in aspects of unclear laws, regulations, administrative commands, but, especially in recent years, China has more laws, regulations, and administrative commands. Those regulations and commands issued by different regulatory bodies are often contradictory with each other. For example, labour law issued by labour ministry is different from that issued by other administrative bodies in terms of meaning, ways of interpretation and other aspects."

(Info M8)

One senior president of M9 illustrated the difficulties posed by a lack of transparency:

"Doing business in China is not easy because, as I said, until very short time ago there was very strict control by the government over many sectors. Production was divided into three encouraged industries. That was not a free market. Central government issues, loans, rules, regulations did not necessarily exist. Once they are published they can be understood. But, as I mentioned before, some internal regulations and documents or new issues are not necessarily by law to be done, and not necessarily is forbidden by law. The WTO will make the whole system more transparent. Procedures will be

shorten. Your accuracy will be increased. We still have officials as does Europe. Never mind, they will make it difficult, but it will be getting well. We need clear rules. Once we started procedures we will not be told about internal documents. ... If you talk about importing it will be a complicated procedure because there are no clear rules on initial controls, on whole standards. It is still complicated but it will be simplified. ... To know Chinese is not easy because regulations and laws are often made after a period of time. It was sophisticated not to the moment but to cases thereafter. The laws were issued on 1<sup>st</sup> Oct but we were informed on 15<sup>th</sup> Nov. These involved an important case of an Italian entrepreneur. That is not logical. In Italy or other countries in Europe they would be informed immediately after laws were issued. Then you have published things, websites and so on. Again with the transparency that comes with the WTO all these will be sorted out, but not immediately. WTO is not a magic word meaning everything will be easier and cheaper.”

(Info M9)

The North Asia manager of M14 also confirmed:

“In terms of law they may say this today and change it tomorrow.”

(Info M14)

The country president of M11 also commented:

“Regulations are not transparent. Often you have different departments, organisations, ministries governing the same problems. They are not consistent. There are a lot of major problems violating IPR.”

(Info M11)

Moreover, lack of documents, publications, websites, and business logic, as well as incorrect and delayed data, inefficient information and communication system and the Chinese attitude towards information and knowledge, together resulted in lack of transparency of Chinese businesses. As one Senior Vice President of M8 explained:

“Foreign firms normally have more routes to learn relevant information about their customers. For example, companies in the stock markets need to have certain degree of transparency. They need to publish quarterly about their plans, business situation on each division etc. And relatively speaking their annual reports contain more truth. Moreover, they can also get more reliable market analysis published by relevant bodies. But in China, relatively speaking, it is more difficult as it lacks transparency. Firms may wait for two years to get a formal report. If you look for statistics for year 2000 by Statistic Bureau they may sell you information for year 1997 or 1998. In foreign giant companies the annual report or quarterly report will be available in public in only two months’ time, now even four weeks’ time, even three weeks’ time in the future, as new information system are adopted and all information is at hand. What they need to do is just to organise it for publication. That means they only need some time to edit it. Furthermore, experienced multinationals normally can foresee what they need to know from customers’ published information, their own accumulated data, and the development plans of some relevant institutions who contract customers’ projects and their customers’ business routine. In addition, customers’ websites are also good sources of information.”

(Info M8)

My interviews with two participants from C2 (Info C2a; Info C2b,) and one participant from a Chinese institution and supervision body (Info C4) also proved that the Chinese market significantly lacks diffused industrial knowledge. As the president of C2 confirmed:

“Of course nobody is willing to disclose his individual knowledge. We do not work through documents. We work through meetings and most times through individual communications. We made our greatest effort to retain our key talents. We offer shares, high salaries, houses, and private schools for kids, cars and drivers. I built factories for key managers to manage more freely. I think we made more efforts than foreign firms to retain key talents and that is why they do not leave for multinationals.”

(Info C2a)

The engineering manager of this company (Info C2b) added further evidence to the undiffused nature of local knowledge of local firms. He said:

“He (the president) is the kind, you know, who does not want to disclose anything to others. Two years’ ago he was suggested by the strategic experts to deal in the stock market but he strongly disagreed fearing that he would lose control of everything. He had two main concerns. One was that he feared being acquired by a strong business in the stock market. The other was that the auditing process would finally disclose his real business information to others although books for dealing in the stock market are often purposely cooked. We do not have anything published, documented, shared. Meetings and direct oral reports are the main ways of formal business communication in this firm. Our competitor did better as it is dealing in the stock market and they have a joint venture with an Italian company. But you know those published simple things can often tell people nothing. People deal in stocks in the Chinese stock market by intuition. ... One thing is interesting however he now starts to realise that managers need computers so we all now have computers. You can email me any time. But we still use mobile to communicate internally. The computer is just a symbol of the boss’ incentives to employees.”

(Info C2a)

The statement of the director of C4 further certified this point:

“We do not have exact data about the industry. We are the only sector editor and publisher in this industry but we publish articles and opinions based on our experience, contacts with companies and estimation. Our frontline engineers often know more as they often directly contact different companies themselves. The two articles you read last year written by me about the situation and trend of the market contain a lot of data but they are all estimated. Also it is not possible to get the true data as this sector is changing daily. It is very difficult to know the just-in-time information. In addition, nobody has done a survey in detail on the numbers of companies in this sector as it is impossible to do it. We estimated last year, only in Beijing, there were about 600 manufacturers in this sector. How could we gather information from so many of them?”

(Info C4).

Indeed, the highly bureaucratic administration and economic system also seriously hindered local knowledge diffusion.



Furthermore, participants from both European and Chinese firms pointed out that Chinese culture had negative impact on diffusion of knowledge. Chinese are not used to stating personal perceptions for public discussion. Their perceptions often were embedded in individual behaviours, implying that people who wanted to know them often had to personally sense their culture. As the president of C1 explained:

“Unlike Western culture, Chinese culture has a tacit nature. This tacit culture determines Chinese behaviour from top-line government to bottom-line ordinary people. If you observe the behaviour of different governments in the world you can notice this. Westerners often immediately reacted on key issues but Chinese government often did not. They often reacted later than others. The difference of reactions of American and Chinese government towards the recent matter of American spy aeroplane is a good example. I think the behaviour of Chinese government represents Chinese culture. This culture is difficult to read. It lacks transparency.”

(Info C1a)

The engineering manager of C2 illustrated the implicit management style of this company.

He said:

“As the business is getting big it lacks transparency. He (the president) cannot go to each branch to supervise as he did before. They do report to him but they do not tell him the truth. They like to tell him good news to please his ears unless the problem is really serious, the fire wrapped up in paper. ... The communication style is always indirect, delivering hidden and mixed messages. Some Chinese do not even understand other Chinese. He has expectations on us but he never makes them clear. There is a matter of face there. You have to guess the true meanings behind his behaviour. ... But being direct does cause trouble. A few times, I have pointed out the management problems he did not like to listen, as he was used to having people around him pleasing his ears, including those professors in his strategic group and his nephews. But in China everywhere is the same. There is question time in the US but not in China. It is not only a political difference it is also part of the culture.”

(Info C2b)

In addition, managers from some multinationals also realised that some specialised tacit knowledge was non-transferable or took a long time to acquire (Info M16; Info M9: Info M11; Info M12), especially for new-comers. For example, one senior president of M16 illustrated that personal relations and contacts considered extremely important in China took a long time to acquire because *'the process of winning the knowledge and trust from a number of individuals in your customers' networks and the authority organisations dealing with lasts a number of years'* (Info M16). However, this was required to do business in China in an efficient way and is a *'part of knowledge often underestimated'* (Info M16). This is reflected from the sentiment of the president of C1 presented earlier in this chapter<sup>8</sup>. This respondent also demonstrated that some tactics used by local business people are not easy to be learnt<sup>9</sup>.

In addition to its undiffused and tacit nature, China local knowledge was also proved fast-evolving. The composition of China's economic structure had continued to change. A great surge of new companies, both domestic and foreign, dramatic reform on state-owned enterprises, open up of more sectors, different degree of economic development in different regions, influence of foreign cultures and other external knowledge, and rapid change of educational system were all attributed to the wide scope and fast-changing nature of local knowledge. As one senior president of M16 confirmed:

**"Local knowledge has been evolving extremely rapidly. Since the market is so young, impressive and fascinating. If we take a comparison between a small country like Sweden and China, if you look at the development here, there is a new mobile system installed here in China each month, which has got the same size as the total network system in Sweden. You are facing completely different perspectives here. One important experience during my short time in China is that China is developing extremely fast. During this period China has developed into the biggest mobile user in the world. During the same period the Chinese operators have taken the first position**

winning the operators worldwide, such as Unicom, which is a fairly new operator. They are on position 5 or 6. China is an extremely fast-moving market. It is fascinating that things are developing so fast. China is undergoing very big changes. It is fascinating to be able to closely follow these developments.”

(Info M16)

The managing director also illustrated how local market had been changing:

“China market has been changing very rapidly. In the building material industry 6-7 years ago it was mainly imported press that was sold in the domestic market. So there was a construction boom in the mid 90s. There were a number of JV foreign companies set up to produce construction materials and building materials in Pudong Shanghai. They ran in a way that it was not difficult to make money. They were extremely profitable. What we saw toward the end of the 1990s was growing companies coming in with similar press. For example, in our industry there was a great surge of 40 new companies that appeared in two years, which were domestic companies. They produce products at a lower quality and lower cost. Competition at that time was incredible and intense. What I was doing was to go back to the fundamentals, my product, and my systems, ahead of other companies. The biggest change of the market is the explosion of producers. It is related to the government policy and encouragement on private enterprises in China, which I think is a wonderful thing. The market is still a problem in distribution channels. Some companies have to develop their own transportation system. This is why the national government has huge development on road system in China. There are now super high-ways from North to South from East to West, very very convenient. This is a step change from a few years ago. So the distribution system has been improved. There is also a developing sense of private company setting up agents for foreign companies or distributor foreign companies. Five years ago again there was no hardware stores. There was no building materials markets. Now there are several in each city. So the distribution channels have been improving a lot.”

(Info M7)

Similarly, a senior president of M8 illustrated the rapid change of China market at all levels:

“China is more and more open. Media are breaking new lines. Government officials are more and more open. They gradually accept different ideas. In the market it is changing too. In the past, whatever projects, big or small, were all controlled by a few specific persons and departments. But now we can see significant improvement. We realise management at different levels all have certain degree of decision making power. Each level of government has some power. We can also see some foreign methodology being adopted by different bodies. For example, we saw before only selective bidding but now we see bidding projects. Now everywhere we see international bidding, local bidding and so on. Although they do it in different ways at least they are using the right term to explain things. They are trying to use competitive bidding type. This is a big change. Another change is that customers are used to employing overall assessment criteria not only on price. So what we are teaching our salesmen is value based selling. It means our products can have higher price as we have other advantages in features, maintenance, services, etc. All in a word, overall our product is economic. It is not based on price only, because our customers have this kind of thinking change we thought it was important to teach our people this.”

(Info M8)

However, such a fast-changing nature of local market knowledge had led to high business uncertainty according to the respondent from M8:

“But we’ve been operating in China for so many years. If we compare the results of our company’s first five years’ plan with the feasibility plan we did for those first five years we find none of the feasibility was done right, either market price was done too high or material cost was estimated too low. Nothing was correct. But we have to go ahead as all of our plans were done under the specific environments of that time. We wish we could better use our local knowledge to adjust our plan but it was still too far away from reality. Things are not foreseeable. It is just like the 9.11 event in America. Another aeroplane dropped again two months’ later. Who knew in advance? So in the present situation, the market is changing too rapidly and the economic situation is not foreseeable. Too many unforeseeable factors! The market is getting more and more invisible. If only from economic aspect this is acceptable but from administrative aspects it is not acceptable. Now most foreign companies complain about policy changes. Sometimes a new policy is adopted suddenly without consulting any body or a period of trial time. The change suddenly happens and you do not know what the implications would be for your business. Recently I saw a new law, which will come

into effect from May next year, about occupational disease. It could have great impact on our business. So what is occupational disease? There is no definition. A typist may have that only by looking at the screen every day. In China people have a deep perception that 'China is a guanxi society'. So it is more people-controlled than law-controlled."

(Info M8)

Hence, our participated firms come to the conclusion that learning is endless, as the managing director of M15 stressed:

"For my personal opinion I think from business side I am still learning and everyday we have some new experience. I think it is a never-ending development. As China is changing so fast you can never say 'now I have it'. We'll have to know new things."

(Info M15)

Similarly, the country president of M11 stated:

"We emphasis lifetime learning. Nobody came here fully prepared for everything. To tackle changes you have to keep learning"

(Info M11).

Therefore, the results testified that China local knowledge had a highly tacit, undiffused and fast-changing nature; some specific local knowledge took years to learn and even could not be fully learnt. The intrinsic and fast-evolving nature of China local knowledge suggests that the cost of acquiring and exploiting local knowledge may neither be fixed nor be offset by transferring home-based technology, as asserted by Hymer (1976)<sup>10</sup> and other scholars.<sup>11</sup> This indicates that local knowledge may have greater impacts upon the multinational firm's business performance in China market than its home-based knowledge transferred to China.

## **6.4 Local Knowledge and China Business Performance**

Many studies have focused upon the role of home-based ownership advantage, technology in particular, as a key determinant factor for the multinational firm's business success in a host market, arguing that location-based disadvantage can be offset through importing home-based ownership advantage. However, the empirical results show that although home-based expertise transferred to China market is a critical advantage, local knowledge has greater impact upon the multinational firm's business performance in China. This is consistent with the research results of Luo's (2001) study. Managers in this study from both European and Chinese sides were convinced about the role of local knowledge as a key differentiator in China market. It was considered to be the key determinant factor for the survival of the multinational firm. As one senior president of M16 commented:

“Local knowledge is extremely important from surviving point of view. Most of our competitors in China are multinationals. We meet everywhere. We know each other well. Whether we can survive in China market depends on our local competence, depends on whether we can win the knowledge and trust of local customers, local authorities, and local employees.”

(Info M16)

China's unique social and political system, industrial and economic structure, and cultural and cognitive background often posed exceptionally difficult problems for foreign companies seeking to explore China opportunities. Multinationals that understood it and proactively exploited its value experienced fewer difficulties and had more chance to succeed in this dynamic business environment, while those that were not aware of it met difficult challenges or lost in the middle kingdom. As the human resource director of M17 confirmed:

“Local knowledge is certainly important. If you ask any company they would answer yes. It is a book including things from politics, economy, culture ..., from every area, talking about business risks and telling you how to avoid risks and take business chances. The answer is yes.”

(Info M17)

Similarly, one senior vice president of M8 also confirmed:

“Knowledge is always important. I remember that in the Art of War by Sunzi there is a saying ‘knowing oneself and knowing the other, one hundred victories in one hundred battles.’ It is absolutely useful in business, our reasons for investment, strategic decisions, and our feasibility plans. ... Whether China is difficult depends on to what extent you understand the market and your customers.”

(Info M8)

The general manager of M7 also explained:

“It is tough if you do not understand the business environment you are working in, if you don’t understand the political environment, legal environment, and market environment. If a foreign company has understanding of those aspects including the labour law and its implication and a good understanding of the political structure? For us, the building material industry, do we understand where the state ministry building material industry picks to cooperate? We need to understand the government structure and how to relate within. If we have an understanding of customers? If we understand the regulations and how these regulations are implemented? How we can work with the customers’ department? If we understand all these aspects then it will not be such a big task in which it’s being. If you understand the supply chain in your business and the distribution chain of your business, through maybe independent distributors through agents directly to end-users, if you understand the distribution system or if you designed your own system it will not be such a task. To point to your question China is not tough if you understand it.”

(Info M7)

According to the president of C2 multinationals which lost out to local rivals were often those that failed to respond to local customers' needs with cutting-edge technologies or first-class services because of a lack of understanding of that local market and customers.

He said:

“We have foreign, Italian and American, competitors but our key rival is LH (a Chinese company). The two foreign companies produce a limited range of products, serving star-level hotels. We have more than a hundred products, serving different levels of consumers. It is possibly too simple to say foreign companies focus on high-end products because they have superior technology. In my opinion, they do so because they do not understand the market, they do not understand local customers, they do not understand us. It is not a quality versus cost issue. We are producing low cost products to suit local consumers' need but they are not low quality products. We have been employing key technical talents in this industry; we collaborate with the research centre to work on the cost issue. We consider right from technical aspects to the alternative solutions. Our international suppliers introduced first-class technology into our company. Our national suppliers have been conducting lab work to offer us ingredients at highest quality but lowest cost. We lower the cost through the adoption of high technology. So you see there is misunderstanding here. In some companies or industries local producers may use poor quality raw material and poor technology to produce low-end products. This is not our case. More than 80% of our machines are imported from European countries, especially Germany. We also use a great proportion of additives produced by foreign companies. We have been producing high-end products for years for hotels but we focus on products suitable to ordinary people. Foreign firms certainly have the technology but they do not understand how to respond to local customers' needs with it. The market is not there.”

(Info C2a)

With solid understanding of local working habits and local culture M10 had successfully delivered first-class service to its customers. As the business development manager illustrated:



“Delay is a rooted issue in China, purchasing delay, supply delay, engineering delay, and construction delay. This is what foreign companies most fear. That is why they need us to manage. We know these problems and we know how to sort them out, as we know the reasons for these habits. We send people to the engineering institutes to supervise the progress. We have the chart plan and we closely follow that plan. We have meetings with them each Monday and put everything on the wall alerting all involved in the process of the project. So the people involved all have the pressure. As to quality we also send people there to work with them. In case there is any problem we know immediately and work out the solution immediately. Manufacturing too, we have two sets of timetable. We also send people to the factory. We have superior, independent frontline workers. As to safety in China people lack of sense of safety. We did very well in this area. BP normally invites our people to supervise safety for their projects. We faced difficulties in implementing safety procedures. For example, a person from Electronic Bureau once came here to set up a pressure transmitter for us. According to Chinese tradition he could have just had the work done without his safety hat on. But according to the international standard everybody who enters the construction site must have a hat on. If you ask them to put on a working suit and hat they think you do not respect them. We have to convince them. We find the right way to persuade them. We have strict supervision system and we also have safety meetings weekly. We implement procedures step-by-step, level-by-level. So delivery, quality, safety are all important to ensure customer satisfaction. We did very well in this area.”

(Info M10)

Recognizing that China was characterised by highly bureaucratic administrative system leading to inefficiency and invisible rules and regulations that often resulted in difficulties in the multinational firm’s business operation, M15 proactively acquired relevant knowledge of administration to ensure successful set up of its business in this market. As the managing director of this company explained:

“In Germany you can control the decision making process better than in China. The decision making process is often in hands of the administrators in China. There is no split of administration from economy. ... I have to say we in China found it difficult to set up our business subsidiary. We spent four years doing so. A limited subsidiary business is normally forbidden in China. You cannot get it. We knew getting a

business license would be very difficult because not only business license but also our professional business scope was not in the Chinese law. So we knew we would get into another black hole. Then we would like to have our business name. But it was impossible. According to Chinese law to put a foreign country name before 'limited' is something not allowed. But we knew the problem from before. So for us we had no problem. We knew this from our customers. This is the major blow sometimes to their businesses, sometimes kills their businesses. We know that the statistics are not reliable. The real information about the market situation is very difficult to get. But for us, we did not find it difficult as we knew them before we acted and we were very well prepared for those.”

(Info M15)

By understanding the role of good relationship in acquiring local knowledge and winning business deals in China, European multinationals that took a foothold in this market actively cultivated relationships with relevant local individuals and organisations. As the managing director of M12 explained:

“As you see the way to do business is through relationships in China. If you don't have relationships you don't sell. People in small business have to have their sister in law, brother in law and so on in the Power Bureau. We work with them. Their brothers in the power bureau buy our products.”

(Info M12)

Similarly, the general manager of M7 stated:

“We understand there are a number of external organisations with strong impacts on our business. We choose to make frequent contact with them. ... Are they knowledge holders? Yes. What can be done without good relationship with them? Who can interpret the internal documents? ... The Tax Bureau tends to be consistent when they handle the decision in a certain area and when they established the relationship with an enterprise.”

(Info M7)

A good understanding of local culture and local way of thinking enabled some European multinationals to build up good relationships with local knowledge holders (Info M16), design the right motivation system (Info M17), implement a knowledge sharing strategy (Info M8) or a global plan (Info M17), attract and retain qualified local employees (Info M16, M17), and work smoothly with Chinese business partners (Info M16; Info M9, Info M10). As the human resource director of M17 explained:

“We have a booklet called M17 (real name omitted) Management Methodology. We have a Chinese version for each employee. It talks about company vision, the value of the company. It is easy to follow. It is very globalised. If we are a world leading company, as it says in the book, then we must be world-leading company in China. This needs localisation. Then we need to consider how to make the vision objectified. We need to consider what products we have for this year and what products we are going to market next year. We need to localise the objective to fulfil it. As to the company’s culture and management, the vision and the value are globalised but when we design employee compensation and motivation system we need to consider local cultural thinking.”

(Info M17)

In contrast, without a good understanding of local habits M13 failed to build up a good relationship with local authorities and de-motivated its local employees. As its investment manager explained:

“I give you an example. When we negotiated Changsha project we invited some managers from Foreign Currency Administration Bureau and Environmental Protection Bureau as we would deal with transfer of foreign currency and other issues. We discussed this until 2:00pm and sent them directly after the meeting. Normally people would have invited them to lunch together and then ask them to go. Our Chinese colleague who saw them off felt very embarrassed and bought two ice creams for him with his own money, it was summer time, very hot. ... Later we needed to get approval from the environmental bureau for building up our factories. We were required by foreign banks to provide a document from that bureau about the investment

arrangement. But that department said we state-level departments never issued any such kind of document to outsiders. They had their own work procedures. The local branch should report to them and they answer to it. But we said our bank could only accept the document from the central government and not from the provincial government. We fortunately had an employee who worked in that bureau before. He invited a person from that department to dine together talking about how this could be done. That person suggested us to make a meeting note for that day's meeting and then send him for signature and stamp. He found the solution for us and helped us in this way. It was so simple! My colleague reported to our boss and our boss said 'give him a tin of beer'. My colleague was very disappointed and said to that person 'we'll never help them anymore.'

(Info M13)

Without an understanding of regional issues and local behaviour M13 failed to collaborate with locals and consequently experienced considerable difficulties:

"They could not understand. They said: 'we invested in China and signed the contract. Why should we also pay for moving of local farmers?' They thought it was irrelevant to their business and it was very expensive. And they are right. But this is part of the business environment you have to know it before you conduct your business there and you have to cooperate with locals. Local partners should know how to deal with this."

(Info M13)

Without a good relationship with local government M13 lost in bidding for the first BOT project in its sector in China market. As the investment manager explained:

"French Power had a close relationship with Chinese government. We arrived later and everything takes time. So we should not assume that we can do everything we want to do in China without such relationship."

(Info M13)

By not understanding that China also had a very complex economic structure differing greatly from developed economies, M13 failed to foresee all its business risks. As the respondent of M13 explained:

“Unilever has been doing in fast moving consuming industry. They have relatively much lower dependence on the government. But the electricity power sector is very much government influenced. It is more difficult for us than Unilever to do well in China. Electricity is part of Chinese daily needs. It has to be controlled by the government at the moment. Otherwise the Chinese people could hardly survive. This company lacked this understanding.”

(Info M13)

Without a good understanding of the rapidly changing nature of the market, M13 negotiated an unrealistic business contract that resulted in further problems:

“Another important factor is that Chinese Electricity Net possibly could promise you that they would buy a certain quantity of electricity from you at a certain price for 20 years but the thing is China is under reform in every sector. They could not really guarantee everything in such a business environment. Anything any policy might change any time for you and them as well. For example, privatisation might bring you to resign the contract with somebody else. This is not avoidable. But foreign investors would consider this natural risk as irrespective to law in China. It is a shock to foreign firms.”

(Info M13)

The lesson of M13’s business failure suggests that home-based strength does not necessarily secure a multinational firm’s international competitive position. As the investment manager of M13 elaborated:

“M13 (real name omitted) had many, about more than ten, main competitors. But it had advantages. According to the feedback from provincial and city level government officials, we do not know how other higher level officials think about this firm as we had only small projects and we had no chance to deal with higher level government, M13 was very well-known as they had been operating for many years and established a good business record in developed economies. They all considered M13 as very experienced in technology, engineering, and management mechanism. They also knew they had money. So they wanted to cooperate with them. But doing business in China

is absolutely more complicated than in developed countries as everything in China is developing. Business procedures and many other issues are more complicated than those in developed countries. China is still in the period of reform and government influence is significant. ... The price of electricity we sell was regulated too. This was out of our consideration before we invested. We signed the contract with our partners and Chinese government and, according to the contract, the price of electricity would be something above our operational cost and this would be changed according to cost change including any foreign exchange rate difference. The Chinese side signed the contract as they normally do. They certainly agreed with you on everything when you input your money but they could change everything they wanted whenever they considered it was necessary. Even if the Electricity Bureau had agreed the County electricity department would not agree if so they would incur a loss. They would have to consider the affordability of the local people as economic disparity across different regions is huge. Even if the county level electricity department had agreed the pricing authority would not agree as they would need to consider local affordability together with profitability of state-owned firms as people there would need to have something to eat under the present system. They were not balanced. M13 did not realise this complication. They considered everybody's reasonability from the words in the contract. The contract said that 'the price of coal would not change in 20 years' time' and that 'electricity's basic price would not change but could be justified'. But when we operated the business things were completely different. Our boss was the kind, conservative and resistant to change, not flexible. We cannot complain about his personality but this kind of attitude seriously affected further business negotiations. Things happened already you had to consider effective solutions to those problems rather than endless disputes about items in the contract. It does not work in China. You had to be cleverer and take the initiative to work with them rather than against them. You needed to give up things which were unrealistic. This is the only way to minimise your losses. You had to consider what is your true benefit rather than just stick to the contract. ... The reason for the business failure of this company as a whole is that they lacked an understanding of the complexity of local business issues. Their strategic plans were not realistic."

(Info M13)

**Lack of local knowledge not only resulted in M13's China business failure but also led to its considerable difficulties in its business withdrawal:**

“Chinese government officials wanted face. They would not like this kind of thing to happen during their leadership period. Another important reason is that the Chinese administration style was characterised by distributed responsibilities in a variety of authorities. FDI was administered by China Foreign Trade and Economy Commission and its provincial divisions. But once you withdraw you would have to get approval from different bodies including Foreign Currency Administration Bureau. In principle, you are allowed to withdraw but the documents you need to submit are a mountain and procedures are too complicated to deal with.”

(Info M13)

Thus, the role of local knowledge as the key source of competitive advantage is apparent.

As the investment manager of M13 concluded:

“So far the central competition in China is based on understanding of local issues. How well you can develop your business in China greatly depends on to what extent you can deal with these issues.”

(Info M13)

Although some multinationals in specific sectors did show strong reliance on home-based technology, such as the pharmaceutical industry, local knowledge still took a critical role in their success in China. As the country president of M11 stressed:

“First of all, our company builds its teams in which we have been innovating. We have very innovative drugs for treating disease. That has to be the bottom line, the bases of our business. We introduce the highest technology here as our core competence. The other one is that we have very well trained local talents, marketing and sales organisations where they interface with our customers and local organisations.”

(Info M11)

With the multinational firm’s increasing recognition on China’s strong talent base the role of local knowledge as key differentiator in this strategic market is apparent. Viewing at

such a knowledge base more multinational firms established their R&D centres in China.

As one senior president of M16 stressed:

“R&D in China is very important to us. It is important to our Chinese customers. ... It is obvious that our products in China need to have the highest standard quality but the lowest cost. Our long-term strategy is to continuously have our R&D activities in China. ... We have one in Shanghai operating for a number of years. We also are developing one research activity for the next generation of our mobile together with our customers in the south provinces. This centre is located in Shenzhen. Then we also have research activities in Beijing with MII and technical authorities for future technology. And finally we also have within our joint venture organisations, research activities supporting the production and development of the costs within producing JVs.”

(Info M16)

In the similar vein, the human resource director of M17 confirmed:

“Biotechnology has no country boundary. The establishment of our R&D centres in China will not only support China business but will utilise our rich local talent base serving our global business.”

(Info M17)

Therefore, multinationals increasingly recognised the value of local knowledge and showed significant reliance on local knowledge and local competence. Full understanding of the role of local knowledge as the key source of competitive advantage had led to increasing commitment of the multinational firm to local knowledge exploitation.



## **6.5 Conclusion**

Throughout this chapter I have attempted to illuminate many facets of the concept of China local knowledge through concrete examples collected from the live businesses, as a way to explore the impact of local knowledge upon the multinational firm's business performance. My reasoning has been that if we are truly to understand whether local knowledge is a key source of competitive advantage in China market we must examine its true nature. The findings presented here are consistent with the analyses in Chapter 4 arguing that China local knowledge is highly tacit, undiffused and fast-evolving; some local knowledge is even non-transferable. Therefore, China local knowledge, by nature, differs significantly from global knowledge transferred to China market, which is more codified and widely available. This intrinsic and fast-evolving nature of China local knowledge determines its greater impact upon the multinational firm's business performance. The findings show how a multinational firm with established home-based strength failed because of a lack of local knowledge, suggesting that local knowledge disadvantage cannot necessarily be offset by the multinational firm's home-based ownership advantage. I have also pointed out the necessity to strategically manage local knowledge for achieving competitive advantage. Beyond these results China local knowledge ranges widely. Three dimensions of China local knowledge critical to business conduct in China have been identified: knowledge of administration, knowledge of industrial and economic structure, and knowledge of culture, which provides the foundation for our understanding of China local knowledge and a guiding point for knowledge holder identification.

## Notes

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<sup>1</sup> See, for example, Zaheer (1995), Buckley and Casson (1976), Caves (1982), Dunning (1977), Hennart (1982), Hymer (1976), Kogut and Zander (1993).

<sup>2</sup> See, for example, Makino and Delios (1996), Johanson and Vahlne (1977), Davidson (1980), Erramilli and Rao (1990), Li (1994), Johanson and Mattson (1987).

<sup>3</sup> See Chapter 4 for detailed information on the fieldwork.

<sup>4</sup> This idiom means to blame oneself.

<sup>5</sup> See, for example, Makino and Delios (1996), Lord and Ranft (2000).

<sup>6</sup> See Page 7 for detailed quotation.

<sup>7</sup> See Chapter 8 for detained illustration about cultural features of local Chinese.

<sup>8</sup> See Page 4 for detailed quotation.

<sup>9</sup> See Page 4 for detailed evidence.

<sup>10</sup> See Hymer (1976). He says: "National firms have the general advantage of better information about their country: its economy, its language, its law and its politics. To a foreigner the cost of acquiring this information may be considerable. But note that it is a fixed cost; once incurred by establishing a foreign operation, it need not be incurred again" (p34)

<sup>11</sup> See, for example, Zaheer (1995), Kogut and Zander (1993).

## Chapter Seven

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### Local Knowledge Sources in China

“Many companies obtain their knowledge from experience. Others learn through hiring, grafting on new members who possess knowledge not previously available within the firm. Neither of these methods, however, may be adequate in the international setting.”

*(Lee, 1999, p.38)*

“We have a long-term commitment to our local knowledge holders. ... We develop good relationships with employees, customers, JV partners, and local government. We also build up collaborative relationships with local universities, institutes, and experienced international peers. Local employees, customers and co-operators alike are our key local resources and key elements of our competitiveness.”

*(Senior Vice President, Multinational 16, Interview, 11<sup>th</sup> Dec. 2001)*

#### 7.1 Introduction

Local knowledge is a key source of competitive advantage in China market. Yet, who are the main local knowledge holders is unclear in the literature. Researchers in international business often look at learning effects from joint ventures (Makino and Delios, 1996; Inkpen, 1998) and internal knowledge transfer (Lord and Ranft, 2000). However, the broad scope and intrinsic nature of China local knowledge suggests that local knowledge sources may extend beyond these dimensions. Other local knowledge sources essential to China business conduct may exist but might have been overlooked. In order to determine the scope of local knowledge management and the unit of analysis of this study I

empirically identified China local knowledge sources. This chapter presents the main results of this investigation. I argue that China local knowledge sources are highly dispersed, hence, the scope of local knowledge management involves individuals and organisations far beyond business transactions. My intention here is to test the suitability of the unit of analysis used for developing the theoretical model.

## **7.2 Local Knowledge Sources**

### **7.2.1 The Concept of Knowledge Holder**

As stated in Chapter 4 the concept of knowledge holder was specified in advance and used to identify local knowledge sources. To facilitate understanding of local knowledge sources it is defined as:

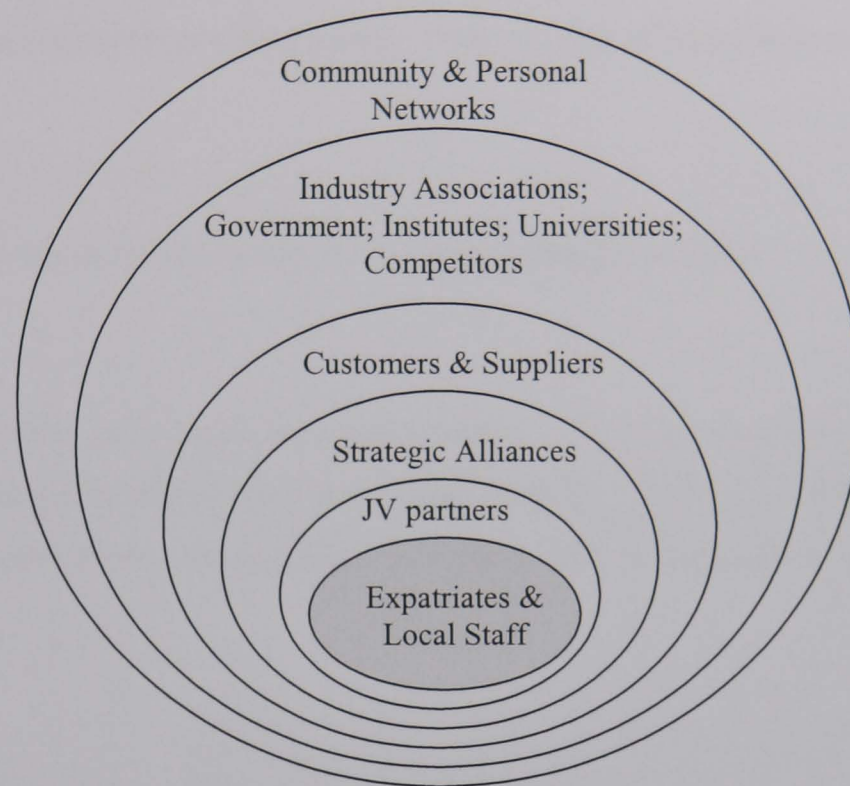
“By knowledge holder we mean an individual or a collective group of people or an organised body who possess certain knowledge. Knowledge holders may be within one organisation or outside an organisation or even cross organisations or industries.”

(Chapter 4:3)

### **7.2.2 Local Knowledge Holders in China**

The empirical evidence indicates that local knowledge sources in China are dispersed. They include expatriates and local employees, joint venture partners and international partners, other strategic alliances, customers, distributors and suppliers, Chinese authorities, industry associations, institutes and universities, community networks, and

individuals. They are depicted in Figure 7.1 in peripherals in descending order in accordance with the degrees of their business interactions with the multinational firm.



**Figure 7.1 Local Knowledge Sources**

#### *7.2.2.1 Expatriates and local staff*

All participants agreed that expatriates and local staff are key local knowledge holders.

As the human resource director of M17 confirmed:

“If a person has no knowledge essential to conduct his work in our business then his position is not necessary.”

(Info M17)

Similarly, the managing director of M15 emphasised that each soul of the company was a local knowledge holder. He said:

“Internal local knowledge holders? Let’s say 50-50. From the foreign administration side I am the only foreigner. Employees deal with day-to-day business. Without Chinese staff we can do nothing. I think we cannot say somebody is more important than other persons. Everybody is very important to the company because if the job he/she executes does not work the company does not work. We are all knowledge holders within our job descriptions. There is a lot of knowledge residing in people.”

(Info M15)

This is echoed by the remarks of the North Asia Manager of M14:

“Everybody is a local knowledge holder. For our business, I would say middle managers are crucial local knowledge holders. They deal with front line business. Expatriates deal at international level more. But it is difficult to say. Everybody might be.”

(Info M14)

Experienced expatriates’ local or Asian experience, or the experience from developing economies, is one of the determinate factors for the multinational firm’s business success (Info M10, M13). Their highly cultural sensitivity, understanding of the bureaucratic administration system, understanding of the importance of diversity, economic conditions and market complexity often lead to more successful management of local relations and effective business strategies based upon both global and local strengths. For example, a senior president of M9 involved in China business as early as 1970s and accumulated years’ of China experience essential to deal with a tightly controlled business. He stated that:

“Local knowledge. First of all, experience. I lived in China for 6 and half years. I have worked on China business since early 1972, when there was no car production here. It was a different world.”

(Info M9)

Local staff, frontline managers in particular, are considered to be crucial sources of local knowledge. *'They are the main knowledge holders as they are in the marketplace and deal with customers'* (Info M8). This was affirmed by all managers interviewed and evidenced, for example, in statements such as:

“During the past 20 years of time you developed a lot of people knowing how to run a factory. You have a lot of people knowing how to negotiate the myth. You also have a lot of people knowing how to deal with distributors. So from this point the local knowledge you called is widely available. Then you can hire these people to help you. Of course management talent in China is still very thin. Very few people can become general managers. In this respect we are very lucky that we have the kind of people who can help us. ... Our local managers are extremely good. They told me how to do business in China. My management teams are holders of this kind of knowledge.”

(Info M11)

“The knowledge of customers comes from a number of sources. Of course, there is the sales force, the marketing representatives. They contact the customers. ... It seems our organisation has a good relationship with the bureau but that knowledge is normally held by individuals. Therefore, there is an issue we have to consider if we would let a person go or not, who holds the relationship, and whether it would affect our relationship.”

(Info M7)

Therefore, local staff are in a good position to know the local market and local people. Given the fast-changing nature of local knowledge their role as main local knowledge acquirer cannot be ignored. As one senior president of M16 confirmed:

“M16 (real name omitted) realises that to understand customers' requirements and find out the specific solutions depend on localisation of working people. We attract, recruit, and retain qualified people.”

(Info M16)

Hence, managing local staff as local knowledge holders is crucial in order to best utilise their rich local knowledge.

However, respondents also held the view that the fast-shifting nature of China market, coupled with its complexity and its huge size, meant that having experienced expatriates and local staff was not adequate to tackle every business issue, especially for those organisations which intended to explore China's highly controlled sectors. Consequently, many external bodies and organisations or even individuals (Info M1, M2, M6, M12) were considered useful sources of local knowledge. Between them, Chinese joint venture partners were considered as important local knowledge holders.

#### ***7.2.2.2 Chinese joint venture partners***

The empirical results indicate that, consistent with Inkpen and Beamish's (1997) assertion, joint venture partners are good sources of local knowledge, although they may not always be valued as such. They may have specialised local knowledge on the market and have good relationships with local authorities, distributors and other industry players. They also have cultural advantage when handling local personnel issues. Consequently, a main reason for forming JVs with local firms is to access and utilise their local expertise. As one senior president of M16 explained:

**“When we go for a joint venture with our partner, both sides should consider what we contribute to this firm is expert knowledge. And the partners do have specific knowledge and competence, which would take us a long time to acquire. Consequently they are very important for our success. ... We have different type of JVs. We have producing, service, and developing JVs. All of these are successful and important in different ways, especially if you talk about the service JVs, which were normally formed with the customers. By being the JV partner with our customers we've been in**



a much better position together with the customers. That is very successful. When it comes to the producing JVs, we have two, they are both industry groups and very experienced. They have good relationships with authorities. They are providing the local knowledge required to be successful in the market.”

(Info M16)

Viewing the role of local JV partners as knowledge holders of local issues M11 built up long-term partnership with its JV partners:

“I think our partner in our pharmaceutical site is very helpful in many aspects. They help us with the government, with local regulators. Also in the animal health site they helped a lot because animal health sector is also like pharmaceutical industry, which needs a lot of such help. ... Our partners help us to build discipline to run the business. If wholly owned sometimes you go back to headquarters for money to keep it going but with JVs you are unlikely to do so. You have to do something about it. Two sides will work together to solve it and discipline it. It is just like large size US businesses they use outside directors. The outsiders could also put discipline to your law. So it is always to be good to keep a critical eye. Then you question yourself and say ‘Am I doing the right thing for the shareholders’.”

(Info M11)

According to this respondent, joint venture partners are particularly useful in the early stage of the foreign business:

“In the beginning definitely. You do not know anything about China. You need local partners to help you to go through the myth of regulations and the people who govern them or have contact with them.”

(Info M11)

One senior president of M9 also confirmed:

“We have good relationship with them as all of them are required by the government. ... The Chinese have relations with so-called unions, government and banks so on. We have the technology. The Chinese partners have the knowledge, very important knowledge, of procedures, how to approach the government institutions, how to handle personnel and so on. We always have good relationships.”

(Info M9)

However, the role of local JV partners as local knowledge holders was underestimated by a few foreign companies. JV partners were either misperceived as ‘trouble-makers’ (Info M14) or ‘landlord’ (Info M13). The reason for this was that joint venture was the required entry mode in many sectors therefore local JV partners were not necessarily the expected local knowledge holders (Info M14). However, the empirical data show that even such JV partners did have specific local knowledge advantages, such as their existing regional relationships. As the investment manager of M13 confirmed:

“Our JV partners either offered land or established factories. They also facilitated local relationships. They could have done that more effectively. It all depended on whether they were willing to do so. Foreigners could not do it as they would not see you, like what happened to American Anrong in Hainan. Americans waited outside for a long time wishing to see the provincial leader but he escaped from the back door of the building. For government controlled projects who you choose to ally with is critically important. This is not like any consumer industry in which as long as you produce high quality goods at a low cost you have the chance to win. In this sector you must have government support. To do this better you absolutely need a local partner. Little things, people may never draw attention to, like that the local people steal your coal everyday would ruin your business. Only local partners could sort out issues like this.”

(Info M13)

Clearly, the role of local JV partners as important sources of knowledge holders should not be ignored. This, however, does not suggest that the multinational firm must form joint ventures with local organisations just in order to access their local knowledge base. In fact, many multinationals found that to ally with external knowledge holders through

specific business projects is also an effective and less problematic way of utilising external local knowledge.

### ***7.2.2.3 Other strategic alliances***

One problem with existing studies on local knowledge management is that there has been an unbalanced reliance upon learning from JV partners and self-experience. However, the empirical evidence suggests that strategic alliances other than equity joint ventures widely adopted to fulfil specific business project in China market are also good sources of specialised local knowledge. A good example is that given by the human resource director of M17:

“Generally speaking, we have an independent operating tradition. But we cooperate with other local firms to educate our patients. This may include organisations in other sectors such as instructor producers and the Pharmaceutical Bureau. Last time when our CEO visited us we talked to the Hygiene Ministry about our education programmes and they all supported us, as the education campaign needed to be led by this ministry, which worked with others to fulfil our specific education mission. ... Our company’s main advantage is that we are well focused. We focus on what we can do best. ... We trust outsourced business partners. Whenever necessary we ask experienced professionals to assist. ... We cannot imagine how an isolated firm can survive in another country. ... All people involved are important including doctors, nurses, and experts and so on because they take important role in education. The media is important as well in education. Each article we write to the media includes the words in the end of each article ‘you are part of us’. We are all working in the same team.”

(Info M17)

Similarly, the business development manager of M10 emphasised the role of strategic alliances as important local knowledge holders. He said:

“We need to cooperate with clients’ own appointed local organisations. ... They have technical knowledge of our clients’ projects and some practical knowledge of working with other local organisations. Therefore, we need not only technical communication but also cultural communication and exchange.”

(Info M10)

Recognising that strategic alliances are useful sources of local knowledge, M15 established its knowledge network by involving its external business partners. As the managing director illustrated:

“We need partners. The partners network is regarded as competence centre. We would like to be a competence centre, a centre of knowledge for our customers, consulting companies, forwarding companies, construction, agents etc. The German Chamber and Embassy is also part of our customers. So of course we share information and we have the networks. If we cannot sort out the questions we’ll forward the questions to other parties and ask others to contact them. Yes, this is very important. We do this with international partnerships in China as well as back in Germany as well as with the Chinese authorities. We have quite good contacts. We store knowledge from these kinds of relevant authorities. Of course, we also store knowledge through hiring people.”

(Info M15)

Thus, the role of local strategic alliances as specific local knowledge holders has been recognised among executives of European multinationals.

#### ***7.2.2.4 Customers and suppliers***

Customers were widely recognised as the best local knowledge holders of the market and themselves. This point is reflected from the following sentiment of the country president of M11:

“We expatriates spend most of our lives in different countries. We cannot put the whole Swiss system into China. It is only suitable to Switzerland. We have to learn here. We learn from our own people, through talking to them. Of course, we also talk to our customers, distributors to find their needs and how to satisfy their needs better than competitors and better than expectation. We learn by doing and by going out of our company to a large extent.”

(Info M11)

Viewing at the critical role of customers and suppliers as knowledge holders, M8 developed the technology for integrating customers and suppliers' knowledge into its knowledge sharing system. As one senior president of M8 confirmed:

“Customers know best. We have suppliers this side and channel partners on the other side. We need to closely cooperate with both customers and channel partners. This network will include everything of industrial IT in it.”

(Info M8)

Consequently, multinationals have made real efforts to stay close to and work together with their customers in order to know them ahead of their competitors and give any support required just in time. For example, M15 regularly organised social activities for its customers:

“We organise customer activities regularly. We have regular meetings. Before Christmas we organised an event. We offered food, drinks and wine. We asked them not to pay for food but RMB10 for charity.”

(Info M15)

M9 chose to team up with JV partners in commercial activities in order to learn from local customers although there was a strict restriction on its involvement in trading in its sector by the local government. As one senior president of M9 emphasised:

“You have to be here for a period of time to leave your business to be handled by Chinese. That is why we want to pursue any commercial issues jointly with Chinese partners. Our staff have to know the customers. We cannot sell products to dealers or agents and let them sell them onto whomever we never meet. We need the feedback about, say, ‘the quality should include the specific components’; ‘our requirement should have different colour and size’; ‘of course your car like a Honda will be in a better position’. Little by little we’ll gain new customers. So we have to know the customers.”

(Info M9)

Suppliers are also important local knowledge holders about the market and local sourcing. With the increasing importance of China market as a ‘*strategic hub*’ (Info M16) for supplying the whole Asian market or even global business of the multinational firm, this category of knowledge becomes more important to its entire operation. A senior president of M16 explained:

“For our business model, we need to localise production, sourcing and our suppliers due to the fact that, from a financial point of view, we can most likely develop our sub-suppliers in China to supply with the same quality but lower price compared to importing from outside. ... China is today turning into one of the world supply houses which means that, in order for us to achieve economy of scale and to be able to achieve production capacity and capabilities, we need to export a lot of products and services outside China, which was originally required by the government. ... China is very developing and important country which can be used as a base of our activities at least to support our business all over the world.”

(Info M16)

#### **7.2.2.5 Industry associations, governmental bodies, local institutions and competitors**

The empirical results suggest that industry associations sponsored and controlled by the government and other authorities such as local ministries, bureaus, departments are all good sources of local knowledge of administration and regulation issues. They serve as

main sources for multinationals to seek clarification and interpretation on legal terms and regulations. Because of the significant influence of these knowledge holders on multinationals' China business operation, especially in tightly controlled sectors, these relationships were perceived as key factors for business performance. As the senior president of M16 emphasised:

“It is extremely important to have good knowledge of and relationships with the regulation bodies, tax, technical and business licenses alike. I mean you can deal with small issues by yourself but still it is important to make differences relating to whether you can do business or not. You have to be very up to the changes in regulatory aspect and those are possibly the biggest and fastest changes.”

(Info M16)

Similarly, the country president of M11 stressed:

“You have regulators as your partners. You try to work with them, the tax bureau, human health or drug administrators or the pricing bureau. All these people are your new partners. They do not invest in your business but you have to work with them to help with your business. Local knowledge of how to register drugs, what kind of procedures you need to follow ... Of course you talk to the regulators. They know what to do and they can help with this.”

(Info M11)

Realising local authorities are good sources of knowledge of administration M9 chose to regularly meet relevant persons of administrative bodies:

“We have regular meetings with officials, ministries, administration commissions and so on, not necessarily on the top level but we exchange views on issues concerned daily.”

(Info M9)

Similarly, viewing at the role of governmental departments as local knowledge holders M7 paid particular attention to its relationship with external bodies:

“In terms of market knowledge, there are a number of associations supporting the bureau by the name it would appear to be Industry Association, government sponsored and controlled. ... In China there is a plasterboard association. They operate materials association as a subsidiary to the state ministry in the building industry. They are responsible for developing the case. We are a member of that association. We can give them advice. We see opportunities for importing development in that case. We choose to make frequent contact with them because they can offer services. Are they knowledge holders? Yes. What can be done without good relationship with them? Who can interpret the internal documents? The path between the bureau and the associations is open to us, you know, in an official way. And this may be regarding restrictions on certain producers in terms of quality. We all have to pass quality tests. Whether you can pass or not depends on your knowledge of the associations. Who holds the knowledge? Well, what kind of knowledge we are talking about? There is documented knowledge, the labour law. What is not documented is the application of laws and the regulated laws, maybe contract law, or many other laws. The written law and the application law cannot be two conversions. There is where you are who you are. In Tianjin, the Labour Bureau is quite open about the fact that they will interpret the labour law as exactly as it is. My experience, not always a common interpretation. So knowledge is often documented, fairly open available. What is not open available is the way the written law interpreted. ... Relationships with external bodies, especially the government, are particular. If you are going to do business you have to manage relationships with relevant people in different departments. Yes, it *is* important.”

(Info M7)

According to the investment manager of M13 government officials were not only knowledge holders about regulations, they were also good problem solvers as they also understood how to avoid procedures and risks. Using the following example, he illustrated how could local officials help with simplifying Chinese business procedures:



“We needed a document from that bureau for investment arrangement by foreign banks. But that bureau said we never issued any such kind of document to outsiders. They had their own work procedures. The local branch should report to them and they answered to it. But our bank could only accept a document from the central government but not from the provincial government. We fortunately had an employee who had worked in that bureau before. He invited a person to dine together talking about how could this be done. The person suggested us to make a meeting note for that day’s meeting and then send him for signature and stamp. He found the solution for us and helped us in this way. It was so simple!”

(Info M13)

In addition, local research institutions and universities were also perceived as key local professional knowledge holders because of the local talent base they had. As the respondent of M8 stated:

“The real difficulty is how to collect market information. We may collect it from people who have worked in this field but we are not sure how real the information could be. We could also get information from government authorities. Actually some of their organisations such as institutes, research centres etc., or some consulting companies, hold loads of information. ... We in China do have some R&D activities. Some specific departments cooperate with other organisations on specific technical matters. We sometimes cooperate with universities etc.”

(Info M8)

M11 jointly worked with a local institution to develop a new product that could be marketed worldwide:

“We work with Shanghai Institute of Medical Material. ... We find what works and what does not. Then we have the agreement on, if they get it marketed, sales and loyalty so on.”

(Info M11)

Those without business relationships with related external bodies often chose to frequently contact their external knowledge holders. As one senior president of M9 confirmed:

“We do not have many business relationships with universities and other organisations but we exchange views with other organisations.”

(Info M9)

External knowledge is often considered the key determinant factor for a business' success by Chinese firms. Consequently, building guanxi with individuals of external organisations has been a key activity for the local management involved. As the communications manager of C2 commented:

“He (the president) does not spend much time in the company. He spends more than 80% of his time in building guanxi. As he is now a key economic contributor he is often around by some people at certain level. We middle management in this company hardly see him.”

(Info C2c)

The president of this company confirmed:

“In China some specific industry suppliers serve as the main information disseminator. They are our main sources of information on the market, technology, competitors and other suppliers. However, we do not intentionally cultivate guanxi with them as they all take the initiative to share knowledge with us in order to make deals. Main industry players all have this advantage. Some small firms may not. Therefore, our networks often focus on distributors, governmental and supervision bodies, banks, universities, institutes and other relevant individuals.”

(Info C2a)

The president of C 1 added such networks were established even with competitors. He said:

“I regularly dine with the general manager of our main competitor. I know exactly what has been going on there. He was hired as the general manager, therefore, not as committed as myself to the business. I sometimes have sleepless nights but not him. He didn’t care much whether he disclosed information on his company.”

(Info C1a)

Hence, there is the need for the multinational firm to be aware of this useful body of external knowledge.

#### ***7.2.2.6 Local communities and individuals***

The empirical results also suggest that multinational firms were often involved in different international networks and communities organised by chambers, foreign government service bodies and industry peers. They often served as local knowledge holders of current local market issues including local human resource, distribution, legal issues and so on. For example, M15 regularly organised social activities participated by the whole German community:

“We have activities for all customers and the whole German community. We have afternoon meetings such as production efficiency, legal issues, sometimes, even Chinese medicine we had once, very wide-ranging. ... General managers from operating companies come as delegations from whatever industry. We try to always meet this situation.”

(Info M15)

Similarly, realising that some international communities in China are good sources of local knowledge, M8 was actively involved in networked activities organised by foreign chambers:

“Foreign firms often communicate each other through chambers. They normally organise according to their own interests some specific social groups. They get together to discuss common concern or benchmark their business with others. For example, they communicate on pay levels and so on. But you also need to contribute. There is a department called ‘year check’. They discuss laws, regulations, operation, social responsibility in detail and so on. They meet regularly. This is very valuable.”

(Info M8)

Therefore, local knowledge sources are dispersed. Though local knowledge holders have a certain degree of similar knowledge they tend to be critical in different aspects. For example, local middle managers were considered good sources of knowledge about local culture and cognition, which is more tacit than other categories of local knowledge. Local administrators were conceived as holders of knowledge about local administration, which is less diffused. Whilst local industry associations were perceived as knowledge holders of local economy and industry, which is fast-evolving. The complementary nature of their knowledge base suggested little hints of hierarchy of their importance. This is strongly supported by the data. For example, the senior vice president at M16 stressed that ‘*these are all very important*’ (Info M16). Strategically managing all these local knowledge sources can certainly increase visibility in the China market. Meanwhile, this finding has demonstrated that the local knowledge of experienced expatriates and acquired through recruiting local staff is inadequate for the multinational firm to conduct business in emerging markets.<sup>1</sup>

## **7.4 Conclusion**

This chapter has identified a long series of local knowledge holders in China, which suggested the dispersed nature of local knowledge sources. The research results have

demonstrated the proposition, put forward in Chapter 4, about the scope of local knowledge management, that local knowledge management needs to be extended far beyond immediate business transactions. These results further suggest that conventional studies examining learning effects from joint ventures (Makino and Delios, 1996; Inkpen, 1998) and internal knowledge transfer (Lord and Ranft, 2000) are limited. In order to develop local competitive advantage it is crucial for the multinational firm to explore strategies towards full exploitation of local knowledge sources. This has indicated the suitability of the unit of analysis employed in Chapter 4 for developing the theoretical model.

## Notes

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<sup>1</sup> See, for example, Lee (1999).

## **Chapter Eight**

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### **Developing Competitive Advantage from Local Knowledge Sources: European Multinationals in China**

“Doing business in China is different. ... We need a very high degree of local knowledge. As a billion organisation you cannot really try everywhere. In a market like the Chinese one, we need to build our business on local competence, on local knowledge.”

*(Senior Vice President, Multinational 16, Interview, 11<sup>th</sup> Dec. 2001)*

“The central competition in China is on understanding of local issues. How well you can develop your business in China greatly depends on to what extent you can deal with these issues.”

*(Investment Manager, Multinational 13, Interview, 28<sup>th</sup> Nov. 2001)*

#### **8.1 Introduction**

Local knowledge has been exclusively viewed as the key source of competitive advantage among executives in China.<sup>1</sup> This chapter presents the findings about actual local knowledge management practices observed and the measurable and immeasurable results achieved from these activities. These research results are based on the analyses of face-to-face interviews with managers from 11 European multinationals, field observation of 2 Chinese projects involving 6 European companies, and 17 multi-level interviews conducted at 4 Chinese organizations.<sup>2</sup> The focus of this chapter is on the strategic management process of local knowledge, those management barriers hindering its effectiveness, and the conditions under which the management impediments can be

strategically removed. Part of the analysis of local knowledge management process in this chapter is in direct dialogue with existing studies which suggest that, to mitigate local knowledge disadvantage, local knowledge should be acquired and transferred. Drawing from the empirical evidence it is argued that conventional knowledge transfer approach is not an optimal choice of mitigating local knowledge disadvantage in China. To exploit the full value of China local knowledge, knowledge integration mechanisms should be employed as compensation. In contrast to the neglect of implementation issues in previous studies it will identify the historical and cultural traits of local knowledge holders which pose difficulties in the management process and explore strategic means for resolving such problems. The objective of this chapter is to empirically test the detailed argument put forward in Chapter 4 which sought to explain how local knowledge can be exploited to achieve superior business performance in China. The intention is to determine the extent to which the theoretical model is broadly applicable in addressing the research problem.

## **8.2 Local Knowledge Management Process**

The empirical data suggest that European multinationals employed a '*China strategy*' towards best exploitation of local knowledge, which encompassed three specific strategic efforts - knowledge penetration, knowledge blending and knowledge integration (Figure 8.1). The deployment of this management process was based on understanding of the huge knowledge gap between Europeans and local Chinese, arising from certain country-specific differentials<sup>3</sup>. It responded to the undiffused, highly tacit and fast-evolving nature of China local knowledge<sup>4</sup>, and the dispersed feature of local knowledge sources<sup>5</sup>. The objective of these strategic efforts was clearly reflected from the statement of a senior vice president of M16:



“M16’s (real name omitted) success lies in its ability to build up local capabilities. We fully understand that to be a future telecom leader in China we need to have a good understanding of local culture, social economic characteristics rather than blindly move our global methodology, including technology to China. To best facilitate this objective we build up solid cooperative relationships with local customers, local government, local universities, institutes and experienced international peers.”

(Info M16)

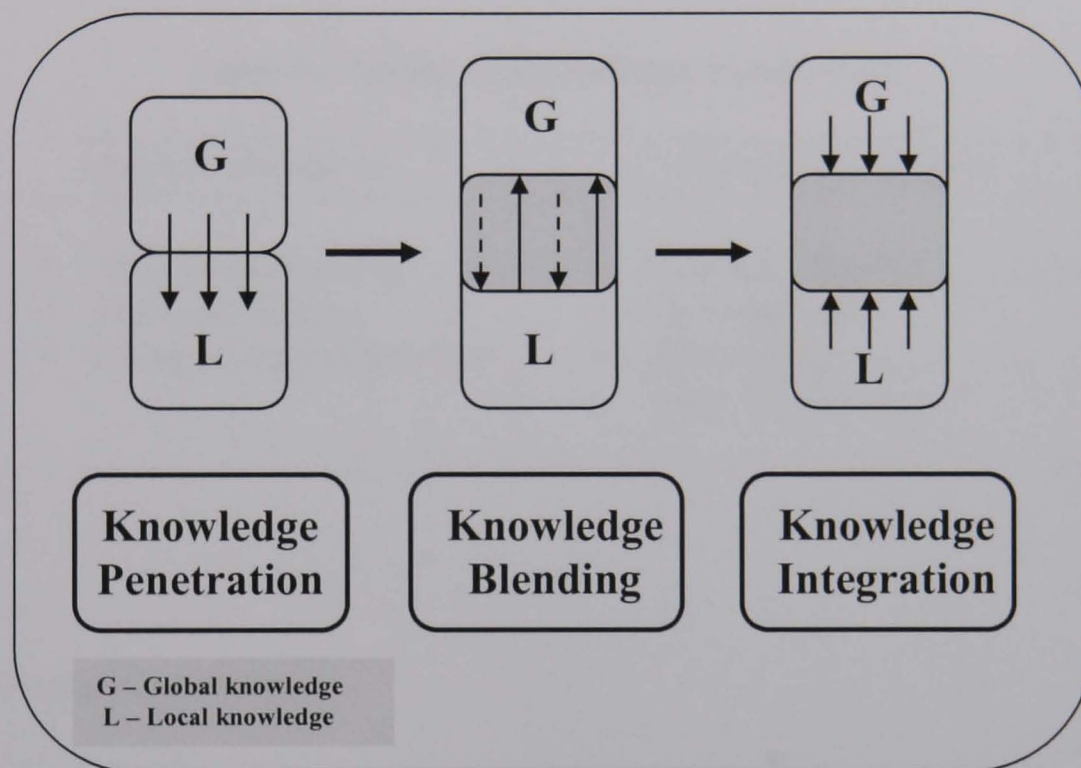


Figure 8.1 Local Knowledge Management Process

### 8.2.1 Knowledge Penetration: Creating the Instrument for Local Communication

Studies of local knowledge management have often overlooked the role of language as an essential instrument in conducting cross-border knowledge management activities. The empirical data suggest that there was a real knowledge gap between European staff and local Chinese which restricted mutual communication. In order to develop the dialect, a common language, for local communication, and build up common understanding of the corporation, global knowledge penetration strategies were proactively deployed before

exploitation of local knowledge. The main infiltration tactics adopted are listed in Table 8.1. These activities were carried out constantly at a high cost. The scope of knowledge penetration activities extended beyond business boundaries in response to dispersed local knowledge sources. The content of the global knowledge transferred to China market ranged from explicit technology and management procedures to tacit corporate culture and individual beliefs.

**Table 8.1 Means of Knowledge Penetration**

<i>Internal penetration</i>	<i>External penetration</i>
<ul style="list-style-type: none"> <li>▪ Theoretical training</li> <li>▪ Practical training</li> <li>▪ Company social activities</li> </ul>	<ul style="list-style-type: none"> <li>▪ External training</li> <li>▪ Demonstration</li> <li>▪ Advertising</li> <li>▪ Network activities</li> </ul>

**8.2.1.1 Internal penetration**

**8.2.1.1.1 Internal theoretical training**

Theoretical training of local employees was cited by most managers in the interviews as one of the most effective means of knowledge penetration. It occurred at different levels of the business in a variety of forms. A senior vice president of M8 provided a typical example. At M8 formal training programmes were drawn up yearly. The theoretical training was designed to enhance local staff's general knowledge associated with their basic quality and professional skills. More specific training of local employees was also carried out regularly to build up their specific strengths. Most local staff had the opportunities to participate in specific courses such as R&D Orientation, Languages, and

PC Skills. Managers were required to draw up suitable training programmes for each employee at the beginning of each year and training plans for the following year. In these plans, they were required to elaborate how to enhance each employee's knowledge base according to his/her strengths and weaknesses, and what specific training of this employee would be needed. Aside from overall corporate level theoretical training of local staff each department also offered departmental level training to enhance its workforce's professional knowledge. In addition, this multinational firm also sponsored and cooperated with selected universities such as China-European International Management Institute on its tailored MBA when training selected staff. Theoretical training played an important role in improving communication between Europeans and local staff. As the North Asian Manager of M14 confirmed:

“Yes, it is very helpful. We now have a common language, a useful tool. Local communication within the company is easier. But the cost is high.”

(Info M14)

#### *8.2.1.1.2 Practical training*

European multinationals also influenced local knowledge holders' knowledge base at large through daily business activities. This was evidenced in both interviews and field observations. They all expressly adopted global management procedures and exercised some global practices in China market. Local staff could learn through business interactions with European staff. The effect of this process was significant, especially at multinationals with limited business in China, because of the more intensive personal interactions occurred between Europeans and Chinese staff.

Additionally, multinationals often sent local staff, mostly managers, abroad for overseas practical training. For example, 400 Chinese at all levels of M9 were trained in its mother company. M10 also had staff working in the UK, Netherlands, America and Singapore to gain practical global experience. The practical training programmes attended by local staff ranged from a few weeks' short-term visit to one year's on-the-job practical learning. These programmes provided local staff the opportunity to gain first-hand corporate experience.

#### *8.2.1.1.3 Company social activities*

In order to promote corporate culture and foster employee attachment to the corporate these European multinationals regularly organized company-wide social activities ranging from birthday party to collective travel. The managing director of M15 provided the following example:

“Each year we organise employee trips for two or three days. We do not sleep in two-star hotels but normally three or four-star ones. We've been to Hainan and Tibet. As to where we go and how we spend the money I leave the decisions to them but I would like to spend it as a team.”

(Info M15)

Through these activities, local staff directly sensed corporate, as well as individual, culture and understood European social behaviour and ways of thinking (Info M18).

### **8.2.1.2 External penetration**

#### **8.2.1.2.1 External training**

Some training was also offered to external local knowledge holders with the intention of increasing their global knowledge base. For example, M16 chose to undertake specific training of local customers through its academy worldwide in order to influence local customers' knowledge base and facilitate greater mutual understanding. Some young talents of its customers were selected to attend its tailored MBA programmes. M11 ran seminars for local distributors and government officials to gain fundamental corporate knowledge. Training of local suppliers was also evident, for instance at M9.

#### **8.2.1.2.2 Demonstration**

Key external local knowledge holders such as local authorities and local customers that were good sources of knowledge of administration and knowledge of industrial and economic structure were also regularly invited to overseas companies or international conferences and fairs. For example, M9 carried out training of local officials in Europe to *'show them what a free economy should be and how a multinational's business is actually managed in a free economy'* (Info M9). In March 1999, Jiang Zemin, former president of China, and his delegation visited headquarters of M11 in Europe, where the CEO gave an introduction of the company and its research (Info M11). During my field observation, 4 of the 6 European companies participated invited their local customers to their companies in Europe.

#### *8.2.1.2.3 Advertising*

One unique marketing strategy pinpointed the role of advertising in knowledge penetration, or '*education*' in the words of the Human Resource Director of M17. Knowledge penetration via advertising, such as advertising materials, education campaigns, press and mass media, was considered a useful way to influence local customer perceptions. As the respondent of M14 remarked:

“In Europe as well as the US, only about 3-5% of our budget is spent on marketing but here in China it is about 25%. People in your distribution chain have to understand you and your products. The cost in China is not low.”

(Info M14)

#### *8.2.1.2.4 Network activities*

In order to establish more mutual understanding and influence external local decision-makers' individual perceptions, European multinationals engaged in intensive networking activities. These lobbying activities were conducted at all levels from dining with a department officer to meeting with Jiang Zemin, the former Chinese president. European multinationals realized the need for dialogue with external knowledge holders such as local customers and local government.

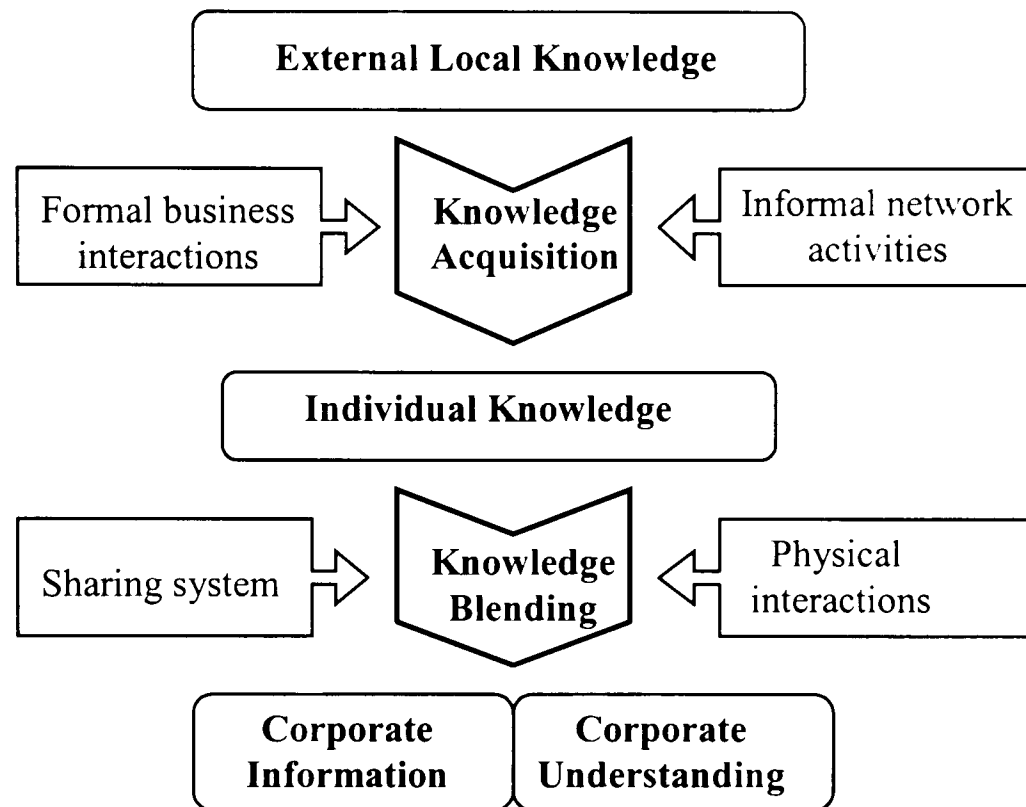
#### *8.2.1.3 Benefits from knowledge penetration*

Through knowledge penetration European multinationals increased and influenced local knowledge holders' knowledge base, and improved local communication, albeit with the drawback of high costs (Info M14). Local knowledge holders could communicate ideas in

global terms and forms (Info M14), and they could also better utilize their local expertise because they assumed more business responsibilities (Info M8). This knowledge penetration strategy established the foundation and interface for local knowledge blending as illustrated below (Info M16).

### **8.2.2 Knowledge Blending: Developing Corporate Common Knowledge Base**

Studies on local knowledge management have thus far focused on the role of knowledge acquisition and transfer in mitigating local knowledge disadvantages faced by foreign investors<sup>6</sup>. Empirical data show that executives of European multinationals did pay attention to the role of knowledge acquisition and transfer in exploiting local knowledge, and intended that, by doing so, they could turn individual local knowledge into a corporate asset. Consequently, their knowledge penetration strategies were closely followed by their second strategic effort – a wide scope knowledge blending process characterized by intensive interactions between local knowledge seekers and local knowledge holders. In this phase local knowledge was acquired and blended with global knowledge to form a corporate common knowledge base (Figure 8.2).



**Figure 8.2 Knowledge Blending Process**

### ***8.2.2.1 Local knowledge acquisition***

Realising the fast-changing nature of local knowledge in China market European multinationals recognised the need to keep pace with the dynamic business environment. In order to acquire local knowledge they engaged in intensive formal business interactions with external local knowledge holders as well as informal networked activities. Because of the generally undiffused, highly tacit, dispersed and fast-evolving nature of China local knowledge these companies found that local knowledge was more difficult to capture, including explicit knowledge. They realised that they had to build wide and strong business and social relationships with external knowledge holders in order to get relatively correct and well-interpreted local knowledge, knowledge of administration and knowledge of industrial and economic structure in particular.



On the one hand they paved ways to formally access external local knowledge holders such as local customers and local authorities. For example, in order to acquire local customer knowledge, numerous efforts were made by those European multinationals. Frequent business contact with customers at different levels was cited by all participants as the most frequently used method to gain more customer knowledge. Additionally, M2, M3 and M6 gained in-depth understanding of their customer (C2) through supporting its new product development. M14 and M8 established their own distribution systems across the country in order to get access to customer knowledge. M16 formed joint ventures with its Chinese customers believing that by doing so they would be closer to their customers according to one senior president (Info M16). M9 chose to jointly work with its local partners in distribution in order to acquire knowledge of local distributors and customers. M7 established a multi-layered communication system linking itself with its customer-related local knowledge holders. In this system, its technical sales force directly joined the end-users' projects and *'worked together with local designers, institutes, contractors and subcontractors and other service companies, in conjunction with its distributors'* (Info M7). Through its three-stage technical co-operation with its customer-related knowledge holders its *'sales network was able to effectively report back key facts on each local project to its networked database'*. Local customer knowledge was thereby constantly acquired through this management system. The general manager of M7 also explained how they acquired knowledge of local administration through deliberate business interactions:

“I know it is important to maintain relationships with external bodies, associations or bureaus that have impacts on our business. I need to maintain relationships to gain information I require. We choose to make frequent contact with them because they can offer services. What can be done without a good relationship with them? Who can interpret the internal documents?”

(Info M7)

On the other hand, informal networked activities and other social entertaining activities in China were intensively organized. They were undertaken not only for the purpose of acquiring tacit knowledge but also the explicit local knowledge, as the managing director of M15 illustrated:

“We know the statistics are not reliable. The real information about the market situation is very difficult to get. But for us, we did not find that difficult, as we knew this before we acted, and we were very well prepared. We talk often to authorities including lawyers. We have a very strong political lobby. Our project has strong support from the German Federal government. Also the head of Siemens is one of our main supporters. ... This you can see the political importance of the background at the moment. On the China side, Long Yongtu, for example, attended our opening ceremony in Beijing, along with other senior officials.”

(Info M15)

The networked activities range widely, from dining with local customers or officers to meeting with central government officials. CEOs of European multinationals regularly flew to Beijing to meet key government officials. As the respondent of M8 commented:

“In other countries we rarely see which particular business goes to the government to solve problems. Their communication is more company-to-company focused. Here we have many things to talk to the government about. We often see from the TV today that this president meets the boss of this or that company and someone else in another company tomorrow. I have never seen John Mayer or G. W. Bush meet a chairman of a

business. When they meet they talk about something. In China the real separation of business from politics will take some time but by that day China will be different.”

(Info M8)

Business entertaining activities undertaken in China were very country-specific, including time-consuming dining and wining with customers, organizing overseas visits and travelling, and other entertaining activities for customers and even their families (Info M1-M6, Info C2, C5). The purpose of organising these activities was two fold: (1) to access and acquire local knowledge from external knowledge holders (Info M2, M4), (2) to enhance mutual understanding (Info M6).

In addition, some multinationals were also active in wider networked activities organised by international communities. Being members of these communities allowed them to continue to upgrade their understanding of key local issues (Info M8; Info M15). As one senior president of M8 illustrated:

“Foreign firms often communicate with each other through chambers. They normally organise, according to their own interests, some specific social groups. They get together to discuss common concern or benchmark their business with others. For example, they communicate respective pay levels or so on. But you also need to contribute. There is a department called Year Check. They discuss laws, regulations, operation, social responsibility in detail and so on. They meet regularly. This is very valuable.”

(Info M8)

Therefore, in order to acquire fast-changing local knowledge, explicit or tacit, building good business and social relationships with external knowledge holders, is crucial. This evidence demonstrated that external undiffused explicit, and some tacit, local knowledge was being constantly acquired through socialised activities.

However, the local knowledge acquired through these activities often resided in individuals, and was perceived as individual asset rather than corporate resource (Info M8 M17). All managers interviewed agreed that front-line managers that interacted with external knowledge holders on a daily basis had accumulated considerable local knowledge. They were the key local knowledge holders of the multinational firm. Yet, *'it is difficult to share this knowledge in a company.'* (Info M8). According to estimates about the China market, average turnover of employees is around 14-15% (Info M17). Thus turning individual knowledge into corporate asset is becoming more critical (Info M8, M17). The search for strategies of managing individual local knowledge has therefore become a corporate objective:

“Obviously in addition to tangible assets we have intangible assets, and they are very important. In addition to brand, image and reputation we also have some other intangible assets held by individual employees but not by the company as they are very individual. We realise they are very important. But how could we change them into corporate knowledge?”

(Info M17)

#### ***8.2.2.2 Knowledge blending: developing corporate information base***

In order to blend the acquired local knowledge with global knowledge, and develop their corporate information base, these multinationals employed in-built knowledge dissemination systems such as central filing system, databanks etc. to promote and facilitate greater internal local knowledge transfer and sharing. As one of the senior president of M16 illustrated:

“At the bottom you have the knowledge building activities, systems spreading into all different areas, which push the market forward, and that is what is necessary to supply what the market requires.”

(Info M16)

In these systems, some local knowledge is processed, articulated and diffused for wider public use. This was apparent in all companies participated. A typical example of such a system was that given by one senior president of M8:

“We stressed when we first established our business here that we must establish a management system. This system requires people from different departments to establish their own database. We call it central filing system. Even if you have two months’ holiday anybody else can often continue your work immediately. We have been establishing our management system to avoid any possible impacts from any accidental issues. For example, we can establish customer database. We need to input customer relations and other things in. This does have some real effects.”

(Info M8)

This system enabled real time knowledge to be codified and shared onsite or via the Internet. It built up structured knowledge to facilitate just-in-time decision-makings. Its employees worldwide were linked in real time through this decision support system that blended pieces of knowledge for all to share. The benefit of this investment in decision support and knowledge management is that:

“Our management has gained a real-time tool with which to both take the pulse of the organisation and deliver key messages. Employees are better informed on how their personal efforts interface with others. The internal ‘marketing’ of information creates a friendly spirit of competition that helps to yield better communications tools-reusable far beyond the authoring individual or business unit. Most important, the real-time integration of information systems has placed us in a position to participate in a dynamic era of e-business partnership with our customers, channel partners, suppliers and shareholders. Our products enter the era of knowledge-based solution.”

(Krantz, M8, 2000).

Another typical example is that given by the business development manager of M10, where local employees were connected virtually with global staff and global resources through modern communication facilities:

“Virtual Office is an Internet system, via which people feel like sitting in one office. We have the KNET satellite. It enables us to share everything. For instance, what you did in the UK can be seen here. We can design the same project here. We can consult anybody on our work. They will tell you immediately, and give you suggestions. This includes videoconference. ... Our virtual system is No.2 in the engineering sector in the UK. As to design we also have software systems. We have SCOPENET for purchasing. After login we know the worldwide types of machinery, their prices everything. It is all shared. Through our system we can do things like one person designs and another person reviews. We also have virtual group meetings. We spent a lot on such communication.”

(Info M10)

Similarly, the general manager of M7 illustrated how local customer knowledge was blended into its global knowledge base:

“We have a wide sales network in terms of sales representatives employed by our company. They spend time with designers, institutes, and decoration companies for the architectures. They give us information on our products ... They deal with contractors, subcontractors. It is not the distributors who give us the feedback it is the contractors.

Each representative on each project reports back three facts to Tianjin where we have all the database and networked information.”

(Info M7)

Moreover, well-established document systems had long been embedded in the business routine of multinationals to codify and share what had been going on in daily terms. In addition, their local employees were all required to review the business process and write reports regularly. Local staff were becoming required to contribute to internal publications shared at corporate level (Info M17).

However, multinationals that adopted knowledge codification and sharing systems questioned their effectiveness. It was easier to establish systems than to effectively put them to use. “*We can do some but not all.*” said the respondent of M8. Similarly, the human resource director of M17 concerned:

“We can put in customer names, addresses and so on but not anything in any depth, for example, mutual understanding.”

(Info M17)

Nevertheless, it was still considered one useful means to create common working knowledge, essential to knowledge integration.

### ***8.2.2.3 Knowledge blending: developing corporate-level understanding***

Given the limitations they faced in sharing local knowledge through robust systems European multinationals depended on physical interactions to blend local knowledge, tacit knowledge in particular, into corporate-level understanding. Business activities such as regular meetings, instant meetings, teamwork, seminars, and company social activities as

well as informal physical interactions were all repeatedly mentioned as evidence of physical communication within the multinational firm. These activities were organised on a daily or regular basis in each business unit and regularly organised across business units e.g. board meetings participated by general managers of each business unit (Info M14) or across borders regularly e.g. worldwide human resource directors' meeting (Info M17). Of these activities business meetings were the most frequently used, as the respondent of M7 stated:

“The department managers report to me. We have regular meetings every two weeks. I see them more often. We go through the issues and seek solutions for the problems. Communication ... there is a big change. You can see it here. I hope we are building the ceiling of unity and interaction.”

(Info M7)

Emphasising the role of physical contact in diffusing knowledge, the managing director of M12 did not only hold meetings with local staff but also claimed to adopt an open-door policy to increase employee access:

“First of all, I have an open door policy. People can all talk to me without knocking. Even I may need to change a little bit so that my work as a manager will not be influenced too much but I'll keep approachable. ... The second thing is we have meetings. I call it a 'huddle' as we get together for meetings and the word is funny. We discuss general issues or a party whatever. Then I have sales meetings with sales people, commercial meetings with commercial team. I have support meetings with support groups. I call them often, but we also have regular huddles at least every two weeks.”

(Info M12)

This company also organised its local sales staff as teams of twins to develop its redundant local customer knowledge base:



“We are trying not to lose the top clients when top performers leave. This is why everybody has a second home, a weekend home, another product. To make sure anything happens to the first guy I still have the second guy who knows. This is a two-tier structure.”

(Info M12)

At M17, local staff were rotated to gain knowledge beyond their specialised areas or immediate duties:

“We have job rotation, joint coaching and other practices. We each year have many times’ overseas training and conferences. Before you go you certainly need to know the business as a whole first in order that you can communicate with different people from different areas.”

(Info M17)

The field observation data reveal that instant meetings and informal chatting were sometimes key methods used to blend emerging local insights with global perspectives. Consider the following dialogue between the chief representative of M6 and his Danish boss, recorded during field observation:

*“Chief representative: He (president of C2) wanted 20 machines for the price of one.*

*Danish boss: He makes money. Why didn’t he want us to make money?*

*Chief representative: But I am afraid we’ll have to consider the deal, on a credit basis, I mean. He is the second biggest customer in China.*

*Danish boss: We would not be able to make money in that case. When could he pay the rest?*

*Chief representative: In a year’s time. He’s never broken his promise to my knowledge. He also has the potential to purchase more items in the near future as he’s just acquired the biggest state-owned factory in Nanjing. We would have long-term profit.*

*...”*

(Info M6)

Such knowledge of the local customer's business behaviour and potential is shared through a short dialogue between the local manager and his European boss. Such immediate meetings and informal communication occur many times each day during a trade fair. It is unrealistic to externalise everything that local staff know and to blend it into corporate knowledge base through shared systems. These physical interactions ensured immediate local knowledge flow between organisational members.

Physical interaction through social activities was also considered an effective way of sharing local knowledge, knowledge of culture and cognition in particular. For example, the China manager of M18 stated:

“You have to understand the mentality and the way people do things in their daily life, the problems they face and how they approach local issues, their way of thinking after 40 years of a planned economy and communism. You need a good local working team supporting you. You should think about how to establish the right type of friendship with your local staff, one that is totally different from your home ones but can give you a lot. To share and make use of their knowledge you need to talk to them, have Maotai (banquet served Chinese whiskey) together, go to Karaoke with them.”

(Info M18)

#### **8.2.2.4 Benefits from knowledge blending**

The adoption of knowledge blending process provides a number of benefits to the multinational firm: (1) to avoid sudden loss of critical local knowledge with the loss of key employees; (2) to improve the corporate responsiveness; (3) to lead to more effective business decisions and innovative management ideas. This is evidenced in the following remarks of three respondents:

“We have been establishing our management system to avoid any possible impacts from any accidental issues. It is sometimes difficult to avoid turnover of employees.”

(Info M8)

“We communicate a lot anyhow and it is important to communicate in order for you to be fully updated on what is happening and response as quickly as possible.”

(Info M16)

“You always have to be open for new trends in changes in markets, customs, products, ... If you do not even think about how to adjust your business to the new situation how could you stand out in the even tougher competition in the future? ... During the years we marketed in China our business decisions and proposals were all based on experience of local staff, understanding of local market situation and customer expectations. Based on such knowledge we adjusted our marketing methods, including selling our collagen casings in printed version. This is not possible in Germany and other European markets. We applied this idea in developing printed collagen casings. ... Based on such knowledge we also gained entry to major customers in China. ... We would not achieve what we have been achieving without such understanding.”

(Info M18)

The evidence presented here shows that knowledge transfer is important for developing corporate capabilities. It is the mechanism through which individual knowledge can be utilised in a broader business context. The embedded collective knowledge created through knowledge acquisition, sharing and application activities could improve overall performance. However, past research on the role of knowledge transfer approach in mitigating the local knowledge disadvantage faced by foreign investors has not always recognised the limitations.

### **8.2.2.5 Limitations of knowledge blending**

The findings show that, despite the great attention paid to knowledge penetration and knowledge blending, European multinationals found local knowledge difficult to acquire and blend with global knowledge. The attempt to transfer local knowledge by European multinationals in China indeed encountered difficult challenges. These difficulties were six fold.

First, the perception that knowledge is *'individual asset'* was rooted in local people's mind (Info M8, M17). Therefore, *'it is difficult to share this knowledge in a company'* (Info M8). The impacts of perceptions on local knowledge transfer initiatives were significant (Info M8, M17). Changing historically rooted beliefs does take time, and the high employee turnover rate in China exacerbated such difficulties.

Second, some *'delicate'* local issues do require local specialists with good problem-solving skills to tackle (Info M12, M13). Such specialised knowledge is difficult to transfer (Info M7, M12). Some critical local staff with specialised local knowledge are not *'replaceable'* (Info M17). This has raised the issue how to manage these specialised local knowledge holders, and how to utilize such local expertise. As the general manager of M7 said:

“It seems our organisation has a good relationship with the bureau but that knowledge is normally held by individuals. Therefore there is an issue we have to consider if we would let a person go or not. Who holds the relationship? Whether it would affect our relationship?”

(Info M7)

Third, transferring local knowledge required considerable tangible resources (Info M10). The constraints of tangible resources to the acquisition of intangible asset have to be considered. As the respondent of M10 commented:

“It is convenient but it depends on how frequently you use it, whether you can afford it. It is expensive. It is helpful for communication. It is a technical advantage but not a cost advantage.”

(Info M10)

Fourth, learning takes time, but China local knowledge evolves fast. Seeking to learn everything about China market was not an efficient way of exploiting local knowledge (Info M1, M9, M16, C1). As the respondent of M16 commented:

“Our local partners do have valuable knowledge that would take us a long time to acquire. ... The China market has been changing so fast. It is fascinating to be here witnessing such a tremendous change. You can't wait until you gain that knowledge. There is massive opportunity here. The network market in Beijing here is equivalent to the entire market in our home country.”

(Info M16)

Fifth, most multinationals realised that a company's knowledge base was often not enough to explore China's full potential. There was a need to utilise the dispersed local knowledge held by a variety of external organisations in different geographic locations. As one senior president of M8 explained:

“A company's knowledge is always limited. To win a contract like the Three Gorges Project, the biggest project in the world, requires collaborating with many specialised companies. It is impossible to acquire all the knowledge you need in a market like China.”

(Info M8).

Sixth, local knowledge was not widely available and accessible. The problem encountered by M8 in acquiring local customer knowledge demonstrated this point:

“We require our salespeople to have an account manager for each main customer and to have an account team. The first thing they need to do is an account plan. They need to know how much each customer in the electronic and automation industry will invest, what proportion our products account for in their total purchasing plan, what is our position in their plan, and to achieve this what resources we may need and what we now need to do. We thought we knew the customer but actually when we answered these questions we found we knew nothing about them. We knew nothing at all! We knew little things like they purchased from us before but nothing in detail. We knew our customers were going to purchase but we did not know their overall purchasing plan, their near and medium term investment plan. So we certainly did not know what percentage of our products would be in their plan and how much they would like to buy from us. How could we establish a target, a plan without this knowledge? Consequently, how could we set appropriate incentive system to reward and encourage people to make the deal? There were no criteria. At present this is our main challenge. ... You have many channels to learn more detailed information in more developed economies but in China this is difficult to do.”

(Info M8)

These difficulties suggest that the decision about what knowledge should be transferred or integrated was contingent on six specific variables rather than its transferability alone, as assumed in the theoretical model. They also suggest the limitations of knowledge transfer approach in developing corporate capabilities and indicate that the present focus on knowledge transfer in existing studies on knowledge management strategy may be unrealistic.

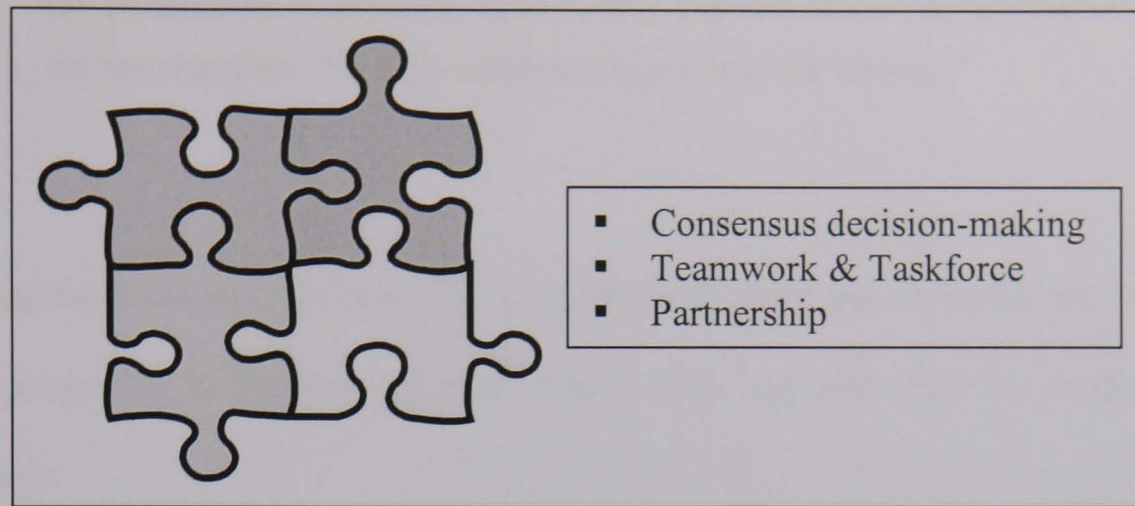
### **8.2.3 Knowledge Integration: Exploiting the Full Value of Local Knowledge**

Many of the studies of knowledge management strategy overly focused upon knowledge transfer as a function of aggregate gains in business performance. These studies argue that collective know-how leads to business success.<sup>7</sup> However, the first-hand data show that local knowledge, especially '*specialist knowledge*' (Info M9), was often integrated with global knowledge to fulfil divergent local business tasks. A knowledge integration approach was adopted to utilize difficult-to-transfer local knowledge, knowledge of local culture and cognition in particular, which may not have been used effectively otherwise. It combined different functional and personal capabilities to reap business opportunities and achieve superior business performance (Figure 8.3). As the business development manager of M10 illustrated:

“We won this contract because we have two kinds of knowledge. One is our overseas knowledge. The other is local knowledge - how to implement this project in China. We have overseas experience but that doesn't mean it works in China. How a firm cooperates with local engineering institutes and construction companies is crucial. We are the knowledge holder of this kind of knowledge. We know how to best combine these two to successfully fulfil the project. This is a big advantage, very convincing.”

(Info M10)

Knowledge integration was realised through consensus business decisions, organized teamwork and taskforce. Externally, European multinationals also formed strategic alliances with external knowledge holders to utilize local expertise that otherwise could not be used in an efficient way. 'Business partnership' was adopted as a key integration strategy for managing external specialised knowledge.



**Figure 8.3 Knowledge Integration**

### **8.2.3.1 Consensus business decision-making**

Consensus business decision-making was observed in all participating European companies. The purpose of corporate business meetings, whether regular or irregular, was two fold. One was to share up-to-date business knowledge (Info M1, M6, M12). The other was to integrate local wisdom into corporate business decisions supporting smooth business operation (Info M7, M8, M12, M16, M18). Local staff were not only involved in frontline business decisions but encouraged to contribute to more corporate-wide business planning and problem-solving (Info M16). Consensual business decision-making strategy offered the opportunity for different perspectives to emerge leading to group decisions that consider the full alternatives. It embeds individual knowledge into collective business actions and combines individual strengths to achieve superior business performance. As the respondent of M16 explained:

“We are proud of the fact that we have a very high level of local competence in our organisation. We have a high proportion of local managers in our top management team. They play an important role in our business decision-making process. We also have international competence influencing into how business is done in China. I think



the combination is important and I believe you should not take anyone away or simply tie them together. The right combination is part of the success.”

(Info M16)

With ongoing localisation process European multinationals had an increasing proportion of local management in their management teams. This was also observed in all field study companies.

Moreover, external local knowledge holders were also invited into business decision-making. For example, M13 gave the example that they invited local officials to work on the solution to a specific issue encountered<sup>8</sup>. Meetings with local business partners were regularly organized at some multinationals to solve mutually concerned issues (Info M9, M11, M10, M16). The researcher also observed involvement of local institutions, local customers, local suppliers, and even local individuals, named ‘*strategic group*’ by the president of C2, in a local customer’s (C2) business planning.

### ***8.2.3.2 Teamwork or taskforce***

Multi-level teamwork was widely adopted among the participated multinationals for best utilisation of individual specialised knowledge. The Country President of M11 stated the importance of teamwork to its business success:

“We do teamwork all the time. That is what the meetings are for. The meetings are really set for seeing whether our team objectives are achieving or achieved. That is why we have the meetings. We do it everyday. ... If you do not work together as a team no matter how much achievement you have got it will not help you.”

(Info M11)

The respondent of M17 illustrated how teams can be purposely organized at different level of the business:

“Teamwork is our spirit. It needs to be organized purposely. We need to strategically allocate the work. We all need to have common goal and understand the value of the teamwork. We strongly adopt it. Nearly all projects are required to be done like that. Teams can be of every kind. They can be organised at department level, can be cross-functional. It is our working direction and also something worth to learn.”

(Info M17)

The business development manager of M10 illustrated how a business-wide team can be formed to fulfil a business objective:

“Business Development is responsible for liaison with clients, making bidding policy and searching local partners. We need to, for example, cooperate with a local engineering institute and a construction company to bid a project. Business Development does the initial work. We also have Engineering Department, Purchasing Department and other project management departments. These departments form a task force or a team to cooperate with business department to do the bidding. We get the contract and then we leave the main task to operational departments. We then focus on facilitating relationship between different organisations such as official requirements and so on, political level, not the job in detail. After that we’ll work on new projects.”

(Info M10)

The respondent of M16 also illustrated how they extended teamwork to their external local knowledge holders:

“We include joint venture partners, customers into our teams. When it comes to achieving certain achievement our customers normally request certain functionality or technical aspects of our products that we need to develop for them. In both cases it is very much team work. The customers know what they want. We need the customers’ input in order to be able to come up with the certain products that customers ask for and normally within a certain time frame. We have a lot of teamwork and co-operation with

customers. We also have teamwork with partners on development with authorities. So whatever a success we are achieving in China it is very much related to teamwork.”

(Info M16)

Therefore, these teams were set to fulfil business goals by combining divergent competencies.

### **8.2.3.3 Partnership**

Local knowledge held by external knowledge holders was perceived more difficult to acquire and harness. As the respondent of M16 pointed out:

“The partners do have specific knowledge and competence which would take us a long time to acquire”

(Info M16).

Business partnership was therefore adopted as a key integration strategy for utilizing external local expertise. As the managing director at M12 confirmed:

“Everything in China is partnership. It would be naïve not to have Chinese partners.”

(Info M12)

Agreeing with this view the respondent of M13 commented:

“Only local partners know how to deal with local specific issues especially when you are operating in a highly controlled sector like ours because you can never imagine what would happen to your business, especially if your business is in less-developed local provinces.”

(Info M13)

In the similar vein, the managing director of M15 illustrated how important strategic alliances are to its China business:

“We serve as a competence centre of our customers. The German Chamber and Embassy is also part of our customers. So of course we share and we have the networks. If we cannot sort out the questions we’ll forward the questions to other parties and ask them to contact them. Yes, this is very important. We do this with international partners in China as well as back to Germany and Chinese authorities, as we have quite good contacts.”

(Info M15)

The importance of local knowledge integration is highlighted especially in a government-controlled sector as the investment manager of M13 stressed:

“In government tightly controlled projects who do you choose to deal with the project is crucially important. This is not like other consuming industry in which as long as you produce the high quality goods at a low cost you could have the chance to win. You must have government support. To do this better you absolutely need a local partner. Little thing that people may never draw attention to like that local people steal your coal everyday would ruin your business. Local partners often know how to deal with this.”

(Info M13)

The respondent of M9 explained how they coordinated with their JV partners:

“We usually split the task of the company. The Chinese partners have the knowledge, very important knowledge, of procedures, of how to approach the government institutions, and of how to handle personnel and so on. They have relations with so-called unions, government and banks so on. We leave these to them.”

(Info M9)

In detail, the respondent of M10 illustrated how they allied with local institutes and local companies to create the market niche in China market:

“Many foreign firms invest in new factories. They know who can design and construct factories in China. But they cannot trust them, as Chinese companies are still not internationalised. So they put on a hat, our company’s name, on top of the projects. We are operating in a niche market. We can facilitate the smooth establishment of the projects with our worldwide resources, experience, standard procedures and, most important, understanding of local partners. We broke the record of GE firms by facilitating GE Shanghai factory. We finished the project two months’ ahead of its world record with high quality. With this reputation and credibility we are easily accepted. It was designed by Chinese and constructed by Chinese. ... Most of materials used were sourced in China. It is first class factory in the world. The key to success is that we know how to partner with local organizations.”

(Info M10)

In addition to partnering with local Chinese companies most multinationals also co-invest together with an experienced international partner to take advantage of the partner’s existing China local knowledge, especially in the beginning of their businesses (Info M11).

Moreover, European multinationals also adopted an integration approach towards utilizing local skills in R&D and other business activities. For example, M11 collaborated with a local institute on developing new products from Chinese herb sources. M9 worked with local international communities for political lobby. M17 allied with local firms and administrative body to educate local patients and develop its market:

“We cooperate with other local firms to have education on patients. This includes organisations in other sectors such as instructor producer for this disease and the Pharmaceutical bureau. Last time when our CEO visited Beijing we talked to the Hygiene Ministry about our education and they all supported us. Our education needed to be led by this ministry who worked with others to fulfil our specific education mission, as our main measure regarding this disease is to reduce the risk and our customers need to understand this.”

(Info M17)

#### **8.2.3.4 Benefits from knowledge integration**

Knowledge integration best utilises the difficult-to-grasp local expertise and exploit the full value of local knowledge sources. Although this mechanism depends upon the working relationship of all involved there was evidence showing that the loss of any party arising from collaborative conflict does not immediately advantage the multinational firm's competitors, as those rivals may not have the right integration mechanism to utilise his/her expertise. This was observed at M7. The general manager who worked for its competitor in Shanghai for a few years successfully found that it was difficult to run M7's China business profitably because there was a lack of suitable methodology to combine his expertise with local staff's value and perceptions. *'They must change to be competitive'* (Info M7). This attested the critical role of corporate integrated knowledge in developing competitive advantage. It directly challenges the assertion, by scholars like Teece (2001), that integrated knowledge is mobile and, thus, the firm that builds its strength on integrated knowledge risks the danger of losing its competence into its competitors' hands.

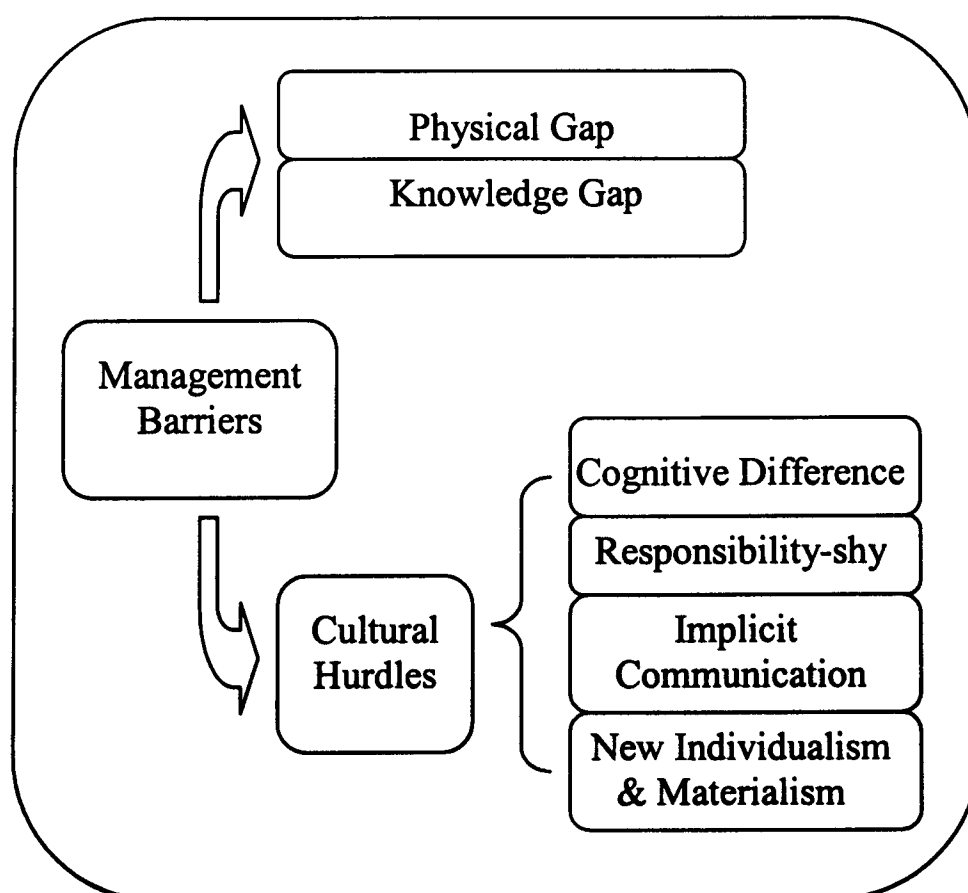
#### **8.2.4 Summary**

This section has empirically investigated the management process strategies adopted by European multinationals in China for developing competitive advantage from local knowledge. It examined how local knowledge was exploited, the degree to which it was transferred, how it flew within and across business boundaries, what hindered that local knowledge flow, what best exploited local knowledge, and what direct benefits resulted from local knowledge management initiatives. It was found that European multinationals' local knowledge management process encompassed three strategic efforts – knowledge penetration, knowledge blending and knowledge integration. They first developed a

language instrument for local communication through transferring home-based knowledge (global knowledge) to the local market. With this language in position they were able to acquire and blend some local knowledge into their corporate knowledge base for more to share. This was realised through intensive internal and external physical interactions, and well-established filing systems. To harness the difficult-to-transfer local specialised knowledge they adopted knowledge integration mechanisms as compensation to a knowledge transfer approach. The main integration mechanisms adopted included consensus decision-making, teamwork and taskforce, and wide-scope business partnerships. This has proved that knowledge transfer is not an optimal choice of exploiting China local knowledge, which has answered the inquiry of Eisenhardt and Santos (2002), who questions whether knowledge transfer is '*strategically wise*', and added insights into the resolution of the contradiction of knowledge transfer-or-integration revealed from previous studies.<sup>9</sup> The evidence demonstrated certain limitations of knowledge transfer approach towards exploiting China local knowledge and how European multinationals strategically adopted both knowledge transfer and integration perspectives to generate benefits from local knowledge. The evidence also showed that both embedded collective knowledge and integrated knowledge were critical to developing competitive advantage. Certain direct benefits resulting from the local knowledge management activities were identified. It was found that the employment of these local knowledge management strategies mitigated against the sudden loss of top performers, improved corporate responsiveness to the fast-changing environment, facilitated generating of innovative ideas critical to business success in China business setting, led to effective business decisions, and built up competencies leading to business success.

### 8.3 Management Barriers

Previous studies of knowledge management neglect implementation problems. This neglect may arise because most knowledge management models are more theoretically than empirically grounded. In order to provide a more complete model of local knowledge management this research identified the main management problems encountered by European multinationals in China and explored the management strategies for resolving them. These country-specific management barriers included physical gap, knowledge gap and four cultural hurdles – cognitive difference, implicit communication, responsibility-shy attitude, and emerging materialism and individualism (Figure 8.4). They all significantly hindered local communication and collaboration, hence, had negative impacts upon performance.



**Figure 8.4 Management Barriers**



### **8.3.1 Physical Gap**

Most managers interviewed agreed that the wide scope of China local knowledge, size of the country, and scale of most multinationals' business increased the scope of knowledge communication and widened the distance of communicators. There are specific physical gaps between knowledge holders and knowledge seekers in China market, serving as a physical barrier to local knowledge communication. However, they also saw it potentially manageable, because they had operated across the world for some years, and, had accumulated experience of managing distances. In particular, they established systemised linkages bridging physical gaps (see 8.4.1).

### **8.3.2 Knowledge Gap**

The empirical data show a significant management barrier is the knowledge gap between knowledge seekers and knowledge holders, Europeans and local Chinese in particular. Although European multinationals invested heavily in bridging the knowledge gap, the gaps between knowledge seekers and knowledge holders were still apparent, and greatly impeded full local communication and collaboration.

First, although *'China has trained numbers of talents who have international vision and good understanding of international business management through China's two decades' open to the world'* (Info M10), *'Senior level management with good management skills in China is still very thin'* (Info M11). The difficulties of staff localisation process suggest that China still lacks management with sufficient understanding and experience of global business. As the respondent of M8 commented:

“China has very good accountants, engineers and people who know the law well. But we need more than that. We need a person who can help CEO identify the potential risk of our business, a real controller. This is very difficult to find. It takes time. This limited local staff’s ability to take responsibility.”

(Info M8)

Consequently, local knowledge possessed by local managers was sometimes not fully utilised because of the limited responsibilities they assumed.

Second, external local knowledge holders, especially at regional level, still had limited international knowledge such as understanding of the market economy, foreign businesses, foreign products, and foreign culture. As the respondent of M11 explained:

“Most provincial-level authorities have no idea about WTO. ... This will be a long education process until everybody is on the same page. Now they are all working on different pages. I do not see there will be a major change in next three to five years. It takes time to educate regulators as well as hospitals about what is sector practice and what is not. ... So there is a lot to be done.”

(Info M15)

Using the following example showing the difference between the education of patients in China and that in Denmark the respondent of M17 explained that local customers in China had limited chance to receive education from external channels in contrast to European customers. She said:

“In China, we do not have educators, trainers like in many other countries. We only have doctors and nurses but nurses do not shoulder much education, as they are too busy. In China, the ratio of doctors to patients is not balanced. Each doctor sees 50-60 patients each day but in the diabetes centre in Denmark each doctor only see 5 patients. It is impossible for doctors to shoulder much education. But in China we need it.”

(Info M17)

In the similar vein, the respondent of M9 found that local suppliers often did not have the management expertise required by multinationals to produce high quality products and just-in-time service to their international customers. Although most managers observed that China was getting close to developed markets and Chinese, including the government officials, were *'more and more professional'* (Info M8, M11, M16) they still shared the view that China still had a long way to go to be fully internationalised.

Consequently, communication with external local knowledge holders was significantly difficult. As the exporting manager of M3 commented:

“It will take a few generations’ time for the Chinese as a whole to sit down like you and me being able to exchange views freely.”

(Info M3)

Third, there is a scarcity of experienced expatriates. Most expatriate managers had very limited understanding of the country and the people before they took their positions in China (Info M8, M1-6). During their short period of stay in China (normally 3 years) they had limited opportunities to communicate with local people due to the language barrier (Info M10, M1-6). The accuracy and depth of their local understanding gained in China depends to a large extent on the qualification of their local translators (Info M1-6). Although some did hire more experienced expatriates or off-shore Chinese and ABCs (American Born Chinese) their local knowledge base, however, was not always enough for meeting their challenging tasks (Info M13, M1-6). As a local marketing manager of M6 commented:

“We need their foreign faces only. They are symbols of quality. They had very limited understanding of China market. As you may have noticed he (the foreign manager)

can't communicate with local officials and customers when we negotiate the deals or dine together although he can speak some Chinese. These foreigners do not speak outside. But they speak inside. You need to spend a lot of time explaining and telling them why business should be done in one way but not in another. They cannot understand it so they always argue. They assume things that work in Europe also work in China."

(Info M6)

The investment manager of M13 commented on off-shore Chinese managers:

"These managers are even worse than pure foreign ones. Some foreign ones do listen as they understand that they are foreign and they need to learn. However, they do not have such a learning attitude. Some of these expatriates are very subjective. They do not completely understand the system and the mechanism, such as tax, customs, and administrative issues. But they do not listen to local Chinese and decide to do things in their own way as they think they know everything about China. Their role in China is a supervisor but not a manager. They often make wrong decisions and blame local staff. The only advantage they have over foreigners is that they know the language. We had this experience. ... We were all very disappointed and gave up further business efforts. It was terrible."

(Info M13)

In addition, according to expatriate managers, European managers working at headquarters or in other economies often had little knowledge of China market. As the managing director explained:

"Let me explain it using this picture. A foreign manager has a head with foreign thinking in his mother company. After he arrived in China he has no head. He has to discard everything in his head and fill in new ideas. But the problem is when he is back to his mother company no one there will be able to understand him. 'What is this guy talking about?' This often happens to expatriates."

(Info M15)

This echoes the sentiment of the respondent of M14:

“They (headquarter managers) do not understand us at all!”

(Info M14)

As a result, communication between local staff, expatriate managers and European staff was considered problematic. Conflict, misunderstanding, and dissatisfaction existed in some multinationals resulting in collaborative difficulties or business failure. A good example is that given by the respondent of M10:

“When Chinese business partners visited our headquarter the staff working there were very cold to them as they thought business partners are not customers, thus, there is no need to treat them well. Local partners were certainly not happy. They (headquarter managers) did not view our business partners as team members that had an important role to play in satisfying our customers. This is different from what local managers think. Let me use an analogy. I produce the cup and you produce the saucer. We are working together to develop a set of products for our customers. We certainly need to respect each other therefore we can best cooperate in order to fulfil the same goal. But they do not understand it this way. They think business partners are less important than customers. We talked to our boss as this affected our collaborative relationship. He said this was cultural difference and we could do nothing about it.”

(Info M10)

Similarly, the respondent of M13 has given concrete examples<sup>10</sup> showing how its European staff's rigid business attitude stemmed from a lack of sensitivity to local culture and basic understanding of the complexity of China market resulted in misunderstanding between expatriates and local partners and local authorities, and further, resulted in its business failure.

Fourth, at micro-level, the researcher observed inadequate common knowledge between local sales staff and emerging customers, which seriously hindered customer knowledge acquisition and flow. As the chief representative of M2 concerned:

“You see these days he (general manager of C5) sit here and there to listen and look but never spoke. What does he think about our products? I was told he was an experienced purchasing manager in another sector. He is not easy to communicate with as he does not speak. His engineer was always around but it is obvious that he is not the decision-maker. He knows nothing about his boss’ perception. ... He (the manager) accepted things from others but not me. I have no idea how I can approach him and where to start.”

(Info M2).

However, the customer (C5) complained:

“They all tell how good their products are. They sell single-function machines. But we need a product portfolio matching our specific situation - budgeting, market potential, factory requirement, existing equipment and so on. We acquired that local state-owned company and we have to use the existing machines. None of them compares regarding the key features of all products produced by their peers. That company (M4) offered a portfolio based on their own product range. We may need to select a product portfolio from different companies for cost reasons and also considering local perceptions as local managers would say ‘You did not consider all possibilities’.”

(Info C5)

Clearly, local sales people of M2 had limited understanding of technical and marketing issues stressed by C5.

Fifth, the human resource director of M17 noticed *‘foreign language does have strong impact on human behaviour’* (Info M17). *‘Some local staff were recruited based on their professional strength rather than foreign language skills.’* This is consistent with the

result from my field observation. Some local staff reveal foreign language deficiency when communicating with Europeans (Info M3, M5).

Therefore, knowledge gaps still exist at many levels which can significantly hinder local knowledge flow and utilisation. This implies the need to further develop common knowledge between local knowledge holders and local knowledge seekers, from the foreign side in particular.

### **8.3.3 Cultural Features**

#### ***8.3.3.1 Cognitive difference***

Most Chinese staff interviewed found that Europeans differ from Chinese in thinking and ways of doing business. In broad terms Chinese thinking is considered solution-driven with an emphasis on reality and holistic analysis while European cognition is principle-driven with an emphasis on causal relationships. This cognitive difference is a main cause of difficulty and conflict in knowledge integration. A typical example is that given by the investment manager of M13:

“They found out who was to blame from the words in the contract. The contract says ‘coal price will not change in 20 years’ time and electricity basic price will not change but can be justified.’ But during operation of the business things were completely different. Their culture is conservative and resistant to change, not flexible. Consequently, their attitude seriously affected further possible business negotiations. Problems happened for which you had to search effective solutions rather than endless argument on specific items in the contract. It does not work in China. You had to be cleverer and take the initiative to work with them rather than against them. You need to give up the things which were unrealistic. This is the only way to minimise your loss. You had to consider what is your true benefit rather than stick to the contract. ... So

during negotiation it is important to work closely with Chinese partners to get government support on specific issues. You will have to give up something.”

(Info M13)

Another typical example is that given by the marketing manager of M5. He commented:

“They cannot tell the difference between courtesy and bribery in China. He (the boss) thought he was working for a global company with worldwide reputation. He should not make deals in such a material way.”

(Info M5)

This was echoed by the sentiment of the investment manager of M13:

“In business none of the activities of entertaining your customers and relevant partners such as inviting them to dine together or gift giving is against the law. By doing that you absolutely gain more than you lose. It is a cultural thing. It is not the matter how much money you spend on it. Once you established this relationship everything in your future business would go smoothly.”

(Info M13)

Chinese were also found to have a particular understanding of government and partner behaviours. For example, the respondent of M13 expressed the following views on the change of contract terms by Chinese side:

“We signed the contract with our partners and Chinese government. According to the contract price of electricity would be something above our operational cost and this would be changed according to cost change including change of foreign exchange rate. The Chinese side signed the contract as they normally did. They certainly agree with you on everything when you input money but they can change whatever they want whenever they consider it necessary. Even Electricity Bureau agrees the County Electricity Department would not agree as if so they would lose. They have to consider what local people can afford, as disparity in their situation across different regions is



huge. Even if the county level electricity department agrees the pricing authority would not agree as they would need to consider local affordability as well as the profitability of state-owned firms, because people there need to have something to eat under the present system. They are not balanced.”

(Info M13)

The human resource director of M17 gave further evidence on this point through her comment on government control issue:

“Some procedures are very complicated. We wish, and the Chinese government also wishes, this to be globalised. But as a government they also need to protect themselves. This is normal. This is what a government should do. They have difficulties to keep balanced.”

(Info M17)

In addition, difference in thinking between both sides were also apparent in business planning. For example, the respondent of M16 commented on the thinking of local partners and government:

“They have pragmatic view of reaching achievement and agreement and sometimes seem short-term when it comes to the planning horizon.”

(Info M16)

However, the Chinese view of European way of making business decisions is that the Europeans place less emphasis on *'reality'* (Info C5). The president of C2 added evidence to this point:

“The world-class technology is now well understood by local firms in our sector. But we do not only focus on high-end products as those multinationals have been doing because we want to best utilise the by-products, our existing machinery and to lower the cost in order to meet majority local customers' needs. It is not realistic in China to

throw our by-products to the dogs. It is not realistic to throw away all the existing machinery running in our plants although we have been spending a lot on importing machines. It is not realistic in China to produce daily consuming products that most Chinese cannot afford. That is not realistic in our sector. The market is not there. Chinese really need and enjoy our products.”

(Info C2a)

Therefore, emphatically such Chinese thinking and ways of doing business were deeply embedded. This cognitive dimension has much influence on daily business decisions. It might lead to useful ideas about avoiding business risks and reaping business opportunities. On the other hand, it may also constrain business development. In order to alleviate differences in knowledge integration and weave this synthetic thinking into multinationals' China business decisions fully understanding of such a cognitive difference is crucial.

### ***8.3.3.2 Implicit communication***

“Unlike Western culture Chinese culture has a tacit nature. This tacit culture determines the Chinese behaviour from top-line government to bottom-line ordinary people. If you observe the behaviour of different governments in the world you can notice this. Westerners often immediately act on key issues but the Chinese government does not. They often react later than others. The difference of the reactions of American and Chinese governments towards the recent matter of American spy aeroplane is a good example. I think the behaviour of Chinese government represents Chinese culture. This culture is difficult to read. It lacks transparency.”

(President, Chinese Company 1, Interview, 15<sup>th</sup> April 2001)

The above statement indicates the implicit nature of Chinese culture. Most managers interviewed discussed implicit local communication in their business. The North Asian Manager of M14 pointed out that *'The Chinese do not tell you much'*. Similarly, the country president of M11 commented that:

“Communication is important. The other day I was thinking, you know, in China people do not like to ask questions. They like you to tell them what to do. They are used to it as for many years their performance judgement is based on what they were told to do. Now suddenly it is all opening up. People should learn to ask questions as the questions are related to whether they are doing the right thing. But they do not do that. The funny thing is in China the word education Xie Wen means you learn to ask but they do not do that and that is one of the major problems of communication. And I think this is a major problem that I need to talk about. You guys have to start to ask questions rather than me tell you what to do all the time. I cannot be right all the time. I am not the God who can be right all the time or you are asked to do something no difference all the time. As a company you have to take the risk. We have to be entrepreneurial. We bound to make mistakes. People who pursue better performance are bound to make mistakes. People should challenge you rather than telling you what to do. This is the last thing I want my company to behave.”

(Info M11)

The respondent of M8 also mentioned that his Chinese colleagues were not active in open discussion and did not bring questions for open debate. Being afraid of making mistakes and losing face of others and his/her own Chinese hesitate to give views on certain areas. Moreover, realising the great cultural difference between Chinese and Europeans some Chinese gave up giving suggestions to avoid misunderstanding on the messages they delivered to Europeans (Info M13). Similarly, a salesman of M6 explained:

“We do not speak much as they would not understand you due to their limited understanding of China situation. You know China is very complicated.”

(Info M6)

Also because of the difference between Chinese view of the world and European thinking Chinese normally need more time to come to a conclusion, hence, are inactive in brainstorming discussions.

In addition, Chinese had strong sense of hierarchy. Expatriates were expected to speak more than Chinese. As the business development manager of M10 illustrated:

“Generally speaking expatriates are your bosses. You’re not at the same level. We have a working gap. So you do not communicate freely. This gap is from hierarchy. As to what extent this gap can be closed I do not know.”

(Info M10)

Therefore, implicit communication was widely recognised as a system and cultural problem which hindered the knowledge blending process and business performance. As the North Asia manager of M14 confirmed:

“It certainly affects business performance. 10 percent? 5 percent? We are not sure.”

(Info M14)

### ***8.3.3.3 Responsibility avoidance***

The research results reveal another management barrier that most Chinese avoid responsibility, which stems from the unique Chinese concept of value. The Chinese consider ‘face’ when bringing out ideas and making decisions. They lose ‘face’ when their ideas brought out are not novel and they lose the other’s ‘face’ when they make decisions without consulting the other, especially their superior. They also fear bearing the consequences of their responsibilities. These are evidenced by the following remarks given by the respondent of M13:

“For example, when we sell our project to another company we get some money. Should we pay tax from this income and how much should we pay? This is a complicated issue, as it is related to the question that to what extent we could evade tax

in China. In this case none of our employees would speak, as it is too complicated to answer. They might fear to give wrong opinions. They would not be able to compensate for any would-be loss. ... Everybody wants a face. None of us wants to show in front of our boss and our colleagues that you know nothing and doing things in a wrong way.”

(Info M13)

Consequently, they do not think they have responsibility to express views during business meetings and they show respect to other people by speaking behind during decision-making. This ‘responsibility-shy’ attitude was observed in most multinationals. Managers considered such a cultural difference was derived from the Chinese hierarchy and the old Chinese economic system. The respondent of M8 also suggested that lack of responsibility might arise from a lack of management skills. But managers interviewed all agreed that Chinese people were changing rapidly. However, the problem would still be there for a few years, according to the respondent of M16.

In addition, lack of responsibility was not the phenomenon among local staff in some multinationals it was more common in Chinese state-owned organisations and local government. As the investment manager at multinational 13 stated:

“The government, especially local government, was bureaucratic and afraid of responsibilities. As long as nobody sues them they will not be responsible for anything. They only care whether they can keep their positions. In Southeast China and coastline areas the situation is better. They are more professional as they have been open for a longer time.”

(Info M13)

Such a business phenomenon, therefore, explains one of the main reasons for inter-partner conflict and suggests great difficulties for the multinational to integrate external local expertise.

#### **8.3.3.4 Materialism and individualism**

The empirical data show that, in 'waking up' from a collective system, more Chinese are moving towards greater materialism and individualism. Coupled with under-developed legal system, different economic system and the economic situation this resulted in 'pragmatic view' (Info M16,8) of the world, aiming at seeking more individual benefit in business. This was a management problem in some multinationals. According to the managing director of multinational 12 it seriously affected local staff's 'team spirit'. Performance related pay resulted in local sales forces fighting for business deals. Externally, this 'seeking direct individual benefit' by decision makers of external knowledge bodies led to management dilemma such as kickbacks, according to the general manager of M7. Consequently, uncovering decision makers' personal needs and satisfying them in different ways formed part of business strategies for this environment (Info M18). Such a business environment often resulted in a low trust culture under where local people tried to protect themselves in different ways including hoarding knowledge. Hence, it was one of the knowledge flow and integration barriers.

#### **8.3.4 Summary**

This section has empirically uncovered resistances in local knowledge management process. Six country-specific features hindering local knowledge management were identified, namely physical gap, knowledge gap and four cultural barriers - cognitive difference, implicit communication, responsibility-shy attitude and emerging materialism and individualism. Evidence from the European multinationals sampled shows how these hinder local knowledge flow and integration. The knowledge gap between local

knowledge holders and knowledge seekers was a particular barrier while cultural features shaped the effectiveness of teamwork and meetings, database quality, and business relations.

#### **8.4 Management Conditions**

Some multinationals had a good understanding of those obstacles and accordingly deployed effective strategies to resolve them but those that had less recognition of the resistances did suffer certain problems. The strategies adopted encompass establishing knowledge interface, enhancing common knowledge base and exerting 'pull and push' forces (Figure 8.5) to overthrow the rooted cultural hurdles.

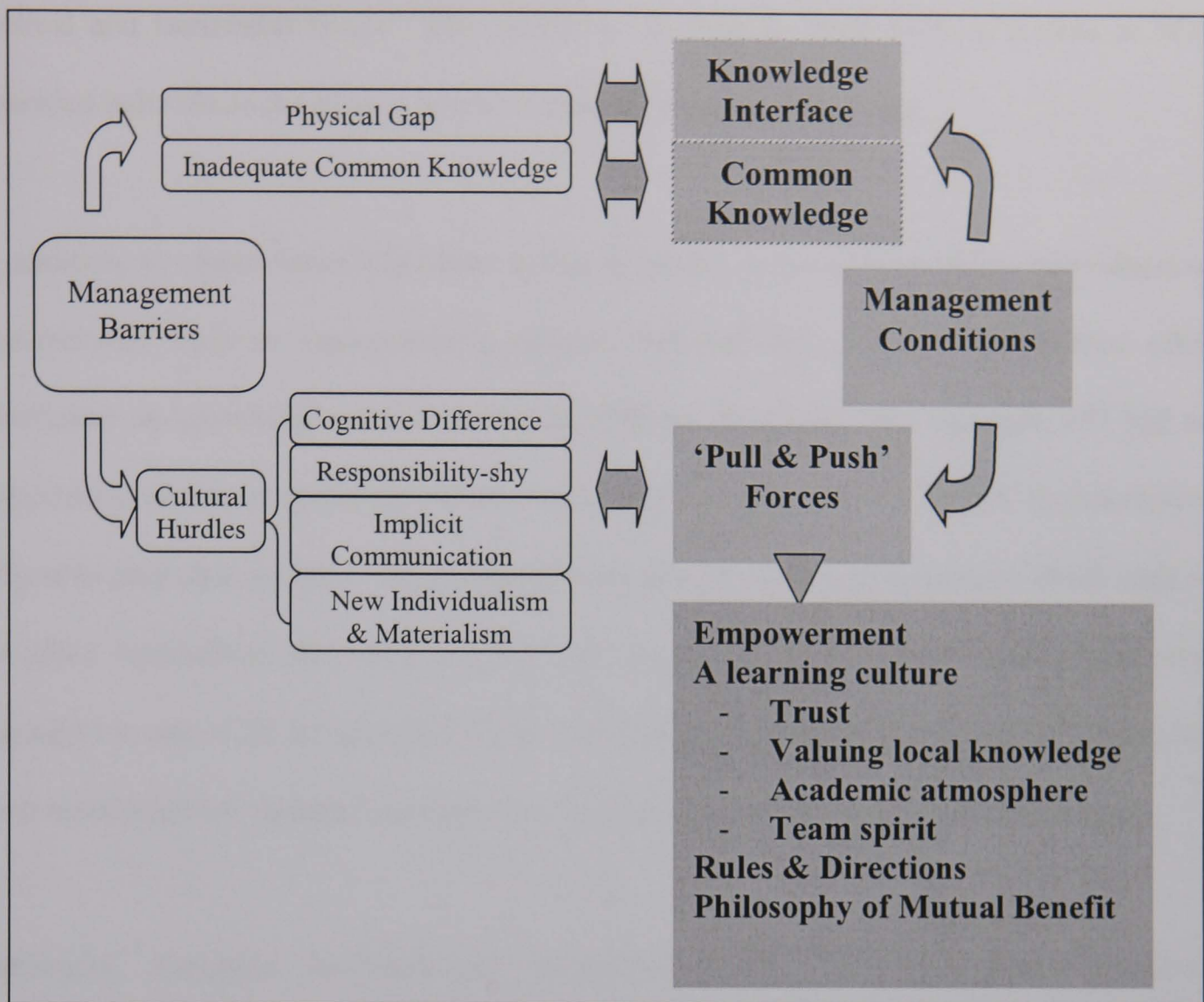


Figure 8.5 Management Conditions

#### 8.4.1 Establishing the Knowledge Interface

The research results reveal that these European multinationals, especially those with business divisions across China, established multi-layered knowledge interfaces in order that different local knowledge holders interact more intensively. Internally, they established shared systems, such as databank, shared documents, and/or shared internal publications, linking every soul of the organisation non-physically. For example, the central filing system of M8 provided the interface for all workforce to share just-in-time business knowledge (Info M8). Some even had virtual systems linking local staff and global workforce (e.g. Info M10). To meet the need for physical contact, these European multinationals organised teamwork, taskforces, meetings, and social activities at both



vertical and horizontal levels. The taskforces formed for each bidding project at M10 provided individuals the chance to utilise their specialised knowledge.

In addition, to ensure knowledge flow across divisions, some administrative individuals or departments, such as representative offices, regional and central headquarters, often functioned as knowledge interfaces linking different divisions. For example, M7 had an engineering manager spending time in each of its division. M9 had its representative offices to play similar roles. This multinational also had a special system in which each of its office representatives held a second, and very important, position (normally general manager) in one of its companies for local knowledge diffusion and integration. However, most multinationals adopted headquarters, holding companies or regional headquarters.

Externally, European multinationals established both macro-level and micro-level knowledge interfaces linking external knowledge holders. At macro-level some multinationals chose to integrate local knowledge holders as joint venture partners as well as other strategic alliances. For example, M16 integrated its customers as joint venture partners, putting itself in the best position to stay close to these knowledge holders (Info M16). It also allied with the local authorities, suppliers, and local research bodies to tackle specific business issues and explore local business opportunities. In addition, European multinationals were also active in network activities with external local knowledge holders. For instance, M7 devoted time to build and maintain good relationships with local authorities and industry associations (Info M7).

At micro-level European multinationals adopted numerous strategies to build links to external local knowledge holders. For example, in addition to having frequent or regular contact with local knowledge holders at different levels, business structures were purposely

being changed. For instance, M8 transformed its management structure from industrial divisions to customer segments in order to stay close to its customers. Most multinationals were trying to establish their own distribution systems in order to better know their local customers even where it was still forbidden in some sectors in China. Some multinationals chose to establish widely located offices in China market as close operational interface to its customers and the market. As one senior president of M16 emphasised:

“We have to be as close as possible to the market. Considering the size of China it is difficult sometimes but we have to make sure we are setting up offices in most and important provinces ensuring shorter access time for customers.”

(Info M16).

While the multi-layered interaction system of M7 was established to facilitate local customer knowledge acquisition and integration into its corporate level. In this system, the technical consultants worked with local customers on project start up. Technical supporters worked with local customers' technical team on specialist issues to ensure greater mutual understanding. Technical directors functioned as first class servers to ensure practical product adoption. The whole technical service system interacted with its customers during the three stages of each project in order to fully understand and support its customers. Local knowledge acquired from each project was sent to central database shared across the entire worldwide organisation. One expatriate functioned as an information facilitator and central communicator through working periodically in each of their divisions. This also ensured sharing of local practice across divisions and effective communication between its China companies and its headquarter in Europe (Info M7).

Linking systems were well established in most multinationals. However, the evidence indicates that putting them into effective use requires more strategic effort.

#### **8.4.2 Enhancing a Common Knowledge Base**

The role of common knowledge as a very important condition under which local knowledge can be better communicated is widely recognised among management of European multinationals in China. Hence, numerous knowledge penetration and knowledge blending strategies were deployed to develop common knowledge base as we elaborated earlier in this chapter. In addition to those efforts, European multinationals that took a foothold in China also deployed unique strategies to enhance its common knowledge base through personnel recruitment (Info M10, M16, M12, M14, M17, M11), career development (Info M8, M14, M17, M9), job rotation (Info M17) and some other specific measures. These measures allowed local staff take more responsibilities, and therefore facilitated local knowledge utilisation. For example, some companies set specific criteria when recruiting in order for local staff to take immediate responsibilities. A good example was that given by the Business Development Manager of M10:

“Many of us worked overseas, many of us have local project experience. All people have had international exposure before they come here. We need people who can pick up the work immediately after he/she is hired.”

(Info M10)

Staff localisation was one of the most pressing tasks of some multinationals. Consequently, succession plans were strategically deployed and followed. Local talents with rich common knowledge were trained and promoted to top management level. The respondent of M8 illustrated how localisation strategy was implemented:

“We have our succession plan. In this plan, you need to identify a potential successor and you are responsible for training on the potential person. You need to know his/her strengths and weaknesses and consult your boss on his tailored training programmes.

After a period of time the potential person can take roles in this position and the person who hands over his work wishes he/she could take new responsibilities. It is difficult to implement but the company has been doing it, especially for expatriates. They are told before they take the expatriate position, normally three years, that they will need to identify at least one successor in three years' time."

(Info M8)

The effect of these strategies was confirmed by those multinationals that adopted them. With both local and global knowledge local staff of these companies claimed superior capabilities of handling local business issues. As the country president of M11 praised:

"Chinese managers can be very good! As long as you train and respect them they can give superior performance. My local staff as a whole are as good as those in Switzerland. My managers are extremely good. They know how to best conduct local business. They know how to manage their people. We are lucky that we have these good managers."

(Info M11)

From the foreign side, expatriates were employed according to relevant experience in China, and/or Asia and/or emerging economies (Info M10, M16, M18). Some worked in China for more than 6 years (Info M9, M12, M14, M15, M18). Some were of Chinese origin (Info M8, M11). Moreover, training was carried out to enhance expatriates' understanding of local industry and regulation issues, such as China Telecom Industry at M16 and China Business Law at M8. A one-week China introduction visit was also organised by most of the selected multinationals for expatriates and their families to gain introduction knowledge of the country and the people. In addition, headquarter managers of most European multinationals visited China regularly and/or attend local business activities such as trade fairs, conferences, local community activities. A job relocation strategy adopted by some multinationals also helps increase local knowledge base of

headquarter managers although it weakens common understanding between expatriates and local staff (Info M15).

These strategies do have some effects upon local communication. As the respondent of M7 confirmed:

“I’ve lived in China for many years and I can speak the language very well. I can communicate with the bureaus, industry associations, customers etc. During meetings we can use both English and Chinese. But they often choose to use English as they want to learn the language. For most foreign managers local communication, yes, it is a problem, but for me it is not.”

(Info M7)

Similarly, the China manager of M18 commented:

“My China experience is absolutely useful for local communication. Otherwise I would not be able to build up a lasting friendship with my local colleagues who feed me everything they can about China; I would not be able to understand local customers; I would not be able to go through the blueprints.”

(Info M18)

At micro-level, practices such as job rotation, hiring common knowledge holders, and personality checks when organising teams, were used to enhance mutual understanding. For example, it was observed that to facilitate customer relationship building and acquisition of customer knowledge M1 and M6 specifically employed external knowledge holders - local authorities, supervision bodies and institutions. These external knowledge holders had developed business relationships with their potential customer (C5), and were in a better position to facilitate customer knowledge flow. The customer knowledge they

obtained from external common knowledge holders helped them communicate with the local customer and helped win particular deals.

In contrast, the European staff of M13 had no China, or even Asian experience before competing in this market (Info M13). They did not understand that they would need a different approach to handling local business issues.<sup>11</sup> They could not pave ways to understand local staff, local business partners, and local authorities. As a result, their local communication and collaboration failed.<sup>12</sup>

Clearly, successful European multinationals deployed strategies to develop and enhance their common knowledge base from both sides. However, the empirical data also show that practices exercised by European multinationals did not yet fully meet the need for successful knowledge flow and integration. There was very limited training to enhance the expatriates' overall understanding of the country and its people. There were also limited methods used to enhance expatriates' local knowledge before assuming positions in China. The reason for this neglect stemmed from a lack of recognition of the need to enhance common knowledge from foreign side. This was evident in the remark of a respondent of M8:

“All of them are very busy. We have no such luxury programmes.”

(Info M8)

### **8.4.3 'Pull and Push' Forces**

Successful European multinationals adopted practices that functioned as hurdle breakers to pull and push local knowledge holders to actively involve in local knowledge management activities. These 'pull and push' forces include (1) empowerment, (2) a learning culture emphasising trust and collaborative spirit, valuing local knowledge, and promoting academic atmosphere, (3) rules and directions, and (4) a business principle of mutual benefit.

#### ***8.4.3.1 Empowerment***

The empirical data support the proposition that appropriate business strategies are made where knowledge is situated. Empowerment allows local knowledge holders to make business decisions and take responsibilities. The research data show a main reason for responsibility-shy attitude was that local staff were not empowered to be responsible for issues they were expected to handle, as the respondent of M13 argued:

“The power and responsibility a company gives to its employees should be balanced whatever position your employee is in. You should not just give him/her responsibilities but no power. Sometimes when Chinese employees are charged to implement a company mission they find they have no power to do so.”

(Info M13)

Evidence from our field observation certified that Chinese staff of M5 could not guarantee Chinese customer' (C2) requirements immediately, suggesting they had limited power. In contrast, the success of M1 in winning part of the project of C2 is attributed to its ability to make immediate decisions. They had the power to make business decisions, and therefore

responded faster than their competitors where local staff had to wait for approval from European headquarters.

Multinationals that adopted this strategy understood that features of implicit communication and responsibility-shy attitude of local knowledge holders arose from a sense of power distance. This was confirmed by interviewees of C1. Many Chinese view empowerment to alleviate power distance as a message of trust and value delivered by the superior. As the Marketing Director of C1 stated:

“I work 7 days a week and I can rarely get home before 10 (pm). It is not required by the boss. We are newly diversified into this sector. My boss does not know this industry well. He left all decisions to me and I feel the pressure to do it well. I could earn a higher salary or have more time for myself if I worked for a foreign enterprise. But my boss does trust me.”

(Info C1b)

Highlighting the role of empowerment in utilising local knowledge M16 strongly adopted it across its China business:

“In our organisation we are trying to as much as possible decentralise and distribute the power in order for everyone to have responsibility and authority. ... Definitely we do not have to take all decisions at headquarters. Many decisions are made at regional headquarters. We have regional headquarters in Beijing for northeast, and Guangzhou for southeast. Many decisions also made directly in the branch of each individual business. So we are not pushing all the information back to headquarters for decision making there. We are working as the facilitator to make sure that different organisations are able to take responsibility and make decisions.”

(Info M16)

Similarly, M9 allocated certain power to local business partners to ensure local issues were handled properly.



In contrast, multinationals which did not adopt this failed to integrate local expertise into corporate business decisions. For example, without empowerment local staff of M13 could not sense any trust from its headquarter managers, resulting in de-motivation in taking responsibility and inappropriate local business decisions. As the respondent of M13 explained:

“My boss had no much decision-making power. Most of the decisions were made at headquarters. ... Some local Chinese were involved in the negotiation process but they were not decision makers. They did not have the last word. ... In China law gets ignored. As long as the money went into their (JV partner) pocket they could do anything they wanted. You must understand this before you invest rather than solely look at the items in the contract. There are many go-betweens. You are very likely to be cheated as all projects look good.”

(Info M13)

Therefore, empowerment could enhance local knowledge involvement in business decisions and improves business performance. It was also one of the most important measures to tackle responsibility-shy attitude and implicit communication.

### ***8.4.3.2 A learning culture***

#### ***8.4.3.2.1 Valuing local knowledge***

The research result suggests that implicit communication and responsibility-shy attitude are also stemmed from sense of being devalued. Therefore, valuing local knowledge (respecting local knowledge holders) was pinpointed to integrate local expertise into the multinational's corporate strength. As the respondent of M16 stressed:

“If you think that what you bring to China is good staff, but that your partners’ knowledge is worthless, you are unlikely to have good relationship, and local partners may not make any contributions.”

(Info M16)

Similarly, local partners were viewed as ‘*critical eyes*’ to M11’s China business and described as ‘*specialist knowledge*’ holders by M9. However, in China the joint venture has previously been the only entry mode sanctioned by government for many sectors. Therefore, criteria for joint venture partner selection might not be based on the value of local partners’ local knowledge, but in order to meet government requirements. Consequently, problems between the multinational firm and its local business partners can happen due to other factors rather than a lack of respect for local knowledge (Info M14).

Internally, a culture valuing knowledge serves as key incentive to retain local staff. For example, benefiting from such a corporate culture M11 maintained a very low employee turnover (around 3%), which was significantly low compared to the average level (14-15%), and thus avoided the loss of local skilled workers. Similarly, the human resource director of M17 commented:

“Whether local staff contribute to business decisions depends on whether you value them”

(Info M17)

In contrast, a lack of such a corporate culture often results in de-motivation, as evidenced at M13:

“Some expatriates are very subjective. They do not completely understand the system and mechanism like tax, customs, and administrative issues. But they still do not listen

to local Chinese and decide to do things in their own way as they think they know everything about China. ... We had this experience. ... We were all very disappointed and gave up further business efforts. It was terrible.”

(Info M13)

Therefore, whether local knowledge is valued does influence attitude of local knowledge holders towards local knowledge utilisation and affect local business performance.

#### *8.4.3.2 Building trust relationships*

“*China is still a guanxi society.*” (Info M8). A corporate culture promoting trust relationship certainly alleviates sense of hierarchy and, hence, facilitates knowledge flow and encourages taking responsibilities. This was evidenced in the following remarks given by the respondent of M13:

“If a person directly reports to a top manager without reporting to his/her boss, the middle manager would not be happy. This is true no matter whether the middle manager is Chinese or European. But if the company culture is family like, meaning everybody in the company from the top No.1 person to a cleaner belongs to the same family, people may do things in a different way. Any person may have specific issues suitable to talk to a person in another department or another team. They should be encouraged to talk to the relevant person rather than following a rigid reporting system. Sometimes you report to your boss and your boss will have to talk to another more relevant person on your behalf. This makes things complicated. It all depends on what a corporate culture you have.”

(Info M13)

The research results show that local knowledge holders highly value trust shown from the foreign side (Info M13). In the interviews, trust was repeatedly cited as one of the most crucial determinants for effective local knowledge flow and integration in China market.

A trust culture was promoted at M8 across the whole corporation to facilitate local knowledge articulation and flow into its central filing system:

“As we just mentioned China is still a guanxi society, we build up trust between people, therefore, we could better establish this database system. It is normal if any personal leaves this company as long as we establish trust relationship.”

(Info M8)

In order to acquire and integrate local knowledge most European multinationals built up good relationships with external local knowledge holders and local staff through long-term cultivation of trust. To do that they showed their long-term commitment to China market, shared knowledge with local staff, partners and the community at large, built up good image in the local community, met expectations of local knowledge holders and offered added value to the local society to increase local knowledge holders' confidence about their China businesses.

Multinationals that failed to build up trust relationships with local knowledge holders encountered great difficulties. For example, M13 experienced considerable difficulties stemmed from a lack of trust with local business partners, local authorities and local staff:

“In the beginning they trusted Chinese staff. The first chief representative was a Chinese. But he disappointed the company. He did something disloyal to the company. So later our boss replaced him. After this our boss himself, and other people at the company, all held the view that Chinese are not trustworthy. We Chinese employees could feel that but we had difficulties to communicate on this issue. This surely raised difficulties to local staff and the company. But after the company decided to sell these projects, the situation improved as the boss gradually realised most Chinese are trustworthy. But he could hardly leave things to be dealt freely by Chinese as his colleagues would then have difficulties in understanding this. ... Things got worse as we didn't have a good relationship with local partners and local authorities. We could

not even withdraw from the market. Too many central and regional authorities have control over us. We have to know all of them. ... He (the boss) said Chinese partners and government could move the earth. He realised the importance of guanxi.”

(Info M13)

#### *8.4.3.2.3 Promoting academic atmosphere*

The researcher observed a lack of academic atmosphere in most multinationals. This seriously hindered local knowledge flow and integration. The China market was invisible and China business was highly risky (Info M14). Local knowledge holders understood that any of their ideas might result in serious loss of business. They were not likely to assert themselves. Promoting an academic atmosphere in which business issues could be treated as academic issues open to debate could improve the situation. This was confirmed by the respondent of M13:

“The boss could say that ‘it doesn’t matter if you tell us something wrong’. Then people would not face the psychological barrier of giving opinions. You need to establish an environment in your company which allows any business issue to be discussed completely freely and be treated as an academic issue rather than an issue related to gain-or-loss.”

(Info M13)

Hence, an academic atmosphere facilitates defining business issues objectively. This message needed to be widely delivered to ensure full understanding. However, there was little evidence from our participants to show such a learning culture was developed. Multinational 8 claimed to promote open debate on business issues but its methods were still in question. Nevertheless, there was recognition of its importance among certain managements. This point is evident, for example, in the following dialogue between the country president of M11 and the researcher:

*“What could you do with that?”*

“By convincing them to open up. I think that is the difference between organisations. You go to Durham, Harvard, the MBA students ask so many questions. They challenge the teachers so much. The teachers have so much difficult time. That is the total cultural difference. I think next time I'll take an example to show the major mistakes I've made. ‘See you should challenge me. You need to use your hypotheses to challenge my assumptions. We are bound to make mistakes.’”

(Info M11)

#### *8.4.3.2.4 Team spirit*

A collaborative culture was claimed in most cases. A number of practices were exercised to promote team spirit such as team social activities (Info M15), team building exercise (Info M11), teamwork training (Info M8, M17). For example, the team-building activities organised at M11 expressly encouraged contribution and collaboration. Under a collaborative culture local staff realised that individual ability was limited (Info M11). To fulfil complicated local business tasks collaborative working was needed which questioned emerging individualism and materialism (Info M10, M15, M16, M17). Working teams also provided the opportunity for local knowledge holders to build up trust relationships, essential to communication and knowledge sharing (Info M10, M15, M16, M17). With the absence of a team spirit local staff of M12 revealed passive attitudes towards company meetings for fear of individual knowledge spill over.

#### *8.4.3.3 Rules and directions*

The research data show European multinationals also employed administration tools, business rules, procedures and monitoring systems, to tackle individualism, bridge the

hierarchy gap and facilitate harnessing local knowledge. The following practices exercised by some of them are good examples.

M10 used business procedures to enhance business interaction and alleviate cultural gap between foreign managers and Chinese managers:

“We at this company have foreign expatriates, Chinese middle managers and then Chinese frontline and British frontline managers. We sense a very limited cultural gap but more of a hierarchy gap. British frontline managers may have good relationships with top managers in their leisure time. But when they work in the company they have to follow company procedures to work with Chinese middle managers. The company is managed according to procedures not according to people. Therefore, we have a very limited cultural gap. Procedures are not personal so you do not sense any cultural difference.”

(Info M10)

M13 made the following rule to push local staff to give views on business issues:

“Each participant must speak for a certain length of time during each meeting and further document needed to be drawn if any participant had more to say.”

(Info M13)

The ‘*account management*’ adopted by M8 exerted pressure on its sales workforce in order for them to uncover customer knowledge through ‘tough task design’. In this system, the sales workforce were required to work out their account plans on each major customer, in which the workforce needed to input fixed information on each customer. In the similar vein, the sales representatives of M7 were required to send three pieces of information on each project to its central data system. Local staff of M1 were required to write very detailed reports on its China market, including the culture, regularly (Info M1).

At M17 the quality of its teamwork was closely monitored. Quiet employees were invited to give views and translator was also employed whenever necessary. Its human resource director also illustrated how its HR staff undertook personality checks for working teams and resolved collaborative problems:

“We are doing team-building work. For example, we sit down together with each department and conduct a HRP analysis. This includes what personality your team member has, how to cooperate with this member, at which stage you are in, as teamwork goes through different stages. Whether you are in shaking stage, cooperative stage or development stage. In the stage of being self-proud how could we cope with problems? So we do monitor this and it is important.”

(Info M17)

Some multinationals adopted explicit job description in order for local staff to clearly understand their responsibilities (Info M15, M8, M17).

Additionally, the performance assessment system adopted often exerted pressure for local employee to continuously acquire knowledge, take responsibilities and utilise its individual knowledge (Info M14, M11). As the respondent of M11 illustrated:

“We have a high performance team. We have now an annual review on performance which clearly saying the last 5%, the lowest 5% performance will be terminated from your employment. Their performance is assessed at both individual and collective levels. About 40% of our salaries are paid based on our overall performance. Performance-related pay is adopted across the whole China business including myself.”

(Info M11)

These practices provide directions and exert pressure for local knowledge holders, local staff in particular, to contribute in local knowledge sharing and utilisation. However, the empirical data also show that with the absence of other forces rules and directions have



limited positive effect on improving local knowledge flow and integration, as demonstrated at M13.

However, there was little evidence about what directions could be used to compensate the time-consuming nature of local thinking during meetings. Full communication before meetings, hence, is suggested in order for local knowledge holders to have enough time to consider key issues in advance.

#### ***8.4.3.4 Adopting the principle of mutual benefit***

*“If everything is beneficial to both sides you can come to the conclusions which enable.”* (Info M16). Mutual-benefit is the espoused business philosophy adopted in China to meet individual and material needs. Realising the Chinese authorities and customers often had *‘pragmatic views’* on business issues, management of M16 *‘often sit down with its partners to listen and analyse issues together in order to find mutual beneficial way of doing things’* (Info M16). This led to its successful collaboration with its Chinese partners. In contrast, having failed to realise such a characteristic of China business environment M13 fought alone and lost in the battle.

These ‘pull and push’ forces were adopted among European multinationals as effective measures to break the cultural hurdles hindering the local knowledge management process. However, the research data also reveal that these measures were not fully understood as a system. They were practiced randomly rather than systematically. Some measures were more widely adopted than others, such as trust and mutual benefit. The measure of promoting academic atmosphere was critical to tackle implicit communication and responsibility-shy attitude, however, it was not demonstrated in any of the participating

companies. Consequently, implementation problems existed in them all. For example, responsibility-shy attitude still existed at M16 although it had successfully managed other cultural issues. This suggests the need for these multinationals to adopt the 'pull and push' forces as a systematic approach.

#### **8.4.4 Summary**

This section explored the best practices European multinationals exercised to overcome local knowledge management barriers. The findings show that European multinationals strived to establish multi-layered knowledge interfaces to bridge specific physical gaps between local knowledge holders and seekers, develop and enhance common knowledge base from both Chinese and foreign sides to alleviate knowledge gaps, and also employed 'pull and push' forces to overcome cultural hurdles rooted in local knowledge holders. The main 'pull and push' forces employed include (1) empowerment, (2) a learning culture emphasising trust and team spirit, valuing local knowledge, and promoting academic atmosphere, (3) rules and directions, and (4) a business principle of mutual benefit. It was found that European companies which deployed strategies to bridge the knowledge gaps through building up solid common knowledge base experienced fewer difficulties in exploiting local knowledge. It was also evident that European companies proactively and systematically adopted 'pull and push' forces to overthrow the cultural hurdles had better chances to embed local expertise in local business decisions.

## **8.5 Conclusion**

The research results broadly show compelling support for the argument advanced in Chapter 4. The evidence presented here paints a nuanced picture of the management strategies for exploiting local knowledge. The findings on local knowledge management process support the contention that knowledge transfer approach and knowledge integration mechanisms should be complementarily used if to exploit the full value of local knowledge. The results support the argument that external local knowledge should be consciously acquired into individual knowledge through intensive business interactions and socialised activities, and some individual knowledge acquired should be codified and disseminated through in-built knowledge sharing systems, while some other knowledge should be directly shared through physical interactions. At the same time, results also show that the difficult-to-transfer local knowledge held by both external and internal knowledge holders could be utilised through knowledge integration mechanisms, characterised by intensive business collaboration. However, the findings also show that the management decision as to what knowledge should be transferred or integrated was contingent on six specific variables, rather than just transferability of the knowledge required alone, as was assumed in the theoretical model. This suggests the need to revise the management process model.

The findings on implementation obstacles are consistent with the analyses in Chapter 4 regarding local knowledge management barriers. Overall, most European multinationals were aware of the six country-specific management barriers that hinder local knowledge flow and integration. However, the results suggest that managers from European companies show in-depth understanding of the knowledge gaps between Europeans and Chinese but limited awareness of the cognitive difference between them. This indicates

that the value, as well as the tacit nature of local knowledge, is often underestimated. Hence, there is the need to highlight the role of tacit local knowledge in business decision-making.

In a number of ways, the more interesting findings regarding implementation strategies come with the analyses of local knowledge management conditions advanced in Chapter 4. The results show that the practices exercised by those European companies to facilitate local knowledge flow and integration did considerably break down management barriers and improve the effectiveness of local knowledge management process. First, the multi-layered knowledge interfaces employed bridged the physical gaps between local knowledge holders and local knowledge seekers. Individuals involved in knowledge management activities had more chances to meet. Second, the increased common knowledge base significantly bridged knowledge gaps between local knowledge providers and local knowledge receivers. It served as a knowledge trajectory facilitating local knowledge flow and integration. It was the language tool used by local knowledge holders to communicate individual knowledge, and also used by local knowledge seekers to absorb new knowledge received. Third, the 'pull and push' forces adopted considerably overcame the cultural barriers rooted in local knowledge management process. However, the results also show that among these practices the bridging of knowledge gaps raised the most attention, suggesting its outstanding role in improving local knowledge management effectiveness. In addition, the results also suggest that the 'pull and push' forces were not adopted systematically, which indicates a lack of systemised recognition on the role of these forces in improving local knowledge management effectiveness.

Considered together, these findings challenged the conventional knowledge acquisition and transfer approach towards exploiting local knowledge and made a contribution to the

unexplored conceptual territory of local knowledge management in the Chinese business context. The results support the argument advanced in the theoretical model but also imply the need for a revised strategic management model of China local knowledge to inform both theory and practice.

## Notes

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<sup>1</sup> See Chapter 6.

<sup>2</sup> See Chapter 5 for detailed information on the fieldwork.

<sup>3</sup> See classification of local knowledge in Chapter 6.

<sup>4</sup> See the nature of local knowledge in Chapter 6.

<sup>5</sup> See Chapter 7.

<sup>6</sup> See, for example, Lee (1999), Lord and Ranft (2000), and Makino and Delios (1996).

<sup>7</sup> See, for example, Nonaka et al (2000), von Krogh et al (2002).

<sup>8</sup> See Chapter 6 for detailed information.

<sup>9</sup> See the debate on management strategies towards tacit knowledge between Nonaka et.al (2000), who believe that tacit knowledge must be transferred in order for its full value to be realised, and Grant (1997), who argues that some specialised tacit knowledge needs to be integrated if to achieve efficiency.

<sup>10</sup> See Chapter 6.

<sup>11</sup> See concrete examples in Chapter 6.

<sup>12</sup> See detailed illustration in Chapter 6.

## **Chapter Nine**

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### **Strategic Management of China Local Knowledge: A Justified Model**

#### **9.1 Introduction**

This chapter draws together key arguments from the theoretical examination and empirical findings to argue how local knowledge should be managed in China. It briefly summarises the main arguments in the theoretical model that have been illuminated in this thesis and assesses the ways and extent to which the research has been able to support its theoretical stand through discussing and analysing the rationale behind the empirical observations. More specifically, it evaluates how defensible is the theoretical model in the face of empirical evidence and discusses the limitations of the evidence. Based upon these analyses it then presents a justified local knowledge management model to inform both theory and practice.

#### **9.2 A Review of the Argument**

This study takes as its starting point the critical role which local knowledge plays in international business performance with particular reference to China. The local knowledge base of the multinational firm is seen as playing a key role in profitability and growth. It examined the nature of China local knowledge and argued that local knowledge in China market was highly tacit, undiffused and fast-changing; some tacit knowledge

might not be transferable (*Proposition 1*). It was further argued that it was this intrinsic and fast-changing nature of local knowledge that determined its greater impact on the multinational firm's business performance in China, more than home-based technology and management practices transferred to this market; it was the key source of competitive advantage in China market (*Proposition 2*).

It further identified the scope of local knowledge holders and argued that local knowledge sources were dispersed. Key local knowledge holders in China included people far beyond the scope of those involved in business transactions (*Proposition 3*). Therefore, local knowledge management strategies should be deployed towards full exploitation of local knowledge sources.

Based on these arguments it proposed a process model of local knowledge management in which (1) external undiffused explicit knowledge was constantly acquired through socialised activities, synthesised and diffused through an in-built diffusion system; (2) some external tacit knowledge was constantly acquired; (3) internal individual tacit local knowledge was codified and diffused into corporate explicit knowledge base used by corporate members either to create embodied corporate tacit knowledge or to create new individual tacit knowledge; and (4) specialised tacit local knowledge was integrated into specialised corporate tacit knowledge base through wider collaborative business activities. It was argued that the multinational firm should employ such a local knowledge management mechanism which emphasised complementary use of knowledge transfer approach and knowledge integration perspective (*Proposition 4*). This process model melted two competing approaches towards managing tacit knowledge - knowledge transfer and knowledge integration - and introduced the key proposition for the proposed general framework for knowledge management (Chapter 2) that the firm's success lies in its ability



to constantly renew its collective tacit knowledge and integrated specialised knowledge that underpin its core competencies.

To further understand how this process could be implemented effectively it identified key local knowledge management barriers by analysing main features of local knowledge holders and investigated means for breaking the associated management hurdles. It argued that Chinese local knowledge holders had wide physical and knowledge gaps with global business professionals and also shared some cultural features which acted as rooted human hurdles for effective local knowledge flow and integration, namely: synthetic view of the world; implicit communication; responsibility-shy attitude; and new materialism and individualism (*Proposition 5*).

Therefore, the second part of the proposed management model of local knowledge encompassed three conditions under which the management barriers could be effectively resolved. These conditions included multi-layered knowledge platforms (internal-external, macro-micro, horizontal-vertical, physical-nonphysical) established to bridge the physical gaps between local knowledge holders and seekers (*Proposition 6*); common knowledge serving as a knowledge conjunction for facilitating local knowledge transfer and integration (*Proposition 7*); and a 'pull and push' system in which rooted human hurdles could be overcome. Such a 'pull and push' system could involve means such as empowerment, explicit job description, rules and directions, tough task assignment, mutual-benefit policy and a learning culture with an emphasis upon trust, collaborative spirit, accountability and academic attitude towards business issues (*Proposition 8*).

We next assess the ways and extent to which the research has been able to support its theoretical stand through discussing and analysing the rationale behind the empirical observations.

### **9.3 Analysis of Evidence: Comparing Local Knowledge Management Approaches in Theory and Practice**

The empirical evidence reported in Chapters 6, 7 and 8 provided a comprehensive understanding of local knowledge and its role in the multinational firm's business performance in China, and how local knowledge was actually managed in practice. In this section, the main findings are used for a comprehensive comparison and discussion of Strategic Management of China Local Knowledge in theory and practice.

#### **9.3.1 The Nature of Local Knowledge**

The empirical findings presented in Chapter 6 indicate that China local knowledge, by nature, differs significantly from global knowledge transferred to the China market, which is codified and widely available within the multinational firm. It is highly tacit, undiffused and fast-evolving; some local knowledge is even non-transferable. This finding is consistent with the key argument put forward in Proposition 1, which confirms the difficulties in transferring local knowledge.

### **9.3.2 The Role of Local Knowledge**

The concrete examples collected on-site have proved that it is the intrinsic and fast-evolving nature of China local knowledge which determines its greater impact upon the multinational firm's business performance. The evidence presented in Chapter 6 showed how a multinational firm with established home-based strengths failed because it did not fully exploit local knowledge, and how some European companies won local deals because of their superior understanding of local customers. This further suggests that local knowledge disadvantage cannot be offset by the multinational firm's home-based ownership advantage. This finding therefore supports the proposition that local knowledge is the key source of competitive advantage in China market (Proposition 2), which indicates the necessity to strategically manage local knowledge for achieving competitive advantage.

### **9.3.3 Local Knowledge Sources**

The empirical research also indicates that, in addition to expatriates, local staff and joint venture partners, other business entities such as local customers, local authorities, local institutions, local communities, and even individuals are also rich sources of the local knowledge which is essential for the smooth operation of foreign business. This finding confirms the proposition that local knowledge sources in China were dispersed (Proposition 3) and suggested the need for the multinational firm to explore other strategies towards full exploitation of local knowledge sources.

### **9.3.4 Local Knowledge Management Process**

The empirical findings presented in Chapter 8 suggest that the management process employed by European multinationals encompassed three strategic efforts – knowledge penetration, knowledge blending and knowledge integration. Global knowledge penetration strategies were first deployed in order to build up common understanding of the corporation and establish the interface for local knowledge flow as European multinationals realized that a huge knowledge gap between European staff and Chinese workforce could block effective communication and cooperation. Knowledge penetration strategy was closely followed by European multinationals' second strategic effort - wide scope knowledge blending process characterized by intensive interactions between local knowledge holders and seekers. At this phase local knowledge, from explicit to tacit, was acquired and blended (diffused) with global knowledge to form the corporate common knowledge base - shared information and collective understanding - for public use. However, the effectiveness of this knowledge transmission process was constrained by a number of context-specific reasons such as the rooted belief that knowledge was an individual asset; transferability of knowledge desired; resource constraints; time demands; dispersed nature of local knowledge sources; and actual availability and accessibility of knowledge required. As compensation, some difficult-to-transfer local expertise was integrated into corporate integrated knowledge base through strategic means like consensus decision-making, organized teamwork and taskforces and strategic partnerships. These results, though apparently slightly different from the theoretical local knowledge management process put forward in Chapter 4, support Proposition 4. It has also been demonstrated that (1) the most valuable knowledge of the firm is a combination of collective tacit knowledge and integrated specialised knowledge, the key argument put forward in Chapter 2; (2) knowledge transfer is not an optimal choice for exploiting China

local knowledge, which is unduely emphasised in local knowledge management literature; and, to realise the full value of local knowledge, both knowledge transfer approach and knowledge integration mechnism should be jointly employed.

However, the findings also indicate that the theoretical model put forward in Chapter 4 may lack some flexibility. On the one hand, it does not consider the complex context-specific constraints on the choice of management strategies for exploiting local knowledge. It was developed from a particular understanding about the transferability of local knowledge. Other context-specific variables identified in the field investigation were likewise overlooked. On the other hand, it also does not consider how the entire management model could be actively employed in the real business context. This qualifies the suitability of the empirical process model and underlines the need to revise the theoretical management process model despite the limited evidence available (see Chapter 5).

### **9.3.5 Management Barriers**

The empirical findings indicate that Chinese local knowledge holders did have wide physical and knowledge gaps with global business professionals and also shared some cultural features which were rooted human hurdles for effective local knowledge flow and integration, namely, cognitive difference; implicit communication; responsibility-shy attitude; and new materialism and individualism. These are consistent with the analyses in Chapter 4 regarding local knowledge management barriers (Proposition 5). Most European multinationals were aware of the six country-specific management barriers that hinder local knowledge flow and integration. However, the results suggest two lines of variance between the theoretical argument and the empirical evidence. The empirical

evidence revealed that, compared to knowledge gaps and cultural hurdles, physical gaps were less recognised. Moreover, there is also a degree of inconsistency between the empirical evidence from foreign executives and local Chinese managers. The results suggest that foreign managers from European companies show in-depth understanding of the knowledge gaps between Europeans and Chinese but less awareness of the cognitive difference between them, while Chinese managers show in-depth understanding of many aspects, particularly the cognitive difference between respective sides, and also, the implicit communication preference of many local Chinese. This indicates that foreign managers often underestimate the value, as well as the tacit nature, of local knowledge. Hence, there is the need to highlight the role of tacit local knowledge for improving business decision-making.

### **9.3.6 Management Conditions**

The empirical findings regarding local knowledge management implementation strategies link with the analyses of local knowledge management conditions advanced in Chapter 4 although there was certain degree of inconsistency.

First, the multi-layered knowledge interfaces employed to bridge the physical gaps between local knowledge holders and local knowledge seekers by European multinationals are concordant with the ideas of multi-layered platforms proposed in Chapter 4 (Proposition 6), despite less recognition of such physical obstacles in practice. This suggests that multi-layered interfaces are effective in linking knowledge seekers and holders in China.

Second, the empirical evidence indicates that an increased common knowledge base can significantly bridge the knowledge gaps between local knowledge providers and local knowledge receivers; common knowledge also does serve as a knowledge trajectory facilitating local knowledge flow and integration (Proposition 7). It was the language tool used by local knowledge holders to communicate individual knowledge, and it was also used by local knowledge seekers to absorb new knowledge received. Wide recognition of such role of common knowledge led to much attention being paid to bridging knowledge gaps in practice. The results confirm the outstanding role of common knowledge in improving local knowledge management effectiveness.

Third, the empirical evidence presented in Chapter 8 also demonstrated that the 'pull and push' forces adopted by European multinationals overcame the cultural barriers rooted in the local knowledge management process. Some multinationals better utilised the cognitive quality of local knowledge holders through empowering their people, decentralizing their organizations to reduce the sense of hierarchy, and making their responsibilities explicit. Some proactively promoted a corporate culture of trust, team spirit and valuing local knowledge. Some exerted pressure upon locals through rules and directions. They also adopted a mutual-benefit business philosophy to tackle individualism and materialism, especially when dealing with external relations. These results show great degree of consistency with the proposition regarding the 'pull and push' system put forward in Chapter 4 (Proposition 8). However, there was no evidence of adopting a culture for promoting an intellectual atmosphere as a means of overcoming implicit communication. Nevertheless, certain evidence strongly called for this. In addition, the results also suggest that the 'pull and push' forces were not adopted systematically, which indicates a lack of systematic recognition about the role of these forces for improving local knowledge management effectiveness. Certain practices were only found in selected

European companies. A larger empirical investigation could secure a more vivid picture of this system. Nevertheless, the existing implementation problems revealed among these companies, such as responsibility-shy attitude of local managers at M16; passive communication of local managers at M8 and M11; individualism and materialism at M12; cognitive conflict at M13 all clearly indicate that deploying these strategic forces as a system appears to be more effective for improving their situation.

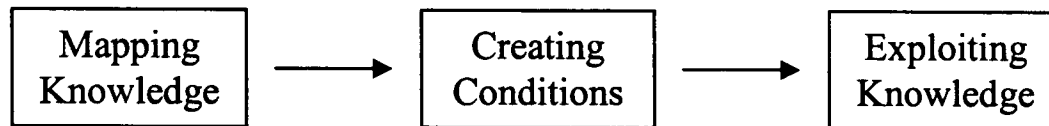
A comparison of the empirical findings with the theoretical arguments indicates that, while the empirical evidence supports the main arguments, certain lines of variance exist too. Taken as a whole, neither the management strategies in theory nor those in practice fully illuminate the causes and forces that help explain performance differences between multinational firms. The theoretical model did not comprehend all the more comprehensive strategic considerations and priorities in the strategic choices faced by multinationals in the real business context while the empirical evidence was limited regarding implementation issues. A concrete management model which melts these would be the introduction of a realistic and holistic management concept regarding strategies for mitigating local knowledge disadvantage faced by foreign investors in China.

#### **9.4 Strategic Management of China Local Knowledge: A Justified Model**

In the light of the above comparisons and analyses of the local knowledge management strategies in both theory and practice this section proposes a revised local knowledge management model that combines the key arguments in the theoretical model and the best practices revealed in practice. In this model, the multinational firm first maps what knowledge it possesses and what knowledge needs to be managed, and then creates



management conditions for its knowledge management initiatives, followed by strategically exploiting the full value of local knowledge (Figure 9.1).



**Figure 9.1 A Justified Local Knowledge Management Model**

#### 9.4.1 Mapping Knowledge

One striking finding of this study is that, unlike the global knowledge transferred to China market which is well-documented, narrowly defined, shared across the business, and easy-to-control, local knowledge ranges widely and is highly tacit, undiffused, dispersed, and fast-evolving. To effectively exploit its full value the multinational firm has to map what type of knowledge it possesses, where it resides, and what knowledge needs to be acquired and managed. Experience from M8 suggests that knowledge mapping can be achieved by direct '*self-mapping*' and indirect '*account management*' (Info M8).

'*Self-mapping*' of knowledge can be undertaken at different levels - individual, team, department, division, and corporate. Its purpose is to excavate in-depth individual knowledge. This is also an effective way to codify tacit knowledge and diffuse explicit knowledge. Although the empirical evidence indicates that many multinationals have an established filing system, the effective use of these systems is often still under question. Reporting documents often contain limited information on what staff know as they are used to record what has been going on in general rather than how the business has been handling. Therefore, much tacit knowledge still resides in individuals. Local actors often

hesitate to share this knowledge through established database or other shared systems. 'Self-mapping' of local knowledge provides individuals the opportunity to articulate their tacit knowledge. More important, the Chinese perception that it is a loss of face to show other people they have inadequate knowledge in his/her specialism could greatly help achieve a good result. The results can be evaluated and shared across the corporation through its central filing system. This also helps identify what they will need to know to be competitive, and facilitates establishing a knowledge acquisition goal.

'Account management' can be used to capture and map knowledge disclosed in decision-making. The multinational firm sets a variety of 'tough tasks' and identifies what knowledge is needed to fulfil each of them, what knowledge is needed but not available, who are the knowledge holders, and whether the knowledge holders are accessible. This knowledge map links all 'account teams' and different decision-making processes together to form the starting point for local knowledge management strategies. 'Account management' helps understand what is required for daily business decisions therefore define what to acquire and manage (Info M8) and what resources are required to achieve desired outcomes.

Although knowledge mapping is neither a theoretically grounded management process nor an identified empirical finding, it was exercised by a few of the European multinationals involved in this study and proved a useful first step in exploiting local knowledge (Info M8).

## **9.4.2 Creating Management Conditions**

A second striking finding of the study is that local knowledge cannot be managed effectively unless certain conditions are present. The multinational firm therefore needs to focus on creating management conditions before any local knowledge management initiative is actually implemented.

### ***9.4.2.1 Developing common knowledge***

The first and foremost condition the multinational firm needs to create is a language instrument, common knowledge shared between knowledge holders and knowledge seekers. The empirical findings indicate that common knowledge takes the most important role in facilitating cross-border knowledge management activities. In order to build up common understanding of the corporation and bridge the knowledge gaps between local knowledge holders and foreign investors which hinder local knowledge management process, the multinational firm needs to deploy a knowledge penetration strategy, a two-way knowledge infiltration mechanism which enhances common knowledge base of knowledge holders and knowledge seekers from respective sides. More specifically, the multinational firm should create a common knowledge base through training, business and social activities, recruitment, job design, and careful employment of common knowledge holders. For local staff, large scale training of local knowledge holders may be necessary at all levels. Moreover, the multinational firm should consider cultural and personality fit factors in addition to individual skills during recruitment and job design. Furthermore, it needs to consider to what degree those responsible for corporate business communication actually suit the external local knowledge holders' situation and whether it is also necessary to employ external common knowledge holders. In addition, it is important to

be aware of the limitations of individuals' knowledge base and tailor training programmes accordingly, management skills and language training in particular. For foreign actors, regular training and/or seminar discussion on local topics for expatriates, even staff working in headquarters in Europe, can be undertaken more regularly. External experts in certain local specialisms can be regularly invited to make key contributions. In general, knowledge penetration strategies should focus on increasing expatriates' local knowledge, local management's international experience, and local staff's foreign language skills.

#### ***9.4.2.2 Establishing knowledge interfaces***

A second condition the multinational firm needs to create is multi-layered knowledge interfaces that link knowledge holders and knowledge seekers at all levels. Though physical gaps between knowledge holders and knowledge seekers were not specifically emphasised by most informants, the actual measures taken to bridge such gaps were relatively extensive. Knowledge interfaces did draw knowledge holders and knowledge seekers closer. Therefore, the multinational firm should establish knowledge interfaces linking knowledge holders and knowledge seekers internally and externally, physically and/or non-physically, and vertically and horizontally at both macro and micro levels. At macro level these interfaces should draw knowledge holders closer to the multinational firm, while at micro level they should be designed to suit individual needs. Vertically they should facilitate bottom-up knowledge flow and integration, and horizontally they should allow inter- and cross-functional cooperation. Internally they should promote ultimate use of shared resources and in-built collaboration and interaction systems that function as the corporate radars to sense and ready to receive knowledge. Externally, they should emphasise the wide scope of network activities, relationships and business contacts.

Because of the undiffused, highly tacit and even non-transferable nature of China local knowledge these interfaces should also be designed to meet the need of acquiring and integrating local knowledge externally and codifying, diffusing, and integrating knowledge internally.

#### ***9.4.2.3 Establishing a 'pull and push' system***

A third condition the multinational firm needs to create is a 'pull and push' system that overcomes the four rooted management barriers. The empirical results indicate that the 'pull and push' forces employed by European companies did penetrate management barriers and improve the effectiveness of local knowledge management process even though they were not adopted systematically. It is therefore strongly recommended that the multinational firm should establish a 'pull and push' system in order to enhance the implementation effectiveness of its local knowledge management initiatives. Such a 'pull and push' system should include measures such as empowerment; an embedded culture promoting trust, value, and academic atmosphere; mutual beneficial principle; rules and directions and so on, all adopted to ensure active participation of local knowledge holders. Among these tools, multilevel teamwork, task force and empowerment are potentially effective means to introduce local thinking into multinationals' strategic decisions; explicit and detailed job description help local knowledge holders understand their responsibilities; empowerment motivates the taking of responsibility; an embedded learning culture with strong emphasis on accountability, valuing local knowledge, trust, and promoting academic atmosphere can tackle low trust and motivate the articulation of tacit knowledge; rules, directions, tough task assignment and empowerment can exert great pressure for local knowledge holders to share and utilise their ideas; factors such as detailed reporting requirement, well-prepared and directed meetings and seminars, well-monitored team and

individual work ensure maximum contribution of local knowledge holders involved; a performance-related pay system which considers both individual and collective performance can be useful, and the principle of mutual benefit, and a corporate culture that promotes collaborative spirit can address the new materialism and individualism feature of local knowledge holders.

### **9.4.3 Exploiting Local Knowledge**

A third striking finding of the study is that local knowledge cannot be fully exploited through knowledge transfer and knowledge acquisition; the very specific nature of China local knowledge and its embedded business context call for complementary use of knowledge transfer approach and knowledge integration mechanism.

#### ***9.4.3.1 Knowledge blending***

The empirical findings indicate that knowledge transfer did take an important role in developing corporate capabilities. It was the mechanism through which individual knowledge was utilised in a broader business context. The embedded collective knowledge created through knowledge acquisition, sharing and application activities did improve the firm's business performance. Therefore, the multinational firm should deploy strategies for acquiring and blending some local knowledge into its corporate knowledge base for more to share. This can be realised through intensive internal and external physical interactions and well-established filing systems. Local knowledge can be constantly acquired through intensive formal business interactions with external local knowledge holders as well as informal networked activities. The multinational firm needs to find ways to formally access external local knowledge holders such as local customers

and local authorities. It also needs to be involved in intensive informal networked activities and other entertaining activities in China. The acquired local knowledge can then be processed, articulated and diffused through in-built knowledge dissemination systems, such as central filing system, databanks, for public use. However, the multinational firm needs to understand that these systems may not be fully effective. It should be understood that it is easier to establish systems than to effectively put them to use. The multinational firm therefore depends on physical interactions to blend local knowledge, tacit knowledge in particular, into corporate level understanding. Thus, business activities such as regular meetings, instant meetings, teamwork, seminars, and company social activities, should be organised on a daily or regular basis in each business unit and across business units or across borders regularly. The adoption of a knowledge blending process can provide a number of benefits to the multinational firm: (1) to avoid sudden loss of critical local knowledge with the loss of key employees; (2) improve corporate responsiveness; (3) lead to better business decisions and innovative management ideas.

However, multinationals should also understand that transferring local knowledge is not an optimal choice of exploiting local knowledge. Rather, it often encounters difficult challenges. These challenges arise from the specialised nature of some local knowledge; rich tangible resources demanded; time constraints; dispersed local knowledge sources; accessibility of local knowledge; and the rooted belief that knowledge is just an 'individual asset'. The multinational firm has to understand that changing historically rooted beliefs does take time, and the high employee turnover rate in China can exacerbate such difficulties; some specialised knowledge is indeed difficult to transfer; transferring local knowledge requires considerable tangible resource; learning takes considerable time but China local knowledge evolves fast; local knowledge sources are dispersed; and local knowledge is not widely available and accessible. These difficulties suggest that the

decision about what knowledge should be transferred or integrated is contingent on six specific variables rather than its transferability alone, as assumed in the theoretical model. They also suggest the limitations of knowledge transfer approach in developing corporate capabilities.

#### ***9.4.3.2 Knowledge integration***

To harness difficult-to-transfer local specialised knowledge the multinational firm should adopt knowledge integration mechanisms as compensation to any knowledge transfer approach. The empirical findings suggest that local knowledge, especially ‘specialist knowledge’, is often integrated with global knowledge to fulfil divergent local business tasks. Knowledge integration approach is adopted to utilise difficult-to-transfer local knowledge, of local culture and cognition in particular, which may not be used effectively otherwise. It combines different functional and personal capabilities to derive business opportunities and achieve better business performance. Knowledge integration can be realised through consensus decision-making, teamwork and taskforce, and wide-scope business partnerships. Externally, multinationals can form strategic alliances with external knowledge holders to utilise local expertise that otherwise could not be fully used. Business partnership can be adopted as a key integration strategy for managing external specialised knowledge. Internally, multinationals can organise regular or irregular corporate business meetings. On the one hand, these meetings should facilitate the sharing of up-to-date business knowledge. On the other hand, they may integrate local wisdom into corporate business decisions. Local staff should not only be involved in frontline business decisions but encouraged to contribute to corporate-wide business planning and problem-solving. Consensus business decision-making strategy offers the opportunity for different perspectives to emerge leading to group decisions that consider more alternatives. It



embeds individual knowledge into collective business actions and combines individual strengths to achieve superior business performance. Multinationals need to have more locals in their management teams. They should also invite external local knowledge holders into certain types of business decision-making. Multi-level teamwork can be widely adopted for best utilisation of individual specialised knowledge. Teams can fulfil business goals by combining their divergent competencies better. Knowledge integration best utilises the difficult-to-grasp local expertise and exploits the full value of local knowledge sources.

## **9.5 Conclusion**

This chapter brings together key arguments from the theoretical examination and empirical findings to argue how local knowledge should be managed in China. The main arguments in the theoretical model that have been articulated in this thesis have been briefly summarised and compared with the empirical findings in order to assess the ways and extent to which the research has been able to support its theoretical position. The rationale behind the observations as well as the limitations of the empirical evidence have been discussed in order to evaluate the legitimacy of the empirical model. Based upon these analyses a justified local knowledge management model has then been presented to inform both theory and practice. The model which melts key arguments and striking empirical findings consists of three strategic efforts – mapping knowledge, creating management conditions, and exploiting local knowledge. Knowledge mapping sets the strategic direction for the multinational firm's local knowledge management initiatives. The creation of management conditions clears the way to effective exploitation of local knowledge. A knowledge exploitation strategy that emphasises complementary use of

knowledge transfer approach and knowledge integration mechanism ensures fuller utilisation of local knowledge. The key arguments of this model have illuminated the findings, consistent with the main arguments of the theoretical model, and thus challenged the conventional knowledge acquisition and transfer approach towards exploiting local knowledge, and also made a contribution to the unexplored conceptual territory of local knowledge management in the Chinese business setting.

By going through the various stages of local knowledge and its management – from the preliminary analysis of knowledge, local knowledge and their management issues to the on-site investigation of local knowledge and its management practices – and by enlarging horizons to include both European multinationals as well as Chinese organisations, the study has tried to provide new insights into this relatively unexplored issue of international management. The findings of this study and the key arguments incorporated in the justified model presented in this chapter constitute a modest contribution to academic research on local knowledge management in China which could help incoming managers to improve their China business performance. In the competitive China business environment, companies cannot afford failures (Info M16). Taking into account the role of local knowledge, the invisible and soft side of its international management, is a way to sustain competitive advantage in this dynamic strategic market.

However, it is also important to draw attention to some caveats: the above justified model is based on the results of a multiple method, *qualitative* empirical investigation and theoretical deduction; to draw general conclusions from such findings risks the danger of neglecting the methodological limitations (see Chapter 5). Moreover, the model of strategic management of China local knowledge should not be used as a panacea for the performance challenges faced by foreign investors in China; the suggestions presented here

should be understood as a comprehensive overview of the causes and forces that explain performance differences between multinational firms in China, which might be useful to scholars and practitioners.

## **Chapter Ten**

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### **Conclusions and Implications**

#### **10.1 Introduction**

This study has attempted to shed light on the puzzling causes and forces that explain performance differences between multinational firms in China. In addressing this issue it has examined the concept of local knowledge and its influence on multinational business performance in China. It then identified the main local knowledge holders in order to determine the most appropriate unit of analysis for further study. It subsequently focused upon investigating management strategies for developing competitive advantage from local knowledge. This chapter brings together what has been found in the preceding chapters and assesses what has been learnt, its implications, and what remains to be discovered and explained.

The first section summarises and reviews the main findings. The aim is to highlight specific results and make a fundamental contribution to the understanding of local knowledge, and local knowledge management strategies with particular reference to China, as well as knowledge management strategies in general.

The subsequent section assesses how this advances our understanding of the causes and forces that explain performance differences between multinational firms in China, and considers the theoretical implications of this study.

It then presents the practical implications of this research for managers of multinational firms to reflect the overarching motivation for this study.

Finally, it discusses its limitations, and what research work is required in the future research agenda.

## **10.2 Review of the Findings**

My inquiry started from the attempt to understand how knowledge can be managed in general business context from an expressly theoretical point of view. Based on two competing approaches to knowledge management in the literature, I proposed a general knowledge management framework (see Chapter 2) which identified the firm's most valuable knowledge, the knowledge underpinning the core competencies of the firm, combined collective tacit knowledge and integrated specialised knowledge, and argued that knowledge transfer process only led to the creation of collective tacit knowledge, which is only part of all the most valuable knowledge of the firm. The firm's competitive strategies, therefore, are to build up core competencies through creating these two categories of knowledge. This suggests that knowledge transfer alone is an inadequate approach towards developing competitive advantage from knowledge, and that knowledge integration mechanisms that lead to the creation of integrated specialised knowledge should be employed as compensation.

By looking at the dynamic nature of the firm's valuable knowledge it then proposed the incorporated strategic focus model which argues that the firm should build its strategy on the renewal of core competencies. The reasoning was that the core competencies of the

firm either are diluted or turn rigid in a changing business environment. In an international business setting, where new knowledge dominates and local culture prevails, this argument implies increasing need to exploit local knowledge, which partially explains why some multinational firms with established home-based strengths underperform in host markets.

Based on these preliminary analyses of knowledge management strategies, I developed a theoretical model of local knowledge management in China business context (see Chapter 4) to argue how China local knowledge can be managed from a theoretical point of view. In this model, external undiffused explicit knowledge is constantly acquired through socialised activities, synthesised and diffused through in-built diffusion system. Some external tacit knowledge is constantly acquired and internal individual tacit local knowledge is codified and integrated into corporate knowledge base for effective decision makings, while specialised local tacit knowledge is integrated into specialised corporate tacit knowledge base for fuller utilisation. The notion of complementary use of knowledge transfer and integration was introduced as the basis for this local knowledge management process. I argued that such a process responds to the highly tacit, undiffused, and fast-evolving nature of China local knowledge and the dispersed nature of local knowledge sources examined in Chapter 4, and that knowledge transfer might not be an optimal choice of managing local knowledge in China. To further understand how this process can be implemented effectively key knowledge communication barriers were identified through analysing main features of local knowledge holders and investigating the strategic means for breaking the associated communication hurdles. I postulated that Chinese local knowledge holders had huge physical and knowledge gaps with global business professionals while sharing some cultural features that serve as rooted human hurdles for effective local knowledge flow and integration. Therefore, the second element of the proposed management model of local knowledge encompasses three conditions under

which communication barriers can be effectively broken. These conditions include multi-layered knowledge platforms on which local knowledge holders are given the maximum chance to meet; common knowledge serving as knowledge conjunction to allow knowledge holders meet positively; and a 'pull and push' system in which rooted human hurdles are resolved.

The argument posited in the theoretical model gives rise to a set of claims regarding competitive management strategies in China. They are essentially concerned with the relationship between China local knowledge and the multinational firm's competitive advantage in China; the management process of China local knowledge; the management barriers hindering knowledge management effectiveness; and the management conditions under which the main impediments can be overcome. By employing a multi-method qualitative approach (see Chapter 5) the research undertaken empirically examined and tested the theoretical model and its key arguments, and brought to light numerous concrete strategies for exploiting the multinational firm's internal and external local knowledge sources, and overcoming the implementation barriers. The empirical evidence reported in Chapters 6, 7 and 8 provided comprehensive understanding of what determines the multinational firm's business success and how local knowledge is managed in practice. The main findings are summarised as following:

First, China local knowledge, by nature, differs significantly from global knowledge, technology and management practices in particular, transferred to China market. Unlike global knowledge transferred to China market, China local knowledge is highly tacit, undiffused and fast-evolving; some is even non-transferable. Although it is clear that both types of knowledge are required for any business to operate in an international market it is argued that the intrinsic and fast-evolving nature of China local knowledge determined its

greater impacts upon the multinational firm's business performance than global knowledge transferred to this market. This finding challenges the dominant proposition in International Business Strategy that location-based disadvantage, local knowledge disadvantage in particular, can be offset by the multinational firm's ownership advantage transferred from home market to host markets at low cost. Evidence from those European multinationals shows that home-based technology and management practices transferred to China often turn rigid in the face of local knowledge shortage. In addition, home-based knowledge is not transferred to China at low cost due to the knowledge gap between European staff and Chinese workforce, and also high employee turn-over in China market. The results indicate that local knowledge is the key source of competitive advantage in China market. This is in line with the research results shown from Luo's (2001) study.

Second, China local knowledge sources are very dispersed. Local knowledge holders include people beyond immediate business transactions. Expatriates, local staff and joint venture partners are only part of all local knowledge sources. This finding suggests that past studies that solely focus on learning effects from joint ventures and internal knowledge transfer are limited; local knowledge management strategies should be deployed towards full exploitation of local knowledge sources.

Third, in China, local knowledge is managed through complementary use of knowledge transfer approach and knowledge integration mechanism. The management process employed by European multinationals encompassed three strategic efforts – knowledge penetration, knowledge blending and knowledge integration. Global knowledge penetration strategies were first deployed in order to build up common understanding of the corporation and establish the interface for local knowledge flow as European multinationals realized that a huge knowledge gap between European staff and Chinese



workforce blocked effective communication and cooperation. Knowledge penetration strategy was closely followed by European multinationals' second strategic effort - wide scope knowledge blending process characterized by intensive interactions between local knowledge holders and seekers. At this phase local knowledge was acquired and blended with global knowledge to form the corporate common knowledge base, shared information and collective understanding. However, the effectiveness of this knowledge transmission process was always under question for a number of context-specific reasons. As compensation, some difficult-to-transfer local expertise was integrated into corporate integrated knowledge base through strategic means like consensus decision-making, organized teamwork and taskforces and strategic partnerships. This result demonstrates that: (1) the most valuable knowledge of the firm is a combination of collective tacit knowledge and integrated specialised knowledge, the key argument put forward in Chapter 2; (2) knowledge transfer, which is unduely emphasised in local knowledge management literature, is not always an optimal choice of exploiting China local knowledge; and, to realise the full value of local knowledge, both knowledge transfer approach and knowledge integration mechnism should be employed.

Fourth, a multinational firm's success in China was also determined by its ability to detect and overcome management barriers hindering its effective implementation of local knowledge management initiatives. Much evidence showed that there were certain implementation barriers encountered by European multinationals in the local knowledge management process. Apart from the more visible physical gaps between knowledge holders and seekers in a complex and vast country, there were some invisible hurdles including the difficult-to-close knowledge gaps between European staff and local workforce, the difficult-to-understand cognitive differences, the difficult-to-change implicit communication style and responsibility-shy attitude, and China's emerging

individualism and materialism. Yet, good performance multinationals had a better understanding of these obstacles and accordingly deployed relevant strategies for resolving such issues. The strategies deployed encompassed efforts to establish multi-layers of interfaces linking knowledge seekers and holders, build up common knowledge base from both sides, and adopt 'pull and push' forces to overcome cultural hurdles. Some multinationals better utilised the cognitive quality of local knowledge holders through empowering their staff, decentralizing organizations to reduce sense of hierarchy, and making more responsibilities explicit. Some proactively promoted a corporate culture of trust, team spirit and valuing local knowledge. Some exerted pressure to locals through rules and directions. They also adopted a mutual-benefit business philosophy to tackle emerging individualism and materialism, especially when dealing with external relations. These findings suggest that context-specific and human factors, which were conventionally neglected, do affect the outcome of knowledge management initiatives.

The empirical evidence from this study strongly supports the main arguments posited in the theoretical model. However, it also suggests three lines of variance between the theoretical model and the evidence – the absence of due recognition of the 'pull and push' factors as a management system in the participating multinationals; the added attention paid to bridging knowledge gap in practice; and the lack of recognition of the physical gaps between knowledge holders and seekers despite the practices for alleviating physical gaps. On that basis a revised local knowledge management model was proposed (see Chapter 9) which combined the key arguments in the theoretical model with the best practices investigated in practice to inform both theory and practice.

### **10.3 Contribution of the Study**

This study set itself the task of increasing our knowledge and understanding of the puzzling causes and forces that explain performance differences between foreign investors in China while addressing the main deficiencies revealed from previous studies. This section considers whether this objective has been met. In search for the puzzling causes and forces that explain performance differences between multinational firms in China this study has drawn heavily on theories both in international business and knowledge management. The research results substantially help to redress a number of deficiencies revealed in the literature in both areas.

First of all, this study is among the first to advance, and provide empirical evidence about, the contention that local knowledge is a key source of competitive advantage in China. In contrast to the conventional view that home-based ownership advantage transferred to host markets can offset local knowledge disadvantage faced by foreign investors it suggests that local knowledge has a greater impact upon the multinational firm's business performance than home-based knowledge transferred to China; foreign investors who deploy management strategies for exploiting the full value of local knowledge are thus able to realise more opportunities. It has examined the nature of China local knowledge and testified that it is highly tacit, undiffused and fast-changing; some local knowledge is even non-transferable. It argued that the intrinsic and fast-evolving nature of China local knowledge particularly determined its vital role in the multinational firm's business success. Using empirical evidence the country's unique social and political system, industrial and economic structure, and cultural and cognitive background are shown to pose difficult problems for foreign companies. It demonstrates that a multinational firm

with superior home-based strength can under-perform, or even fail, in host markets because of a lack of exploitation of local expertise.

This advanced understanding of the causes that explain performance differences between multinational firms in China challenged the dominant proposition in the international business strategy literature that the multinational firm's home-based ownership advantage transferred to host markets at low costs can offset its liabilities of foreignness<sup>1</sup> and suggested the need for managing local knowledge better. Evidence from European multinationals shows that home-based technology and management practices transferred to China often turn rigid in the face of local knowledge shortage. In addition, home-based knowledge is not transferred to China at low cost due to the huge knowledge gap between European staff and Chinese workforce, and high employee turnover in China market. This result indicates that local knowledge in a dynamic host market like China has greater impact upon the multinational firm's business performance than home-based knowledge transferred to that market. This is in line with the results of Luo's (2001) study. The empirical evidence has confirmed the strategic importance of developing competitive advantage from local knowledge. This implies that the over-emphasis upon the role of the multinational firm in transferring know-how and expertise gained in its home market to host markets at low cost, and thereby offsetting the unavoidable extra costs of doing business in a foreign country, which has been dominant in international business literature, is unrealistically limited; more research on how to develop competitive advantage from local knowledge should be undertaken. This echoes the call of a number of researchers (e.g. Zaheer, 2002; Petersen and Pedersen, 2002) for future research.

Secondly, this study is also among the first that sheds much light on actual local knowledge management strategies in the Chinese business environment. In search of these

strategies it examined the main local knowledge and knowledge management approaches. In contrast to a conventional approach that solely focuses upon knowledge transfer as strategic means of exploiting local knowledge in host markets, it argues and empirically tests the idea that knowledge transfer is not an optimal approach towards exploiting local knowledge in China. To realise the full value of local knowledge, both knowledge transfer approach and knowledge integration perspective should indeed be employed. The reasoning has been that the conventional knowledge transfer approach towards local knowledge management has a limited effect on enhancing the multinational firm's competitive advantage. Instead of assuming that shared local knowledge leads to local competitive advantage the most valuable local knowledge of the multinational firm was identified. The result suggests that both collective local knowledge and integrated local knowledge constitute the multinational firm's critical knowledge. Local knowledge management initiatives, therefore, should focus not only on the creation of collective knowledge but also on the development of integrated knowledge. Instead of assuming that local knowledge is widely available and transferable like technology and certain management practices transferred to international markets, it has examined the concept and nature of local knowledge in China business context and shown the significant differences between them. The result suggests that China local knowledge is highly tacit, undiffused and fast-evolving, and some local knowledge is non-transferable. A knowledge integration mechanism that leads to the creation of integrated local knowledge and utilises the difficult-to-transfer local knowledge reveals its use and suitability to developing competitive advantage from China local knowledge as compensation to knowledge transfer approach. The evidence further shows that local knowledge has been integrated through collaborative business activities. However, this is not to suggest that knowledge transfer is less useful in China. Rather, these two competing approaches are seen as complementary in practice.

This enhanced understanding of local knowledge and local knowledge management strategy has also provided insights into the knowledge transfer-or-integration contradiction revealed in the knowledge management literature, and shed light on the knowledge integration mechanism previously less illuminated. The results show that knowledge transfer is complementarily used with knowledge integration in practice not only because of its limitations in utilising the type of difficult-to-transfer knowledge but also because it lacks flexibility, in other words, it does not respond to context-specific requirements. Firms that adopt knowledge integration mechanisms not only enjoy flexibility and speed, but also, more important, create more integrated specialised knowledge, a critical part of the firm's core competencies. This finding has provided insights into the central enquiry of Eisenhardt and Santos (2002) who asked 'is intensive knowledge transfer strategically wise?' According to these researchers clarification of this issue is critical to merge the knowledge-based view into the wider field of strategic management. Moreover, this study has identified the firm's most valuable knowledge that underpins core competencies of the firm, which is perceived to be critical to the further development of the knowledge-based view. It is argued that one of the reasons why a knowledge-based view is not a new theory of the firm is that it is unclear what constitutes the firm's most valuable knowledge (Eisenhardt and Santos, 2002). The findings of this study suggest that the firm's core competencies are a combination of collective tacit knowledge and integrated specialised knowledge. This more clearly indicates the link between knowledge management strategy and the firm's performance, which is unclear from previous studies. In addition, the research has also provided insights into management strategy for mitigating local knowledge disadvantage faced by the multinational firm in its host markets, a longstanding issue in international business literature. It shed light on the highly tacit, undiffused and fast-evolving nature of China local knowledge and argued that the complementary use of a knowledge transfer approach and knowledge integration mechanisms responds to these

characteristics. This suggests that conventional knowledge transfer approach towards exploiting local knowledge is limited and should give rise to a more holistic perspective on managing local knowledge that reconciles knowledge transfer and knowledge integration mechanisms.

Thirdly, this study has offered a more comprehensive understanding of how to develop competitive advantage from local knowledge by focusing upon the full exploitation of all local knowledge sources. Instead of solely focusing on learning effects of joint ventures or internal knowledge transfer it identified the scope of local knowledge sources and determined the appropriate unit of analysis for the research. The results suggest that local knowledge sources are dispersed; local knowledge holders include people beyond corporate staff and joint venture partners. Local customers, local administration bodies, local professional organisations, local communities and universities, even local individuals and competitors are all useful sources of local knowledge in China. Therefore, the view that the local knowledge possessed by experienced expatriates and acquired through recruiting local staff is inadequate for the multinational to conduct business in emerging markets was evident in this study (Makino and Delios, 1996; Lee, 1999).

This again suggests that conventional studies on local knowledge management that solely focus on learning effects of joint ventures or internal knowledge transfer are limited. The very dispersed feature of local knowledge sources in China identified in this study suggests that local knowledge management initiatives should involve people far beyond business transactions; to develop competitive advantage in host markets demands management strategies towards full exploitation of local knowledge sources.

Fourthly, in contrast to the conventional neglect of the context specific and human factors in previous studies on knowledge management it identified the country-specific features and historical and cultural traits of local knowledge holders posing management difficulties and explored various strategic means for breaking management hurdles. It argued, and provided empirical evidence in support of the contention that these factors do affect the outcome of the multinational firm's local knowledge management initiatives. The results suggest that there are significant physical and knowledge gaps between local knowledge holders and seekers. Local knowledge holders also showed cognitive differences; preferred implicit communication; displayed a responsibility-shy attitude; and showed an emerging individualism and materialism, previously less apparent in Chinese society. It illustrated how such rooted features and cultural hurdles impeded knowledge flow and integration in multinationals and what measures were taken or should be taken to resolve the problems. More specifically, it elaborated how physical gaps can be bridged by establishing multi-layered knowledge interfaces linking knowledge holders and seekers at different levels and capacities; how knowledge gaps can be significantly closed by developing common knowledge from both sides; and how cultural hurdles can be strategically broken through by adopting 'pull and push' forces that facilitate active participation in local knowledge management activities. These results indicate that the assumption that knowledge holders actively participate in knowledge management activities, made in previous studies, is problematic; the multinational firm's success in China is eventually contingent upon its ability to understand the management barriers and accordingly deploy effective strategies for overcoming those obstacles.

The research, therefore, has provided substantial insights into knowledge management implementation issues and solutions by looking at human factors previously ignored in knowledge and local knowledge management literature. It also suggests that one problem



of many other knowledge management models is that they assume the active participation of knowledge holders in knowledge management activities.

Finally, an important contribution of this study is the employment of a multi-method qualitative approach, as against a theoretical deduction or survey-based quantitative methods widely adopted in previous studies. As noted in Chapter 5, most previous knowledge management models are theoretically deducted frameworks, and much research on international knowledge management has used survey methods. The use of a multi-method qualitative approach allows difficult-to-articulate soft knowledge management issues embedded in human interactions and perspectives to be closely observed, which should itself increase understanding of the 'soft' and difficult-to-measure local knowledge management issues in China, which have not been fully examined elsewhere. A novel feature of this research is the incorporation of both foreign views and local perspectives by interviewing managers from European multinationals in China and managers at different levels of Chinese organisations which interact with foreign companies, as well as the use of direct observation on interaction process involved by both Europeans and Chinese in practice. It promotes the discovery of the most difficult-to-explain and sensitive strategic issues.

Thus this study has redressed a significant methodological problem within the knowledge management literature – a lack of empirical approaches towards examining knowledge management issues that are difficult-to-measure and sometimes difficult-to-articulate. The multi-method qualitative approach adopted in this study allows these 'soft' and difficult-to-capture issues to surface. Therefore, it is a useful supplement to the dominant theoretical and survey methods in knowledge management literature.

In summary, it can be claimed that the lack of understanding of the puzzling causes and forces that explain performance differences between multinational firms in China market is addressed by this empirical study of strategic management of China local knowledge, although it is still incomplete. A number of deficiencies in knowledge management and international business literature are also redressed by this research.

#### **10.4 Implications for Foreign Investors' China Strategy**

This study centres on local knowledge disadvantage faced by foreign investors in China. It has argued that local knowledge is the key source of the multinational firm's competitive advantage in China market. It sheds light on how local knowledge could be best exploited to achieve superior business performance in China's unique business environment. The implications of this study for foreign investors' China strategy are five fold.

First, the research results suggest that superior business performance cannot be achieved by simply transferring home-based knowledge to China market. China is unique in terms of its economic structure and growth rate, political system, long history and diverse culture, size and population. The unique social and political system, industrial and economic structure, and cultural and cognitive background can pose exceptionally difficult problems for many foreign companies seeking to explore China opportunities. The smooth operation of foreign companies is based on in-depth understanding of China specific differences. Foreign investors who understand these significant differences and, accordingly, deploy management strategies for mitigating local knowledge disadvantage are able to reap more opportunities.

Second, it is critical to note that mitigating local knowledge disadvantage is an important challenge for foreign investors. Simply relying on knowledge acquisition and transfer approach or hiring local hands is unlikely to exploit the full value of China local knowledge. China local knowledge is neither fully transferable nor widely available. Rather, it is highly tacit and undiffused. A management focus on the tacit dimension of local knowledge is required to achieve local competitiveness. Reliance solely on knowledge transfer risks the danger of neglecting the most critical proportion of local expertise. The empirical data show that although multinationals all have established filing systems the effective use of these systems is often under question. Reporting documents often contain limited information on what the reporters know as they are mainly used to record what has been going on in general rather than how the business has been handling. Therefore, much critical local knowledge still resides in individuals. Knowledge integration is recommended to utilise this category of local knowledge. Moreover, multinationals need to be aware of the dispersed nature of local knowledge. Expatriates and local staff do not always constitute the main sources of local knowledge. Local business partners such as joint venture partners, customers, distributors, and suppliers, as well as administrative bodies, institutions, competitors, and many other communities, even individuals, are all useful sources of China local knowledge. Going into business alone is unlikely to be an optimal approach. Wide-scope business collaborations and intensive network building with a variety of local organisations and individuals are called for to develop local competitive advantage from local knowledge sources. Furthermore, multinationals should also bear in mind the point that China local knowledge is fast changing. Accordingly managing local knowledge is a continuous process that deserves full commitment at all levels.

Third, multinationals should understand the management barriers incorporated in the management process and create appropriate management conditions to facilitate their local knowledge management initiatives. They need to bear in mind that it is human factors that determine the successful implementation of any corporate strategy (Scullion, 1995). According to Ghoshal and Bartlett (1998), effective implementation of strategies is problematic for many multinational corporations. Specific mechanisms aiming at bridging knowledge gap and breaking cultural hurdles are necessities to facilitate the local knowledge management process. More specifically, multinationals should develop common knowledge base through recruitment and job design, increasing expatriates' local knowledge, local management's international experience, local staff's foreign language skills, and employing common knowledge holders. From the local staff respective, multinational firms should consider cultural and personality fit factors in addition to individual skills during their recruitment and job design. They also need to consider to what degree the persons responsible for corporate business communication actually suit the external local knowledge holder's situation and whether it is necessary to employ external common knowledge holders. It is important to be aware of the limitations of individuals' knowledge base and accordingly organise tailored training programmes, management skills and language training in particular. We further alert multinationals that language inefficiency does affect human beings' behaviour. Local managers are not necessarily good foreign language speakers. Some employees can seem passive when using foreign languages. From the foreign respective, regular training and/or seminar discussion on local topics for expatriates, even staff working in headquarter in Europe, can be organised. External experts in certain local area can be regularly invited to make key contributions. In addition, multinationals also need to establish a suitable 'push and pull' system in which measures such as empowerment; an embedded culture promoting trust, value, and academic atmosphere; mutual beneficial principle; and rules and directions, are adopted to

ensure active participation of local knowledge holders. Experience from these multinationals shows that a trust and learning culture, an intellectual attitude towards business issues, and empowerment are good potential driving forces that make the people involved feel more valued. Factors such as tough tasks, clear job descriptions, and direction all serve as key factors that push local staff to take more responsibilities. Meanwhile, to tackle any implicit communication and responsibility-shy problems multinationals need to communicate the mission of each business meeting, teamwork, and task well in advance and require further documents from specific participants. This is also a useful approach towards utilising local thinking.

Finally, multinationals should always be holistic and innovative when designing company-specific management mechanisms as companies differ from one another in terms of what specific local knowledge is required, whether their local knowledge holders share some specific features hindering the management process, what business context they are in, and whether their corporate resources match the management initiatives. In addition, Blackler's (1995) and Lam's (2000) knowledge frameworks<sup>2</sup> suggests that different types of knowledge dominate in different types of organizations. Knowledge embedded in organizational routines and rules may carry more weight in large organizations whilst individual skills and expertise may predominant in SMEs. This further suggests that the type of knowledge that dominates within the firm should to some extent influence the way in which knowledge is managed in the firm.

Clearly, taking a foothold in China is difficult, therefore, it is not for the uncommitted investor. Local knowledge disadvantage faced by foreign investors greatly impedes their business performance in China. This difficulty is exacerbated because the main features of local knowledge holders form the natural and rooted knowledge management barriers.

Establishing an effective strategic management model of local knowledge and successfully implementing the system together demand more elaborate planning and commitment at all levels through first mapping local knowledge at different level; setting local knowledge management tasks and determining strategic management direction; identifying and analysing local knowledge holders and locating rooted knowledge communication barriers; establishing multi-layered knowledge platforms; creating common knowledge between communicators; followed by more consideration of the strategic means embedded in a tailored 'pull and push' system for resolving those barriers hindering effective local knowledge flow and integration. And finally, the ideal springboard for local knowledge management efforts is a multinational's own rich global resource. The business experience, technical advantage and credibility garnered in the global market will provide greater confidence and competence of the multinational firm in exploiting China local knowledge and exploring China's potential.

## **10.5 Limitations**

Although the research results have provided a more comprehensive understanding of the puzzling causes and forces that explain performance differences between multinational firms in China, and to some degree enriched the existing literature in both international business and knowledge management, the constraints of this study should not be neglected.

First, although the multi-method qualitative approach employed in this study allows greater understanding of the 'soft' knowledge and knowledge management issues, the empirical data collected are potentially liable to biased results. Evidence from this study shows that the data gathered from a small number of cases which were not all randomly selected, a

one-off meeting with a manager of each multinational firm, hours of meetings with managers of each Chinese firm, and seven days' field observation in a single sector, are still limited. Most managers interviewed held that they would have provided more insights into related issues if they could have given more time to research meetings. A study in greater depth would allow greater understanding of the associated issues.

Second, the empirical data show that the manager's view tends to be constrained by his/her business and cultural background. My field experience suggests that some local middle managers with rich local business experience and adequate understanding of local issues provide more concrete perspectives about the implementation of local knowledge management while some expatriate managers with more international business experience and knowledge often see and explain issues at a more strategic level. For example, some top managers focused on what a management system was used in their companies while certain middle managers emphasised how it worked across the company. Therefore, data collected from interviewing both top and middle managers of each multinational firm would allow greater confidence in the research results.

Third, the sample was selected from European companies. As the study aims at increasing knowledge of the causes and force that explain performance differences between *multinational firms* in China, research findings drawn from *European* multinationals may not systematically apply to other foreign companies. Our evidence suggests that the management strategies of the multinational firm are likely to be influenced by company-specific as well as country-specific traditions. Extending our empirical base to include multinational firms from other countries would allow more generalised results.

Finally, the implementation issues presented in this study are by no means exclusive. The building of a complex knowledge management system actually involves more strategic efforts such as the commitment from executives to the large-scale changes required, and draws upon theories beyond the subject of knowledge management, such as organisational behaviour, and human resource management. Broader investigations into the implementation issues and wider employment of selected management theories would certainly deepen our understanding of local knowledge management issues concerned.

## **10.6 Future Research Agenda**

More research is called for in order to advance our understanding of the multinational firm's competitive international business strategy, and to accelerate the development of KBV.

One possible research direction is to extend the empirical base to include multinationals from other countries. The qualitative approach it adopted determines its general limitations, which could be redressed through wider test across a variety of cases. Previous studies show off-shore Chinese and Japanese investors with more overlapping knowledge with local Chinese experienced less difficulties in China than their Western rivals (Luo, 2001). Certain managers from this study held similar views. However comparison studies between these investors are few (Ritchie, 1998). It is important to see whether their richer understanding of local issues enables smoother business operation and whether our strategic management model developed in this study is equally applicable to investors from these and other economies.



A second direction for future research is to further examine the rationale behind knowledge transfer-or-integration decisions made by multinational firms in order to fully exploit local knowledge. The research results indicate that knowledge transfer is not an optimal approach towards exploiting China local knowledge, and it should be complementarily employed with knowledge integration. It highlighted that the difficult-to-transfer nature of some local knowledge and the competitiveness of combinative tacit local knowledge called for knowledge integration approach. However, the empirical data suggest a wider range of variables affect the extent to which local knowledge is acquired and transferred into a corporate knowledge asset. Certain multinational firms also considered: (1) whether a specific category of local knowledge was relevant to knowledge receivers, (2) whether the specific local knowledge required was accessible, (3) How valuable and durable the knowledge required was within certain time-frame, (4) whether the communication barriers to share the required knowledge was surmountable, (5) whether the resources required matched the firm's strengths, (6) whether the specific business context exerted extra pressure for knowledge transfer. In addition, the field study revealed that each multinational firm had its own specific considerations due to individual differences. For example, two multinationals had a history of '*going alone*' when exploring foreign markets. Consequently, following that tradition became their first reason of favouring external knowledge acquisition and transfer over knowledge integration. Multinationals often chose to deploy a balanced strategy based on full evaluation on these factors and beyond. It would be of value to both theory and practice if future research could systematically examine the rationale of how these considerations are assessed to assist the generation of a suitable approach towards exploiting local expertise. Grant (1997) argues that specialised knowledge needs to be integrated if to achieve 'efficiency'. Such an examination would help examine the broader meaning of 'efficiency'. Multinationals may

tend to adopt integration approach towards exploiting local knowledge in any of the following conditions:

- The tacit local knowledge in China cannot be learnt or the learning process is too time-consuming to meet immediate use of the business opportunities emerged.
- The accessibility of the local knowledge required is under question.
- The communication barriers to sharing knowledge appear insurmountable.
- The local knowledge required is of short-term value.
- The local knowledge required is highly specialised.
- The company strength does not include the resources required.
- The business context exerts extra pressure and limitations to a knowledge transfer approach.

However, these need to be further examined in follow-up field observations in real cases.

A third research direction centres on what implementation problems the local knowledge management initiatives might encounter. As mentioned earlier in this chapter, the implementation of local knowledge management strategy is not only hindered by the historical and cultural features of local knowledge holders examined in this study but also impeded by certain other factors as well. For example, the field study revealed that multinationals often face difficulties in quantifying knowledge contributed by knowledge holders, hence, resulting in confusion when designing internal appraisal systems and negotiating external relations. Therefore, de-motivation existed in certain organizations. This problem prevailed in the process of local knowledge management due to its more intrinsic nature compared to technology transferred to China. Many multinational firms

de-valued local expertise, which was one reason for mutual conflict. This further resulted in a lack of commitment from executives and the recognition of the large-scale changes required. If future research could develop an approach not only linking knowledge strategies with business performance but also assessing the implementation process, multinationals would then have better tools to implement local knowledge management strategies.

A fourth research direction is to explain how local knowledge facilitates formation of appropriate local business strategies towards the key issues faced by multinationals. Three areas revealed from the field study deserve more research attention. The first concerns the ownership issue. Multinationals often face a choice between Greenfield WOE and JVs or M&As. Previous surveys show many WOEs perform better than JVs while this study reveals doing this alone is not always an optimal choice in China. What factors determine the WOE-or-JV decision? The second concerns the choice multinationals in China face between globalisation and localisation. Localisation is perceived to be successful and widely adopted but its scope is not yet fully determined. Should they adapt their management methods, products etc? To what extent? To what extent should they localise their production, staff, sourcing, R&D? The third concerns why the China market has such potential yet many multinationals still feel the market is not there. They focus on the top-level minority of local customers with high-end products while locals focus more on the majority with low-end products. Because they cannot achieve economic scale multinational firms have very high production costs. Consequently they find it difficult to reach profitability. Should they wait for China's economic development until locals build up their own strength? Should they go for low-end products? Or should they pull out of China and return later? Multinationals are really facing a hard choice. These difficult issues could be better explained by employing the concept of local knowledge.

A fifth research direction is to examine the impact of national origins of the European companies investigated. The data show that these foreign companies actually deal with the issue of local knowledge in China in different ways. For example, companies from Scandinavian countries show stronger emphasis upon utilising local specialised knowledge through decentralisation and empowerment; German companies employ more rigid ways of managing local knowledge holders such as explicit reporting system; Spanish companies enjoy more flexible ways of working with local workforce; companies from the UK show greater resistance to local ways of doing business. The performance variance between these companies in China may suggest that their national origins can impact upon their abilities to tap local knowledge. It would be interesting to discover whether there is a causal relationship between their national origins and their performance in the China market.

A final research direction concentrates on testing the key findings of this study with multinational firms in other emerging markets to see to what extent the strategic model of this study can be applied elsewhere. A positive test result would further challenge the dominant proposition of international business strategy, and confirm the role of local knowledge management in this regard.

## Notes

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<sup>1</sup> See, for example, Zaheer (1995), Buckley and Casson (1976), Caves (1982), Dunning (1977), Hennart (1982), Hymer (1976), Kogut and Zander (1993).

<sup>2</sup> Blackler (1995) suggests that there are five types of knowledge that can exist in organizations – embrained, embodied, encultured, embedded and encoded knowledge:

Embrained knowledge is knowledge that is dependent on conceptual skills and cognitive abilities. Embodied knowledge is action oriented and is only partly explicit. Encultured knowledge refers to the process of achieving shared understanding, through the development of an organizational culture. Embedded knowledge is knowledge that resides in systematic routines. It can be analysed by considering the relationships between technologies, roles, procedures and emergent routines. Finally, encoded knowledge is information conveyed by signs and symbols either in manual or electronically transmitted form. (pp. 1024 -5)

Lam (2000) proposes four types of knowledge existing in organizations – embrained, embodied, encoded, and embedded knowledge.

These two frameworks were adapted from Collins' (1993) knowledge structure.

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