The International Expansion of Mainland Chinese Businesses in the Context of Culture – Illustrated by the Example of the Market Entrance of Mainland Chinese Businesses to the German Market

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Preface

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Abbreviations and Acronyms

APFC	Asia Pacific Foundation of Canada
AMA	American Marketing Association
CCPIT	China Council for the Promotion of International Trade
EIJV	Equity International Joint Venture
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
GDP	Gross Domestic Product
HKTNC	Hong Kong Transnational Corporation
I	Internalization (specific advantages)
IA	International Acquisitions
IDP	Investment Development Path
IDV	Individualism Index
IfM	Institut für Mittelstandsforschung Bonn
IGI	International Greenfield Investment
IHK	Industrie- und Handelskammer
IJV	International Joint Venture
IMF	International Monetary Fund
JV	Joint Venture
KfW	Kreditanstalt für Wiederaufbau
KG	Kommanditgesellschaft
L	Location (specific advantages)
LSE	Large Size Enterprise
LTO	Long-Term Orientation
M&A	Mergers & Acquisitions
MAS	Masculinity Index
MNC	Multinational Company
MNE	Multinational Enterprises
MOFCOM	Ministry of Commerce of the People's Republic of China
NBS	National Bureau of Statistics

NOI	Net Outward Investment
O	Ownership (specific advantages)
ODI	Outward Direct Investment
OECD	Organisation for Economic Co-operation and Development
OHG	Offene Handelsgesellschaft
PDI	Power Distance Index
PRC	People’s Republic of China
R&D	Research and Development
RBV	Resource-based View (of the Firm)
SAIC	Shanghai Automotive Industry Corporation
SME	Small- and Medium-sized Enterprises
SOE	State-owned Enterprises
TCA	Transaction Cost Analysis
TCE	Transaction Cost Economics
UAI	Uncertainty Avoidance Index
UNCTAD	United Nations Conference on Trade and Development
WFOE	Wholly Foreign-owned Enterprise
WOS	Wholly-owned Subsidiary

Introduction

> *One of the great engines of globalization is the expansion of companies across borders through mergers, acquisitions, joint venture and subsidiaries. You might have expected these link-ups to result in a sort of standardized corporate culture, an all-encompassing lingua franca of the global worker. But clashes of culture are persisting and even multiplying* (Altman).

For the past years, the world has looked on with astonishment as China became the fastest growing economy worldwide, the darling of multinational companies and the most promising market on earth. An ever expanding economy with a gross domestic growth rate of 9.6 percent for the last 25 years (Anonymous, China GDP Grows at 9.6% in Last 25 Years) and over 1 billion potential consumers represents one of the most lucrative markets for companies from all kinds of industries. Furthermore, significantly lower labor costs in China compared to those in Western countries attracted additional billions of US Dollars of manufacturing investment. Current management literature has tried to keep pace with the rapid economic development of China and produced a slew of research and papers on the development of China, the market entrance of Western companies onto the Chinese market and the difficulties of doing business in China due to legal restrictions, organizational problems and cultural differences and challenges. But so far, little attention has been paid to the development of China and its enterprises away from solely focusing on manufacturing to the international development, production and sale of innovative and qualitative products and services. This is because, at the moment, Mainland Chinese companies have neither mastered these changes convincingly nor do they play a significant role in global business. However, recent developments have shown that Mainland Chinese companies are working hard to close the gap to Western companies in regard to, for example, technology, marketing and management skills. Mainland Chinese companies are trying to catch up with Western multinational companies and are preparing to leap on the global stage by expanding internationally, engaging in the acquisition or merging with other companies, participating in joint ventures and taking on the challenges of being globally active. Until to the end of July, 2006, Mainland Chinese companies have been involved in $62 billion-worth of merging and acquisitions deals of which $9.3 billion were spent on overseas acquisitions by Mainland Chinese businesses as compared to just $2.3 billion in 2005 (Anonymous, "Playing at Home" 61-62). This dissertation argues and illustrates that the internationalization of Mainland Chinese businesses is accelerating. One can be certain that the economic power of China will increase in the coming years, and that Mainland Chinese businesses will play an ever increasing role in international business and their respective host countries. However, while current literature has been discussing the challenges of different cultures for the market entrance of foreign companies in China at length, little attention has been paid to whether and how Chinese companies will deal with cultural differences and subsequent challenges and problems in international business.

Therefore, this dissertation tries to shed light on the internationalization of Mainland Chinese companies, their choice of market entry modes and the significance of culture as a variable in market entry mode decision processes and subsequent business activities on a foreign market as demonstrated by the example of the German market. Chapter 1 of the dissertation is concerned with explaining the theoretical foundation of current research and literature perspective on the internationalization of businesses and the choice of market entry mode. Chapter 2 defines culture and takes a closer look at specific characteristics of Chinese culture. Chapter 3 defines communication and examines specific characteristics of Chinese and German communication styles. Chapter 4 illustrates the internationalization of Overseas Chinese businesses and discusses whether any conclusions or lessons can be drawn for the international expansion of Mainland Chinese businesses.

Chapter 5 describes and analyzes the expansion of Mainland Chinese businesses in the past years while Chapter 6 describes the German market and the investment of Mainland Chinese companies on the German market. At the end of the chapter, hypotheses are proposed which are then discussed in Chapter 7. Additionally, Chapter 7 analyzes the results of the author’s own study and compares them with other available studies current literature. Finally, Chapter 8 gives an outlook on the future development international expansion of Mainland Chinese companies, the significance of China’s growing global presence and what it means for other nations, especially for Germany.

1 Internationalization of the Firm

1.1 Theoretical Approaches to the Internationalization of the Firm

Businesses are expanding internationally in the search for competitive advantages, following their customers and obtaining scale (Finkelstein 1). According to Calof and Beamish, "Internationalization is the process of adapting exchange transaction modality to international markets." (115-116) Calof and Beamish's definition encompasses multistep increases in foreign market commitment in the process of the firm's internationalization (115-116). In the context of the market entrance of a firm, two questions have to be answered. The first is concerned with the motivation of the firm to expand internationally (Madhok 41) which is analyzed in Chapter 1.1. The second question is concerned with the means by which the firm chooses to enter the foreign market (Madhok 41) and is analyzed in the Chapter 1.2 to 1.4.

Hence, the dissertation evaluates and analyzes the different approaches to the motivations and steps in the internationalization of firms. In general, when trying to explain the process of the internationalization of firms, three schools of thought are predominant. The first is concerned with the Uppsala model (internationalization theory), the second refers to the network model of internationalization and the third is the eclectic paradigm according to Dunning.

1.1.1 The Uppsala Internationalization Model

The Uppsala model was developed in the mid 1970s at the Swedish University of Uppsala when researchers focused on the internationalization of Swedish manufacturers and is also known as the internationalization model. The researchers developed a model of the firm's choice of market and form of entry in order to explain the expansion of Swedish companies abroad. The researchers conceptualized a model which distinguishes between four different stages of entering an international market and accompanying internationalization modes of the company. Each expansion stage is accompanied by a higher resource/capital commitment to the internationalization of the firm and the foreign market (Hollensen 47-48):

Stage 1: No regular export activities (sporadic export)

Stage 2: Export via independent representatives (export modes)

Stage 3: Establishment of a foreign sales subsidiary

Stage 4: Foreign product/manufacturing units

Thus, the Uppsala model describes the incremental approach firms take to internationalization. The more experience is gained in the internationalization of the firm by moving from stage 1 to stage 4, the more resources are committed to a market and the higher is the resulting internationalization of the firm. Thus, the internationalization of the firm can be outlined as a subsequence of phases with increasing market commitment as illustrated in Figure 1.

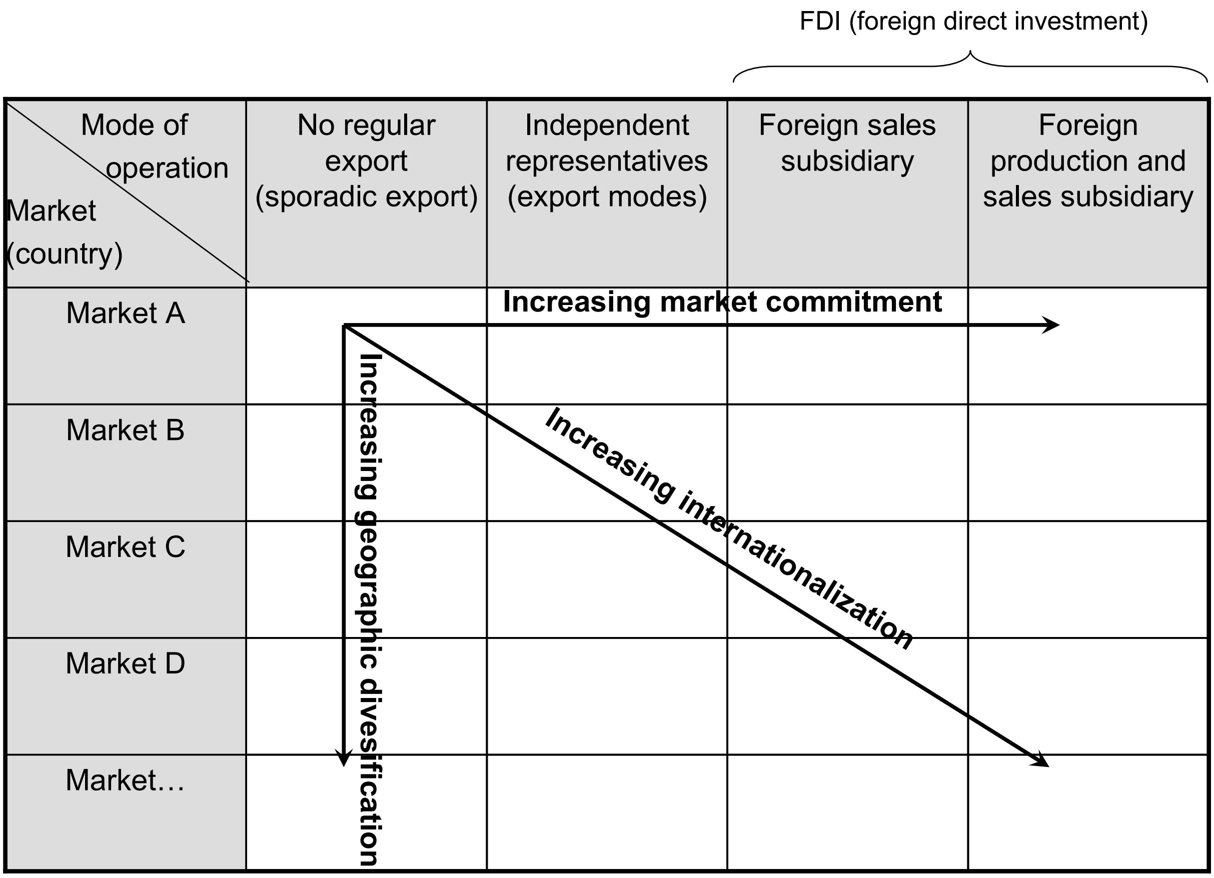

Figure 1: Internationalization of the Firm: An Incremental Approach, Svend Hollensen, <u>Global Marketing: A Market-Responsive Approach</u>, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 48.

Figure 1 shows that a further commitment of resources to a market takes place in incremental steps. The internationalization of the firm develops from sporadic exports to the actual commitment of FDI (foreign direct investment)[1] to a market/country. At the same time the firms diversifies into different geographical markets. The process of geographical diversification and cumulative market commitment leads to the accretion in the internationalization of the firm (Hollensen 49). Eventually, firms tend to enter new markets with successively greater psychic distance [sic]. Johanson defines the psychic distance [sic] as “the sum of factors preventing the flow of information from and to the market. These include differences in language, education, business practices, culture and industrial development.” (Hansson, Sundell and Öhman 10) Thus, the less knowledge and understanding a firm has of a market, the greater is the psychic distance [sic]. Consequently, the more knowledge a firm acquires of a market, the less the psychic distance [sic].

Johanson and Vahlne make a distinction between state and change aspects of internationalization. While the state aspects of internationalization are market commitment and market knowledge, the change aspects are current business activities and commitment decisions. State aspects and change aspects influence and affect each other since market commitment and market knowledge affect commitment decisions and business activities, and vice versa (Johanson and Vahlne 11). The results are causal cycles. The model by Johanson and Vahlne described in Figure 2, therefore, helps to explain why companies entering markets tend to go through a process of 4 stages as described in Figure 1. Because of the interdependence between state and change aspects, the firm enters markets in

[1] Definitions:
1. Foreign direct investment (FDI) is the movement of capital across national frontiers in a manner that grants the investor control over the acquired asset. Thus it is distinct from portfolio investment which may cross borders, but does not offer such control. Firms which source FDI are known as ‘multinational enterprises’ (MNEs) (Wikipedia, Foreign Direct Investment).
2. [Foreign] Direct investment is a category of international investment made by a resident entity in one economy (direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (direct investment enterprise). ”Lasting interest” implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated (OECD, Glossary of Foreign Direct Investment Terms and Definitions 2).

successive steps as postulated by the internationalization model of Johanson and Vahlne.

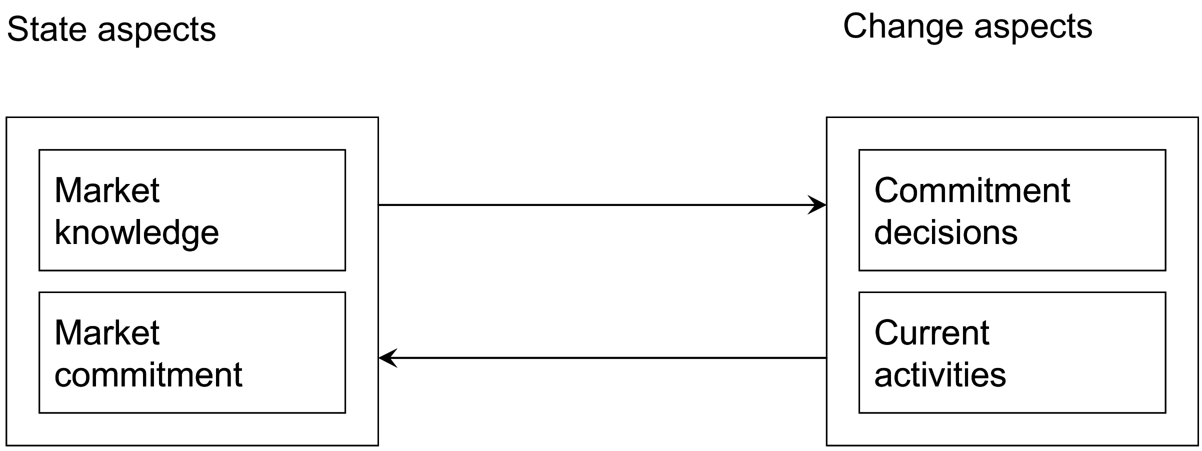

Figure 2: The Internationalisation Process of the Firm, Jan Johanson, and Jan-Erik Vahlne, "The Mechanism of Internationalism," International Marketing Review: Emerald, 1990, 11, Vol. 7, 12.

The market commitment of a firm consists of the amount of resources the firm commits to the market and the degree of commitment to the market. The resources can be the investment in the market (personnel, organization, marketing) while the commitment is the costs attached to finding a different market and transferring the resources there. In other words, the more difficult it is to find alternative uses for the resources and the more specialized these resources are to a market, the higher the commitment is (Hansson, Sundell and Öhman 12).

Johanson and Vahlne differentiate between objective knowledge and experiential knowledge (12). While objective knowledge can be taught and transferred from one person to another, experiential knowledge can only be acquired through personal experience. Thus, experiential knowledge acquired in a market generates business opportunities and is, consequently, a driving force in the internationalization process of the firm as it is moving from one stage (as described above) to another one and, thus, commits more resources to the specific market. But, as the experience is gained in one country, the acquired experience is country-specific and, therefore, is not easily transferable to other countries (Johanson and Vahlne 12). Thus, the internationalization process of the firm takes place in incremental steps in each country.

However, there are three exceptions to the assumption that further market commitment takes place in small steps (Johanson and Vahlne 12):

(1) Firms with large resources are willingly to take larger internationalization steps as the consequences of further committing resources are small

(2) Stable and homogenous market conditions allow market knowledge to be developed or acquired in other ways than through experience

(3) Firms with extensive knowledge about similar markets and market conditions might be able to deduce the experience to apply it to the specific market.

One characteristic of the internationalization model is that the firm is viewed as “a loosely coupled system in which different actors in the firm have different interests and ideas concerning the development of the firm.” (Johanson and Vahlne 12) Hence, the actors who are actively engaged in the foreign market might see the problems and opportunities in the market and act on their own. Johanson and Vahlne conclude, that “the internationalization process, once it has started, will tend to proceed regardless of whether strategic decisions in that direction are made or not.” (12)

In conclusion, the internationalization process model of Johanson and Vahlne can explain two patterns in the internationalization process of the firm. First, it offers an assertion of how firms engage in a foreign market and walk through the different stages of committing more and more resources to the firm’s foreign activities. Thus, the evolving of the specific country/market activities in a chain with subsequent increase of resources to the market can be illustrated. Second, the model explains how firms increasingly enter markets with bigger psychic distance [sic]. Psychic distance [sic], as has been defined above, refers to the difference/distance between the foreign market and the home market in terms of difference in language, culture and business practices (Johanson and Vahlne 13).

The internationalization model of Johanson and Vahlne has been criticized for the deterministic nature of the model. Reid asserts that the model is actually rigid and inflexible because according to the internationalization school, a firm can only enter a market in a sequence of market entry modes accelerating market commitment. Reid, Turnbull and Rosson assert that the firm still has the option of making a strategic choice as to modes of entry and expansion. Reid states that market conditions influence the process, and that the transaction cost model is superior in explaining diversity and variations in the internationalization behavior of firms. Also, according to Forsgre, the model limits the focus on the early stages of the internationalization of the firm. On the contrary, multinational firms with operations in several countries can respond to real market conditions and access previous experience and, therefore, do not have to cope with uncertainties and unknowns common to firms in the early internationalization stages (Johanson and Vahlne 14).

Further criticism is directed at the lack of considering the interdependences between different country markets. Also, due to the globalization of the international markets and activities of the firms, Nordström states, “the world has become a much more homogeneous and that consequently psychic distance [sic] has decreased.” (Johanson and Vahlne 15) Therefore, the value of psychic distance [sic] as a parameter of the internationalization process model would have decreased.

Mattsson argues that this “model leaves us without means to analyze a situation where the firm already is highly internationalized.” (Merger Waves) As a result, the subsequent question of international integration of activities becomes critical for the firm’s internationalization process. Further international integration takes place via mergers & acquisitions (M&A). Greenfield investments and internal growth are not the preferred mode of internationalization anymore. Finally, the internationalized firm can also undergo substantial internationalization processes in which situations, environments and actors change. Consequently, an “embedded” approach as discussed by Johanson and Mattsson (“Internationalization in Industrial Systems”) and Mattsson (“Dynamics of Overlapping Networks”) is needed (Mattsson Merger Waves).

Hence, the criticism directed at the internationalization process model is mainly aimed at the lack of relevance for already internationalized firms due to the rigidness and inflexibility of the stage-based subsequent market entrance model. The network model building upon the Uppsala school, described below, offers an alternative theoretical framework for the internationalization of the firm.

1.1.2 The Network Model

According to Johanson and Mattsson, “in industrial systems, firms are engaged in production, distribution, and use of goods and services. We describe such systems as networks of relationships among firms. There is a division of work in a network that means that firms are dependent on each other.” ("Interorganizational Relations“ 34) Each firm has relationships with customers, distributors, suppliers, etc. in this network and, through indirect relations, also with other firms which represent the supplier’s supplier, customer or competitor. Networks are stable as well as changing since transactions tend to take place in the framework of established relationships, and new relationships are established by chance or old relationships are disrupted (Johanson and Mattsson, "Interorganizational Relations“ 35). Thus, each firm is a member of a network in which transactions are conducted within the framework of established relationship and the firm has indirect access to other firm’s networks via the original firm’s network.

Complementarity of resources is important in networks since the firms depend on each other in the network and interfirm dependence is created. Through the exchange of goods and services with other members of the firm’s network, the company is “operating in the network in which it is engaged.” (Johanson and Mattsson, "Interorganizational Relations“ 36) One of the basic assumptions of the network model is that a firm is dependent on the external resources controlled by other firms and gets access to those external resources through the firm’s network position. The position in the network determines the access of the firm to other firm’s internal assets. The access becomes a market asset to the firm and allows the firm to generate revenue (Johanson and Mattsson, "Interorganizational Relations“ 36).

Johanson and Vahlne assert that “foreign market or network entry of the firm may very well be the result of interaction initiatives taken by other firms which are insiders in the network in the specific country.” (19) Because a network might be extended far beyond country borders, the “international extension of these networks has strong implication for the internationalization of the firm.” (Johanson and Vahlne 19) Thus, in the framework of the network model, internationalization takes place due to the place of a firm in the firm’s network and the networks of other firms which are participants of the firm's original network. These networks may extend beyond any national borders and, thus, accelerate the internationalization of the firm.

Coviello and Martin found support for the proposition by Johanson and Vahlne in a study of small and medium-sized enterprises (SMEs) by determining that the major demand for internationalization of a firm stemmed from the networks of relationships. The formal and informal, technical and social networks the firm possesses and is able to access drove the internationalization of the SMEs. The firms in the study did not undertake expansion in order to, for example, reap benefits of economies of scale. On the contrary, "the choice of initial and subsequent market(s) was driven mainly by the location of clients and network contacts." (Coviello and Martin 50,53) Furthermore, firms are more or less forced to follow their clients and competitors abroad (Finkelstein 1). Thus, the internationalization and subsequent market entry in a foreign country is due to established contacts in the framework of the firm's network and not traceable to managerial decisions about, for example, economies of scale or attractiveness of a certain market.

The network model helps to explain why firms do not follow-through the process-model as posited by the internationalization school (Uppsala model) as described above in this chapter. Firms increase the firm's internationalization capabilities by hiring people with knowledge of foreign market and by maintaining relationships with other companies that are internationally active. By using the networks and capabilities of the employees, the firm is able to leap-frog stages of the internationalization process. The network model, thus, expands and partly rejects the internationalization model as postulated by Johanson and Vahlne (Coviello and Martin 58). Coviello and Martin conclude that "networks of formal and informal relationships are a major influence on internationalization" and "[…]the choice of entry mode also is strongly influenced by network relationships in the form of client preferences and often, the formal client-service provider exchange relationship emerges from the firms' informal and formal networks." (Coviello and Martin 59)

The findings by Coviello and Martin are supported by Jones who found that in her study the firms usually acquired business from outside links. The inward contacts, as Jones states, could come at random intervals with great varying breaks between them, but ultimately lead to the establishment of links between the home firm and the foreign firm; eventually accelerating the internationalization of the home firm. Jones argues that the establishment of inward links with overseas firms is quite common and that the firm has to identify the links which will most likely contribute to the international expansion of the firm. The network links identified to contribute the most to the internationalization of the firm are accelerating the internationalization of the firm by offering business in foreign countries, on the international or global level. Networking is, thus, one of the most important tools and driving forces in the move of firms towards internationalization (Jones 27-28,37).

Bell also criticizes the linear internationalization model by Johanson and Vahlne as being inappropriate for SMEs and the dynamic, complex and frequently non-linear behavior regularly found among SMEs (Bell 72). The network approach to internationalization puts the focus on exchanging transactions and gaining mutual knowledge and trust and the resulting commitment between the international actors (Bell 62). A network model is, therefore, a more appropriate approach to the internationalization of SMEs.

In conclusion, "international expansion is a process by which network positions are established and changed" and, thus, the internationalization process of the firm towards a multinational company[2] (MNC) enables the firm "to effectively 'externalize' some of its activities without losing control of its crucial intangible assets." (Coviello and Martin 47) In effect, the network allows the company to choose from the whole range of possible entry modes without having to step through the different phases of the internationalization process first, as asserted by the Uppsala school. The mutual reliance and trust of the network's members towards other network members ensures stability in the network and minimizes possible risks for members when entering foreign markets by offering network members' resources to the entering network member. The network models, therefore, offers an explanation why some firms do not follow the stage-model of the Uppsala school and accommodates the criticism of the internationalization model voiced by Reid et al. That is why "the concept of a network, both as a metaphor and in terms of the tools and techniques of analysis it provides, reflects the nature and complexity of the multinational

[2] Definition of a MNC: First, the firm must be significantly involved in international business having permanent operations in two or more countries; and second, the capacity for central control of foreign operations must exist (Fayerweather 2-3). The terms multinational corporation (MNC) or multinational enterprise (MNE) or transnational corporation (TNC) or multinational organization (MNO) are used interchangeably in this regard (Wikipedia, Multinational Corporation).

organization and can provide a useful lens through which to examine this entity." (Ghoshal and Bartlett 79)

1.1.3 The Eclectic Paradigm

The eclectic paradigm was first developed by Dunning in 1976. The eclectic paradigm strives to offer a holistic framework for the identification and evaluation of the significance of the initial foreign production by firms and the growth of such productions. The idea of the eclectic paradigm is to offer an explanation of transnational activities by drawing upon several strands of economic theory and to show that "foreign direct investment is just one of a number of possible channels of international economic involvement, each of which is determined by a number of common factors." (Dunning 1) The eclectic paradigm states that the extent, form and pattern of international production are determined by a set of three advantages as discerned by the firm. In other words, the firm's decision to expand and produce internationally is dependent on a set of three advantages available to the firm. Dunning differentiates between ownership-specific advantages, internationalization advantages and locational advantages (Dunning 2).

Ownership-specific advantages in regard to internationalization can be broken down into three different kinds of advantages. First, advantages which derive from the exclusive possession or access to valuable assets. Second, those deriving from being a branch plant of a multinational firm instead of being a totally new-set up business. And third, from the geographical diversification, i.e. from being a multinational firm itself. Dunning elaborates the ownership-specific advantages further to distinguish between asset and transaction advantages of multinational enterprises. While advantages arising from proprietary access to assets refer to structural market distortions, transactional advantages stem from the skill of the enterprise to lessen transactional costs by a common governance of the assets from different countries. The advantages stem out of structural on the one hand, and transactional market imperfections, on the other hand. In conclusion, for a firm to compete internationally or produce in another country, the firm "must possess certain advantages specific to the nature and/or nationality of their ownership." (Dunning 2)

The second paradigm states that firms will produce internationally when they can transfer the firm's ownership-specific advantages across national borders within their organization as opposed to selling it to the foreign market or license the ownership-specific advantages to a foreign-based firm. In other words, if the firm can use the advantages inherit to the firm in the home-country, transfer it to another country and generate a higher return on its investment compared to selling its products to the host market (export) or a local enterprise to resell it (license), the firm will choose to internationalize production. The decision rests also on the perceived costs of transactional failures, such as protection of property rights and quality of products. The higher the perceived costs of transactional failure, the more probable the venturing firm is going to exploit its competitive advantages by internalizing the production versus a contractual arrangement with a foreign-based enterprise. Thus, according to the eclectic paradigm, the firm will favor producing internationally as opposed to entering contractual arrangements when it is more profitable to internalize these advantages in international production than to sell or license the rights to these advantages to a foreign enterprise (Dunning 3).

Locational advantages are the third strand of the eclectic paradigm. A firm will choose to produce internationally when the firm can combine its ownership-specific advantages with the immobile factors available in the host country. The decision to produce internationally and take advantage of resources available in the host country is, thus, not independent of the ownership-specific advantages, structural or transactional, a firm enjoys. It must be to the advantage of the firm to move the production (at least partially) to the host country to take advantage of the available resources. Furthermore, transacting business internationally can even be seen as enhancing the ownership-specific advantages of the firm since not all firms can generate, transfer and sustain their advantages internationally (Dunning 4).

In conclusion, the eclectic paradigm of Dunning offers a possible explanation of the internationalization of firms. The three parameters of the eclectic paradigm, ownership-specific, locational and internationalization advantages can be used to determine the merits of international production for a firm. The interdependency of ownership-specific advantages, whether the advantages can be traced to structural or transactional market imperfections, with international and locational advances underlines the holistic approach of the eclectic paradigm. Dunning offers an explanation of the internationalization of firms by stating that "a combination of the resource requirements of particular economic activities, their geographical disposition, and the transfer costs of their output, helps to explain some of the operations of [multinational enterprises] MNEs." (Dunning 6)

A comparison of the internationalization model of the Uppsala school and the eclectic paradigm shows that the approach of the two models is different. The eclectic paradigm postulates the international production in countries where the firm can put it advantages to use. The internationalization model predicts the entering of neighboring countries due to psychic distance [sic], and the future involvement extends to more distant countries. The internationalization models, thus, postulates a market entry not based on the utilizing of advantages, but on physical and psychic distance [sic] (Johanson and Vahlne 17).

On the one hand, the internationalization model uses one variable for the explanation of the international expansion of the firm, i.e. the firm's knowledge. The eclectic paradigm, on the other hand, "has the objective of giving a full-fledged explanation of the firm's foreign operation, thereby relying on all relevant explanatory factors." (Johanson and Vahlne 17) As has been discussed above, the internationalization models focuses on an incremental approach to internationalization and, thus, explains best the actions of the firm when the present internationalization of the firm is low. The eclectic paradigm has is of high value for the analysis of firms that already gained experience in international markets (Johanson and Vahlne 17).

The main difference between the two models lies with the concept of transaction costs. While the internationalization model recognizes the change of transaction costs over time (due to experience gained) through the incremental approach to internationalization, the eclectic paradigm assumes that "the decision makers involved are rational and well-informed right from the start of the internationalization process." (Johanson and Vahlne 18) In conclusion, the internationalization model is, thus, more dynamic in nature, while the eclectic paradigm is basically static (Johanson and Vahlne 18).

1.1.4 Dimensions of Internationalization

Based on the different models for the choice of internationalization, i.e. the eclectic paradigm, the Uppsala model, and the network model, the firm has to consider the dimensions of internationalization and their effect on the firm's organizational capacity. The organization of the firm has to adjust to the internationalization of its capacity and capabilities. Figure 3 describes the different dimensions of internationalization.

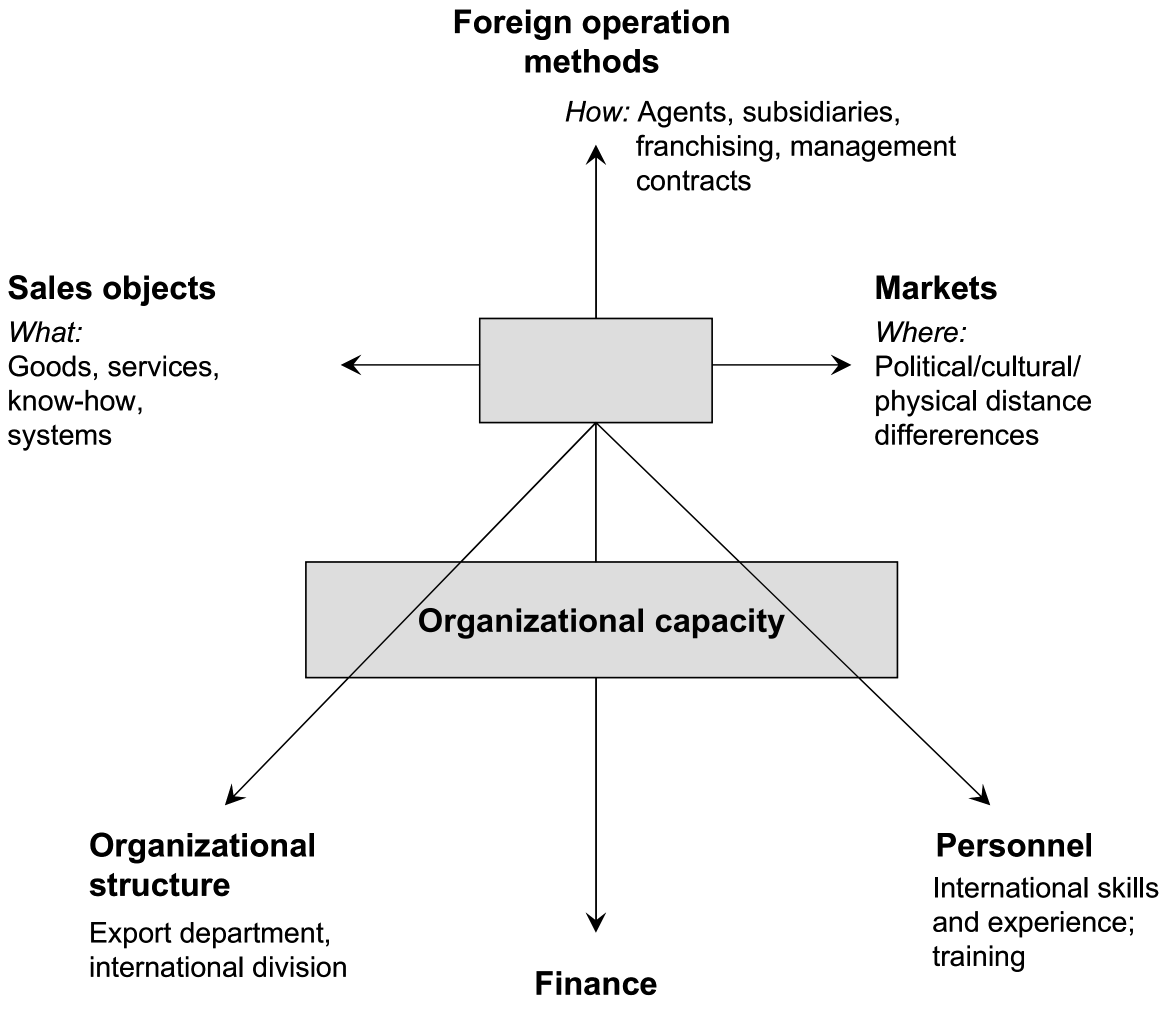

Figure 3: Dimensions of Internationalization, Svend Hollensen, <u>Global Marketing: A Market-Responsive Approach</u>, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 50.

Figure 3 illustrates that, for example, the personnel department has to add international skills and experience to its human resources, i.e. train its employees in doing business internationally. The organizational structure should possibly include an export department which is also determined by the foreign operation method, for example, subsidiaries or franchising. The market has to be analyzed and the sales objectives and, thus, the goods and services to be sold as well as the price for the product in that market, have to be determined (Hollensen 50). Consequently, the different dimensions of internalization affect the organization of the firm and lead to adjustment of organizational capabilities and capacities. In conclusion, the internationalization of the firm according to the Uppsala-model takes place in incremental steps while the network model emphasizes the role of relationships in the internationalization of the firm. The eclectic paradigm explains internationalization with the propensity of firms to use the firm’s unique set of advantages. Regardless which internationalization theory is being considered, the different dimensions of internationalization of the firm affect the organizational structure and the choice of market entry mode. The firm has to decide on the right market entrance form in order to successfully compete in international markets. Without choosing the right market entrance form, the company is not able to successfully compete in foreign markets and, therefore, the wrong choice might impede the expansion of the firm for years to come.

1.2 An Introduction to the Choice of Market Entry Mode

The globalization of businesses has led to an increase in the entrance of foreign competitors into the home market of businesses. In fact, foreign companies now account for a major part of the gross domestic product in all major industrialized countries (Bennett and Blythe 9). While foreign companies might enter the home market of a firm, the internet and the internationalization of services, such as advertising and market research services, have at the same time made it easier for a firm to respond by also conducting business internationally and, thus, for the firm to “visit and examine foreign markets, to select the best locations for operations and thereafter to control international activities.” (Bennett and Blythe 9) According to Bennet and Blythe, there a several reasons why a business would venture abroad and enter foreign markets (8-9):

- Economies of scale and scope[3]
- Existence of lucrative markets abroad
- Saturated markets in the home country
- Response to incoming competitive activity
- New product development can be extremely costly, thus, an international perspective on developing and selling products has to be adopted
- Gain high turnover from international sales
- Less competition in foreign market
- Risk dispersion by investing in more than one country
- More attractive consumer groups in foreign market than in home market

In general, foreign markets offer a business the opportunity to maximize profits or minimize/spread costs and risk by abandoning the sole dependence on the home market and take advantage of the growth of foreign markets and, therefore, strengthen the business' competitiveness. Furthermore, companies may go abroad "to match the international market entry of a domestic rival (the 'bandwagon effect')." (Root 1) Due to the increasing internationalization of firms and, thus, the globalization of whole industries, businesses nowadays have to plan for growth and survival in a world of global competition. Therefore, Root states, "to prosper in the future, every firm will have to become competitive in global terms, whether it remains at home or goes abroad."(2)

The foreign market entry strategy compromises of 5 decisions the company has to make. The decisions required are (Root 3):

(1) Choice of target product/market
(2) Objectives and goals in the target market
(3) Choice of entry mode
(4) Marketing plan
(5) Control system

The company has to arrive at a decision in regard to each of the above mentioned points in order to have a comprehensive and elaborately planned international market entry strategy. Depending on the chosen product and the

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[3] Economies of scale are reductions in unit production costs resulting from large-scale operations. Economies of scope are unit cost reductions resulting from a firm undertaking a wide range of activities, and hence being able to provide common services and inputs useful for each activity (Bennet and Blythe 12).

objectives of the company in the target market, the company will choose a specific entry mode. The company will develop a suitable marketing plan and install a proper control system to evaluate the success in the foreign market and oversee the company's operation (Root 3). There are numerous aspects to be considered in regard to the international market entry strategy, but this dissertation chooses to focus on the choice of market entry mode for a foreign market as the single most important item of the international market entry strategy because of the disastrous consequences misconceived market entrances can have on the future international expansion of firms. If a firm does not plan and execute the market entrance in the international markets properly, the firm will suffer from competitive disadvantages resulting from the choice of the wrong market entry mode, not be able to employ firm specific advantages and squander opportunities offered by doing business in international markets.

Root originally divides all market entry modes into two different categories. The first category is export while the second category refers to the transfer of resources in technology, capital and human skills to the foreign market. Resources available in the foreign market might be partially combined with firm's resources to manufacture products for sale in the foreign markets. The transfer entry mode is further differentiated into contractual and investment entry modes. Root classifies the entry modes as illustrated in Table 1:

Export Entry Modes	Contractual Entry Modes	Investment Entry Modes
Indirect Direct agent/distributor Direct branch/subsidiary Other	Licensing Franchising Technical Agreement Service Contracts Management Contracts Construction/turnkey projects Contract manufacture Technical agreements Service agreements Co-production agreements Other	Sole venture: new establishment Sole venture: acquisition Joint Venture: new establishment/acquisition Other

Table 1: Classification of Entry Modes, compiled from Franklin R. Root, Entry Strategies for International Markets, Massachusetts: Lexington Books, 1987, 6.

The transfer entry mode (contractual entry modes and investment entry modes) can consist of entry modes such as service contracts and contract manufacture with little or zero investment costs which, therefore, can be classified as contractual entry mode. Additionally, the transfer market entry can also take place through an acquisition or the new establishment of a venture. An acquisition or a new establishment requires the company to invest substantial sums into the foreign market and, hence, is classified as investment entry mode[4]. The choice of entry mode is a complex decision which is influenced by a number of often conflicting factors and also leads to a number of trade-offs between different options (Root 6-9).

[4] A comprehensive overview of the different market entry mode options is offered in chapter 1.4

1.2.1 Factors Influencing the Choice of Market Entry Mode

Each market entry strategy is influenced by internal and external factors. External factors include (Root 8-12; Bennett and Blythe 59, 195):

- characteristics of the foreign market, for example, size of the market; local restrictions on setting up foreign-owned businesses
- target country environmental factors, for example, geographic and cultural distance
- target country production factors, for example, quality and amount of raw materials available and
- home country characteristics, for example, the competitiveness of the business in the local market.

Internal factors, such as

- the chosen product and its specifics
- the level of financial commitment and resources
- intangible resources, for example, company's experience and expertise in operating and selling abroad.
- Internal and external factors play a significant and interdependent role when deciding which entry strategy to choose.

The environmental factors of the target country influence both the target country production factors as well as the target country market factors. These three factors together with the home country factors are external factors while product characteristics and resource/commitment factors of the company are internal factors. The basic model of factors influencing the choice of entry modes by Root are illustrated in Figure 4.

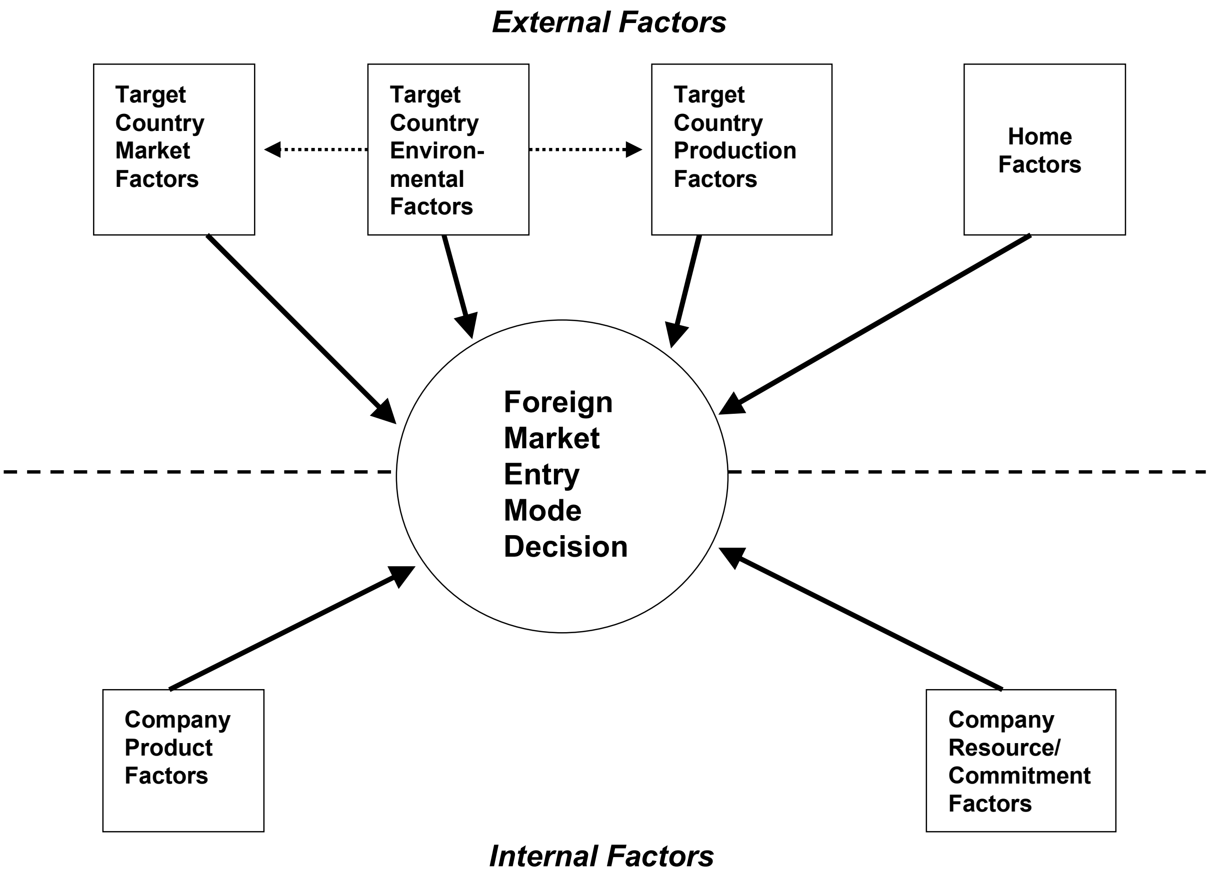

Figure 4: Factors in the Entry Mode Decision, Franklin R. Root, Entry Strategies for International Markets, Massachusetts: Lexington Books, 1987, 9.

The basic model by Root is expanded by Hollensen who adds another two factors that influence the entry mode decision. The factors are desired mode characteristics and transaction-specific behavior (Hollensen 236). Figure 5 displays the factors affecting the choice of foreign market entry mode taking into account the internal and external factors, as well as the desired mode characteristics and the transaction-specific factors.

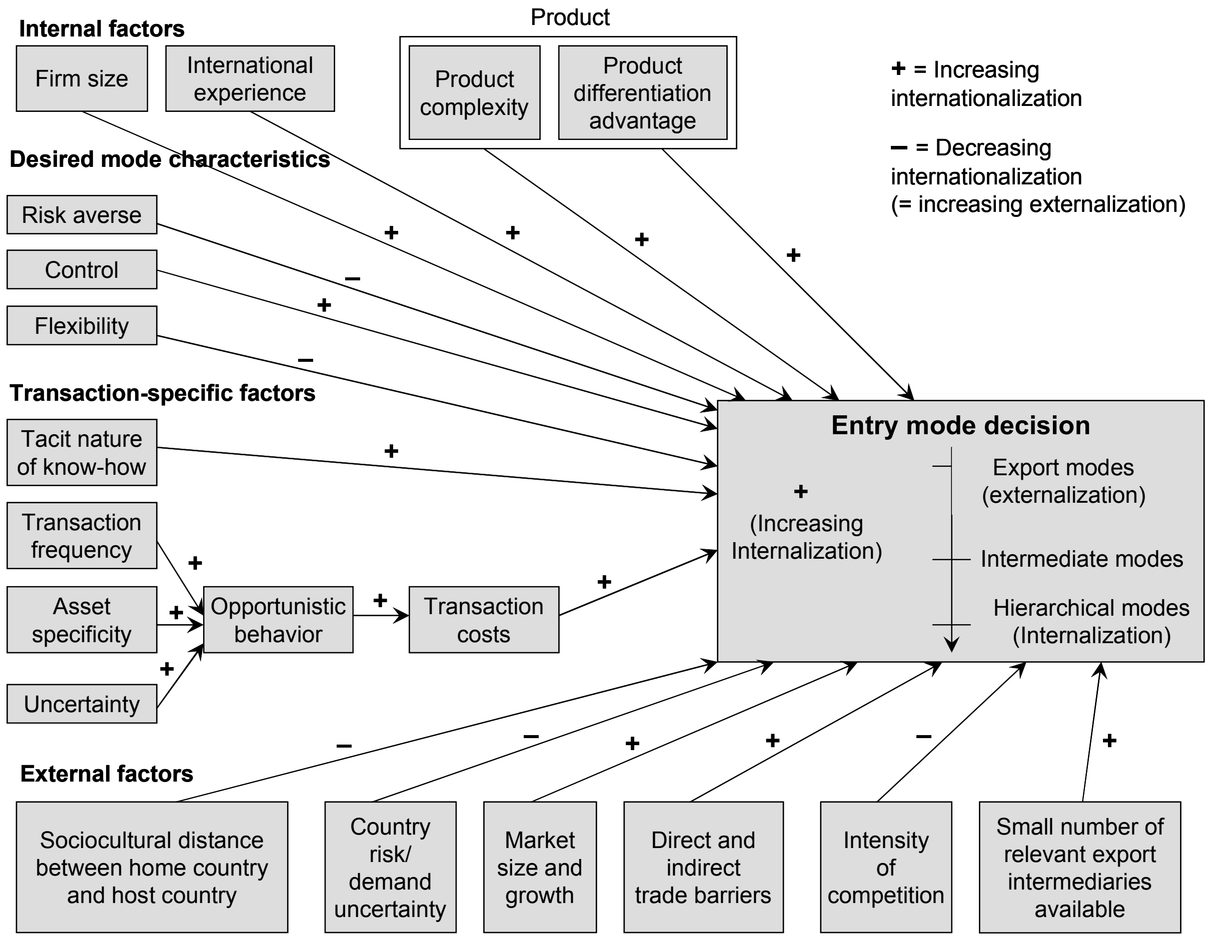

Figure 5: Factors Affecting the Foreign Market Entry Mode Decision, Svend Hollensen, <u>Global Marketing: A Market-Responsive Approach</u>, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 236.

Figure 5 shows the interaction between the product, internal factors, desired mode characteristics, transaction-specific factors and external factors and the effect of these variables on the entry mode decision. Each item of the variables influences the entry mode decision positively towards increasing the internationalization of the firm while a minus indicates the negative effect on the internationalization and leads to increasing externalization. Internal and external factors have been illustrated at the beginning of this section. Product variables include the complexity of the product and the product differentiation advantage. If a market cannot provide the same product due to product complexity, the internationalization of the firm increases. The same holds true for advantages gained from differentiating the product.

Desired mode characteristics compromise of the characteristics risk averse, control and flexibility. If the company and its leaders show a risk-averse behavior, then the company will probably choose export modes, such as direct and indirect exporting. If the company considers the level of control over the operation to be important, then it will probably choose a mode with substantial commitment and control of resources, for example, a wholly-owned subsidiary. Finally, the flexibility of the chosen mode of entry is to be considered. If the market is fast in nature, hierarchical modes, though the least costly of the available operating modes, are too inflexible. Hierarchical modes, i.e. modes in which transactions are mainly conducted internally, incur low transaction costs. Hierarchical modes are at disadvantages in fast-changing markets as hierarchical modes are too slow and inflexible to adapt to a changing market. Intermediate modes, such as joint ventures restrict the options a company has when circumstances in the market are changing quickly (Hollensen 240). Thus, other options such as contractual and exporting entry modes are recommended.

Transaction-specific factors include tacit nature of know-how which refers to the difficulty of transferring know-how when the transfer is tacitly transmitted. The difficulty of transmitting tacit knowledge favors hierarchical modes for conducting transactions. The frequency of the transaction, the uncertainty of the transaction and the specificity of the asset (to be transferred) and the danger of opportunistic behavior and, thus, of increasing transactions cost, all point towards internalization of the transactions (Hollensen 236). Transaction cost economics (TCE) can also provide a framework for the choice of the *modus operandi*[5] of a firm as the firm is an organization in which regular transactions between different participants (departments, employees, functions) are conducted. Thus, the following chapter discusses TCE as a framework for the *modus operandi* of the firm.

[5] Definition of the term *modus operandi*: manner of operating (Webster's Online Dictionary)

1.2.2 *The Transaction Cost Theory – based Approach to the Choice of Modus Operandi of the Firm*

Each business has to decide in which manner the firm wants to conduct business and, eventually, weigh the advantages and disadvantages of each *modus operandi* and its characteristics with regard to the foreign market entry. The transaction cost model can help in choosing the right entry and operating mode for the foreign market because the conceptual framework of TCE provides an adequate tool to describe and analyze business transactions by and within the firm.

The transaction cost model is based on the observations and findings of Coase. Coase asserts that "a firm will tend to expand until the cost of organizing an extra transaction within the firm will become equal to the cost of carrying out the same transaction by means of an exchange on the open market." (395) The enterprise has to determine whether it is more efficient to organize the transaction/exchanges within the firm rather than outsourcing the transaction to the market. In other words, when a firm can produce or transact business within the firm more cheaply, the firm internalizes those transactions. If, on the other hand, the market can offer services and products at a lower price than would be possible by transacting business within the firm, then the firm will rely on the market to perform the transaction. The described model only applies to the perfect world in which there is perfect competition and the costs of operating in the markets would be zero. However, in the real world there are frictions between buyer and seller which result in transaction costs[6]. Thus, transaction costs also inhibit costs for the failure of markets. In order to reduce transaction costs, the firm internalizes transactions, i.e. integrates transactions vertically. Subsequently, a relation between transaction costs and structural decisions can be established (Dusage and Garette 35; Hollensen 53).

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[6] A comprehensive definition of transaction cost is given by Webster's Online Dictionary:

In economics and related disciplines, a transaction cost is a cost incurred in making an economic exchange. For example, most people, when buying or selling a stock, must pay a commission to their broker; that commission is a transaction cost of doing the stock deal. Or consider buying a banana from a store; to purchase the banana, your costs will be not only the price of the banana itself, but also the energy and effort it requires to travel from your house to the store and back, and the time waiting in line, and the effort of the paying itself; the costs above and beyond the cost of the banana as the transaction costs. When rationally evaluating a potential transaction, it is important not to neglect transaction costs that might prove significant (Definition of Transaction Cost).

Transaction costs consist of different kinds of costs in relation to the relationship between buyer and seller. The transaction cost analysis (TCA) framework gives the following equation for the composition of transaction costs (Hollensen 53):

Transaction cost = Ex ante costs + Ex post costs = (search costs + contracting costs) + (monitoring costs + enforcement costs).

Ex ante costs include search costs and contracting costs. Search costs are all costs relating to the cost of gathering information to identify and evaluate potential export intermediaries. These search costs can be prohibitive for especially distant markets, for example, for China and Germany. Other search costs, for example, for Germany and France, might be more acceptable. Contracting costs refer to the costs incurred through negotiations and the writing of the contract between seller and buyer (Hollensen 53-54).

Ex post costs include the costs for monitoring the agreement and the enforcement cost for the actual enforcement of the contract. The monitoring costs are all costs incurred by controlling and monitoring if the buyer and seller fulfill their contractual obligations. The enforcement costs are costs associated with the punishment/sanctioning of the buyer or seller who does not fulfill its contractual obligations (Hollensen 54). Here, an example for the equation is given.

Search costs for German company to find information for Chinese market: 1000
Search costs for German company to find information for French market: 150

Contracting costs with Chinese partner: 500 (due to barriers in culture and language)
Contracting costs with French partner: 200

Monitoring costs for the Chinese partner: 1500
Monitoring costs for the French partner: 500 (closer geographical proximity)

Enforcement costs for Chinese partner: 2000 (legal systems unreliable, thus, high costs for punishment and sanctioning to be expected)
Enforcement costs for French partner: 200 (EU legal system applies, easy to punish non-fulfilling partner)

TCA-Equation: (Ex-ante costs) + (Ex-post costs) = transaction costs

(Search costs + contracting cost) + (monitoring costs + enforcement costs) = transaction costs

Germany-China:	1000 + 1500 + 500 + 2000 = 5000
Germany-France:	200 + 150 + 500 + 200 = 1050

Table 2: Example for TCA Analysis for seller-buyer relationship Germany and China compared to Germany and France.

Hence, applying the TCA framework in the example given in Table 2, the transactions costs for the market entrance of a German business in France are significantly cheaper compared to a possible market entrance in China because of closer geographical and cultural proximity as well as common EU legal legislation.

The underlying principle of the TCA/TCE framework is that each enterprise strives to minimize the ex ante and ex post costs in order to minimize the transaction costs. Williamson argues that hierarchical (internal) organizations and the markets are alternatives for executing transactions while the “object is to assign transactions to markets and hierarchies so as to achieve a most preferred (usually least cost) result, where this is judged principally in terms of transactions costs.” (Williamson 369) Therefore, externalization (markets) and internalization can be, for example, equated with intermediaries, such as agents or contract partners who are market-instruments; and wholly-owned subsidiaries which are instruments for performing transactions internally. Hence, Williamson provides a framework for the internationalization of the firm and the chosen mode of operation. Figure 6 depicts the TCA model for the choice of the internationalization mode.

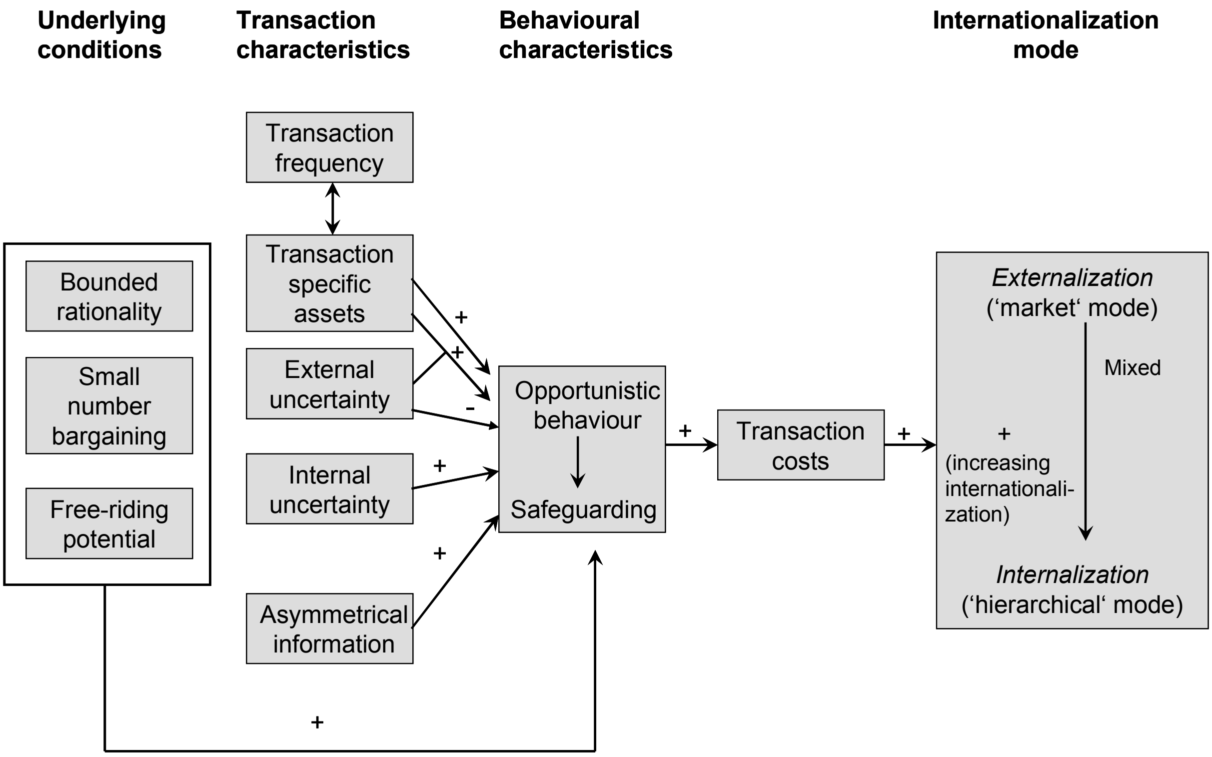

Figure 6: The TCA Model for Choice of 'Internationalization Mode', Svend Hollensen, Global Marketing: A Market-Responsive Approach, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 55.

Figure 6 shows the TCA model and requires some explanation in terms of definitions and meaning of the model. The plus and minus symbols illustrate the correlation between each variable and ultimately between the variables and the internationalization mode of the firm. Bounded rationality refers to the fact that the participants in a transaction have most of the time incomplete information due to the limited ability of human beings to process information (Williamson 370-371). Adverse selection and morale hazard are the result of bounded rationality which affects both participants in the transaction. Adverse selection refers to the impossibility of making ex-ante decisions about the participant in the transaction and the fact that if the one of the participants in the transaction would be likely to, for example, fail to pay the agreed sum, the participant would not disclose so beforehand. Moral hazard refers to costs incurring due to careless or negligent compliance of one party in regard to the object of the transaction or of willful misreporting of negligent behavior of the first party (Williamson 370-371). Thus, the participants, in order to protect themselves from opportunistic behavior, take measures to safeguard themselves in the transaction. The act of safeguarding results in an increase in transaction costs.

Small number bargaining is given whenever there is intense competition on either the buyer or the seller's side and an oligopoly exists on the other side. Small number bargaining increases the threat of opportunistic behavior by the oligopolist, thus, increasing transaction costs (Williamson 373-374, Hollensen 54-55). The free-riding potential concerns especially firms which invest heavily in brand promotion and whose brands are damaged by a new entrant's brand. The new entrant copies the firm's brand closely and uses the firm's brand popularity without sharing in the costs of brand-maintenance and, thus, profits from the established brand for free (Hollensen 55).

The transaction characteristics, includes the transaction frequency and the transaction specific assets. Transaction specific assets are investments in assets which have been undertaken especially for this transaction, for example, training people or special equipment. The transaction frequency refers to the total recurrence of the transaction in the same manner as at the first time. Transaction specific assets and the transaction frequency are key determinants of transactions costs. The internal and external uncertainty surrounding the transaction bars the drafting of a comprehensive contract which includes all possible situations and events. Therefore, the threat of opportunistic behavior from the transaction partner is imminent to the other side (Dusage and Garette 36; Hollensen 55-56).

Figure 6 shows that the firm has to protect itself against opportunistic behavior and, thus, determines the costs for the transaction by taking into account the transaction specific assets, the transaction frequency, external uncertainty, internal uncertainty and symmetrical information. A positive relation (as illustrated by a plus-sign) of the determinants of the TCA model means that, for example, an increase in safeguarding leads to an equal increase in transaction cost. Based on the equation given at the beginning of this part of the section, the total transaction costs are then determined (as demonstrated in an example in Table 2) and the appropriate internationalization mode is chosen. Table 3 gives an overview about the appropriate modes of market entry operation assigned to each possible combination of transaction frequency and asset/investment specificity.

		Asset investment specificity		
		Low	*Medium*	*High*
Frequency of transaction	*Low*	Externalization; occasional transaction	Contracts	Contracts/turnkey projects
	High	Externalization (market transactions = distributor/importer)	Bilateral agreement (joint ventures)	Internationalization (vertical integration = 100% owned subsidiaries)

Table 3: The Characteristics of the Transaction Determine the International Governance Structure, Svend Hollensen, Global Marketing: A Market-Responsive Approach, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 57.

It is the organizational setting in which the transaction takes place that is relevant for the choice of the market entry mode of the company. The organizational setting determines the extent of transactions taking place within and outside of the firm and, therefore, determines the transaction costs. The organizational setting is ultimately the chosen mode of entry and operation in the foreign market. Due to bounded rationality, resulting moral hazard and adverse selection, opportunism is a credible threat to the transaction which results in higher transaction costs. Thus, the transaction has to be organized in such a way as to attenuate opportunism and promote a stable transaction. The firm is a device for economizing on the transaction costs that are incurred by the opportunism and uncertainty of the transaction (Williamson 370). Thus, "hierarchical modes of organization supplant market modes in each instance in the degree to which they serve to economize on bounded rationality and attenuate the exercise of opportunism." (Williamson 371)

As has been shown above, the Transaction Cost theory makes a valuable contribution to the choice of the entry mode because it offers a possible framework for the choice of the *modus operandi* of the firm in a foreign market. "The basic premise is that firms will internalize those activities that they can perform at a lower cost, but will subcontract those activities externally if other providers have a cost advantage." (Pan and Tse) In the framework of the entry mode selection, the objective of transaction analysis, according to Gatignon and Anderson, is "to determine when high entry modes are worth their price to the entrant.” (Gannon 44) In markets where the transaction costs are high, entry modes with hierarchical governance models enhance efficiency, despite bureaucratic costs. The choice of entry mode consists of a trade-off between the transaction costs associated with the market mode of the entry, the company’s need for control and the costs of the hierarchical model (Hoskisson et al. 254). Accordingly, entry modes which offer high degrees of control (for example, wholly-owned subsidiaries) are appropriate entry modes for proprietary products or processes which are arising from know-how because the company wants to hold and protect the exclusive control of the proprietary product or process. Lower control-modes, such as indirect and direct exporting are chosen for tangible products which can be valued more objectively (Gannon 45). It should be noted that the transaction cost economics (TCE) has been criticized, for example, by Zajac and Olsen ("From Transaction Cost to Transactional Value Analysis") for over-emphasizing the cost minimization and neglecting the value creation aspect of a transaction. The resource-based theory of the firm offers a solution to the problem of over-emphasis on cost-reduction and the neglecting of value creation of transactions by focusing on the resources and capabilities of the firm as first discussed by Penrose.

1.2.3 The Resource-based View of the Firm Approach to the Choice of Modus Operandi of the Firm

The foundation for the resource-based view (RBV) of the firm was laid by Edith Penrose in 1959 who argued (24):

> A firm is more than an administrative unit; it is also a collection of productive resources the disposal of which between different uses and over time is determined by administrative decision. When we regard the function of the private business firm from this point of view, the size of the firm is best gauged by some measure of the productive resources it employs.

According to Barney, “a firm’s resources and capabilities include all of the financial, physical, human, and organizational assets used by the firm to develop, manufacture, and deliver products or services to its customers.” (Barney, "Competitive Advantage" 14) Barney identifies 4 important indicators for the resources and capabilities of the firm to generate sustained competitive advantages (Barney, "Competitive Advantage" 14-22):

(1) Value

(2) Rareness

(3) Imperfectly Imitable

(4) (Non) Substitutability

First, do the firm’s resources and capabilities add value by enabling it to exploit opportunities and/ or neutralize threats? Second, how rare are the resources and capabilities amongst the competitors? Third, does the firm without a resource of capability face a costs disadvantage in obtaining it compared to firms that already possess it? Fourth, is the firm organized to exploit the full competitive potential of its resources and capabilities? (Barney, "Competitive Advantage" 14-22)

Four main differences to the transaction cost theory can be identified. First, TCE predicts entry modes because of failure in the external markets under the assumption of opportunism. Hence, according to TCE a hierarchical entry mode is chosen because external markets fail to provide adequate services. Thus, the company chooses to internalize the transaction in a hierarchical mode. If the market can provide the desired services, the company capitalizes on the opportunity to externalize the transaction and let the market provide the service. RBV attributes the different entry modes to the heterogeneity of resources and capabilities available to the firm. Thus, the choice of an entry mode of a particular firm depends not on the costs and risks attached to the use of external markets and, therefore, the choice of hierarchical modes of entry in case of high risk, but rather on the differing resources and capabilities of the firm (Peng 813).

Second, the RBV takes a longitudinal view of the market entry process with multiple entries and dynamic environments in which the company learns from previous experiences and builds upon these experiences when deciding future market entry modes. TCE rely on a relatively statistical set of conditions and focuses on the one-time entries in markets (Peng 813).

Third, TCE focuses solely on the minimization of cost in transactions while the RBV looks at the advantages of doing transactions with a partner. Last but not least, transaction cost economics focuses on the exploitation of firm-specific advantages as opposed to the resource-based view which, besides focusing on the exploitation of firm-specific advantages, also emphasizes the development of these resources through acquisitions or cooperative ventures (Madhok 48-49).

In regard to the resources and capabilities as competitive advantages, Barney differentiates between competitive advantages and sustained competitive advantages. A company wields a competitive advantage, “when it [the company] is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors.” (Barney, "Firm Resources" 102) A sustained competitive advantage is achieved “when it [the company] is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy.” (Barney, "Firm Resources" 102) Therefore, the company has a sustained competitive advantage when other companies are unable to copy or implement the same value creating strategy, for example, a unique business process and the company can, thus, turn the competitive advantage into a decrease in costs, an increase in market share or in revenues.

The RBV of the firm calls on the company to seek out the resources and capabilities which are the company’s competitive advantages. Grant states that “making money in business requires establishing and sustaining competitive advantage,” and that “the characteristics of a firm’s resources and capability are fundamental to strategic decision making and long-term success.” (192) However, a competitive advantage of a firm is threatened by imitation, substitution or innovation through competitors and, therefore, is rather temporary than sustainable (Eschen and Bresser 6). Furthermore, the heterogeneity of the resources and capabilities of competitors requires the firm even to generate new resources and capabilities in order to diminish resource deficits (Eschen and Bresser 7). Heterogeneity of resources and temporary competitive advantages as well as entrepreneurial discovery, the ability of managers to discover resources and capabilities and turn it into a competitive advantage, can lead to a perceived resource gap in a firm (Eschen and Bresser 7-8). Naturally, the business needs to fill the resource gap, possibly by entering a foreign market in order to stay competitive in both the host and the local market as well as to ensure the survival of the firm. Thus, “a robust and sustainable advantage may require a firm to operate in different markets in order to develop various differing though associated capabilities, and thus benefit from the idiosyncratic skills rooted in the particular country.” (Madhok 42) Therefore, the RBV advocates the entrance in foreign markets if idiosyncratic resources and capabilities are available for the firm which can be utilized for sustained competitive advantages.

According to Hoffmann and Schaper-Rinkel, the “resource-based view recommends selecting the mode of organization that provides the best opportunity for sharing and transferring resources.” (134) Applying Grant’s and Hoffmann and Schaper-Rinkel’s assessment to the market entry in a foreign market, it can be concluded that a particular entry decision cannot be viewed in isolation, but must be considered in relation to the overall strategic posture (Hill, Hwang and Kim 117), i.e. maximizing the competitive advantage of the firm’s resources and capabilities. In the framework of the RBV, a company enters a market in order to access, enhance and develop its resources and capabilities (=close resource gap) and choose the market entry mode accordingly. Therefore, “for firms seeking to enter foreign markets, a critical issue is whether they can apply their competitive advantages to those markets.” (Brown, Dev and Zhou 474) If the firms cannot apply the competitive advantage to the market, then the firms have to consider whether the entrance into the market is justified or sensible.

Potential market entrants often lack knowledge about the market to turn their competitive advantages into an adequate return on their resources. A collaboration with a local partner (whose resource is local knowledge) can fill the gap and give the local partner access to the entrant’s resources. Both parties profit from their collaboration by increasing the likelihood of earning a greater return on their resources (Brown, Dev and Zhou 474). Thus, “entrant firms choose entry modes to capitalize on the local partner’s capabilities.” (Brown, Dev and Zhou 475) One of the disadvantages of collaboration is the diffusion of know-how that takes place in the collaboration. If one business owns proprietary knowledge and the knowledge is diffused throughout the collaboration, then the competitive advantage is partially lost which leads to a decrease in the potential return on the firm’s resources. Furthermore, joint ventures are exposed to the high risk of conflict, for example, because of opportunism due to one of the partners taking advantage or exploiting the competitive advantages of the other partner. Also, the different knowledge and resources lead to different expectations and judgment and, thus, to a much higher conflict potential as opposed to full integration (Eschen and Bresser 12). The different resources and knowledge translate into different perceptions about the role of each company in the venture as well as different goals of each company which sets the stage for possible escalating problems in the venture.

Another way to access resources and capabilities, according to the resource-based view of the firm, is the acquisition or merger (M&A)[7] with another business. Resources and capabilities can not easily be acquired on factor markets, are hard to develop internally and accessing resources through collaboration has distinctive disadvantages (as has been discussed above in this chapter), too. Thus, the acquisition of or merging with another business gives the company the possibility to acquire comparatively easily entire knowledge systems with the transfer of specific, complex and tacit resources and capabilities. The assets, resources and knowledge systems are integrated into the acquiring company and contribute to the resources and capabilities of the acquirer. Of course, merging with or acquiring another business under the perspective of the RBV has also disadvantages. M&As are highly irreversible and, consequently, incur sunk costs. Therefore, M&A are not suitable for transacting business or entering in a high-risk market and environment in order to gain access to resources because the probability of sunk costs[8] is relatively high compared to normal markets (Eschen and Bresser 10-15). Eschen and Bresser suggest 3 criterions for the appropriateness of M&A to close a resource gap (15):

(1) These resources are of high strategic value and importance
(2) Resources with a high distance to the existing resource-base have to be acquired and, last but not least
(3) If only moderate or low environmental uncertainty exists.

Therefore, M&A should be used to close a perceived resource gap when the resources are of high strategic value to the company, and, thus essential for the long-term success of the company. Additionally, resources which cannot be developed easily from the existing resources base are recommended to be made accessible through M&A. Finally, M&A is only advisable if the risk of using M&A in

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[7] A complete discussion on M&A is given in chapter 1.4
[8] In economics and in business decision-making, sunk costs are costs that have already been incurred and which cannot be recovered to any significant degree. For example, when you pre-order a movie ticket, the price of the ticket becomes a sunk cost. Even if you decide that you'd rather not go to the movie, there is no way to get back the money you originally paid and you have a sunk cost on your hands. This assumes, of course, that you can't simply return the movie ticket for a refund, and that the odds that you are able to resell the ticket are essentially zero (Dictionary.LaborLawTalk.com).

the certain environment is reasonable and there is a low degree of uncertainty of operating in that environment.

In conclusion, the RBV offers a possible explanation for the *modus operandi* of a firm and, thus, can be used as a framework for the choice of market entry mode. Overcoming the deficit of the transaction cost model which solely focuses on exploiting resources advances, the RBV encompasses the generation of advantages, too. According to the resource-based view of the firm, a firm tries to leverage its resources and capabilities when entering a foreign market, possibly by entering a cooperation or acquiring a business. In the next section the dissertation analyzes frameworks for the choice of the entry mode.

1.3 Framework for the Choice of Entry Mode

The two theoretical approaches to the choice of market entry mode, transaction cost-approach and the resource-based view of the firm have been discussed above. Hence, a framework is needed to comprehensively and coherently integrate the different approaches to the internationalization and the *modus operandi* of a firm into a single outline for the decision about the right organizational mode for the foreign market entrance.

1.3.1 The Decision Rule

Root suggests that there are 3 different decision rules for the selection of the right entry mode according to their complexity. The first is the naïve rule, the second is the pragmatic rule and the last is the strategy rule (159).

The naïve rule refers to the belief of a company and its managers that there is only one way to enter a market. An example would be the statement “we only export” which means that the company only exports to each different market regardless of the specifics and characteristics of each market. The naïve rule, thus, “ignores the heterogeneity of country markets and entry conditions.” (Root 159) The result is that the company leaves promising markets or enters markets with an inadequate kind of entry mode. Despite learning that entering the market through just this one entry mode is probably not successful, the realization still does not lead to a change of choice in the entry mode. Rather than adapting, the company prefers to leave the respective market. The conclusion is, thus, that “the inflexibility of the naïve rule prevents a company from fully exploiting its foreign market opportunity.” (Root 160)

The second rule, the pragmatic rule, refers to a company starting its international expansion with a low-risk entry mode and continually increasing its risk exposure if the chosen entry mode is not workable. Therefore, the company starts with exporting (low risk) and only if this entry mode is not feasible will the company choose another entry mode. Because the company always keeps with the first workable solution, without gathering information about and evaluating other possible entry modes, the company receives a workable entry mode, but not the best entry mode for its company and the target market. Thus, risk aversion still squanders opportunities because the first workable entry mode instead of the best one is chosen (Root 160).

The last decision rule is the strategy rule. The rule calls for the choice of entry mode that best matches the capabilities and resources of the firm to the target market. The strategy decision rule requires a systematic comparison of alternative modes (Root 160). Root warns that “a comparison of alternative entry modes is also complicated by the need of managers to assess the advantages and disadvantages of each mode in terms of a company’s multiple objectives in the target market, objectives that are seldom fully consistent.” (161) Such conflicting objectives can be, for example, growth in sales vs. profitability. Root concludes: “Entry mode comparisons need to be made between projected benefits and costs over a future period. Managers are comparing therefore, expected benefits and costs of alternative entry modes, benefits and costs that are uncertain in some degree.” (161)

According to Root, the company should seek out to make the choice of entry mode by using the strategic decision rule. The firm should compare different entry modes to each other that match the capabilities and resources of the firm. Adjacently, on the basis of the deliberations the most suitable market entry mode for the target country is chosen. The decision for the manager is solely to be based on expected benefits and costs. Strategic and organizational considerations are neglected. Thus, a more comprehensive, descriptive and inclusive framework is needed to integrate other variables beside costs and benefits into the deliberations for the right entry mode choice.

1.3.2 The Hierarchical Model of Choice of Market Entry Mode

Based on the transaction cost theory by Williamson and the internationalization process as described in the Uppsala-model by Johanson and Vahlne in Chapter 1.1.1, Pan and Tse develop a hierarchical model of choice of market entry modes. Pan and Tse argue that the choice of entry mode can be examined from a hierarchical perspective. The hierarchical model by Pan and Tse builds upon two theories. The first one argues that the internationalization of the firm as postulated by Johanson and Vahlne can be described by a stage-model, using risk and (investment) commitment as indicators. The other theory builds upon the strategy rule of Root as discussed above. According to Pan and Tse, managers consider only a few factors at each level of the hierarchy, and even different factors at each level of the hierarchy. Subsequently, managers make a distinct decision at each level of the hierarchy. Basically, the whole hierarchical model of choice of entry mode centers on the question whether the company wants to make an equity investment or not. Following that decision, the manager proceeds to make a decision at the lower level whether the company wants to export, enter a contractual agreement, an equity joint venture or push into the market with a wholly-owned subsidiary. Further options of entry mode choices arise from each possible decision. The hierarchical model of the choice of possible entry modes is illustrated in Figure 7 below.

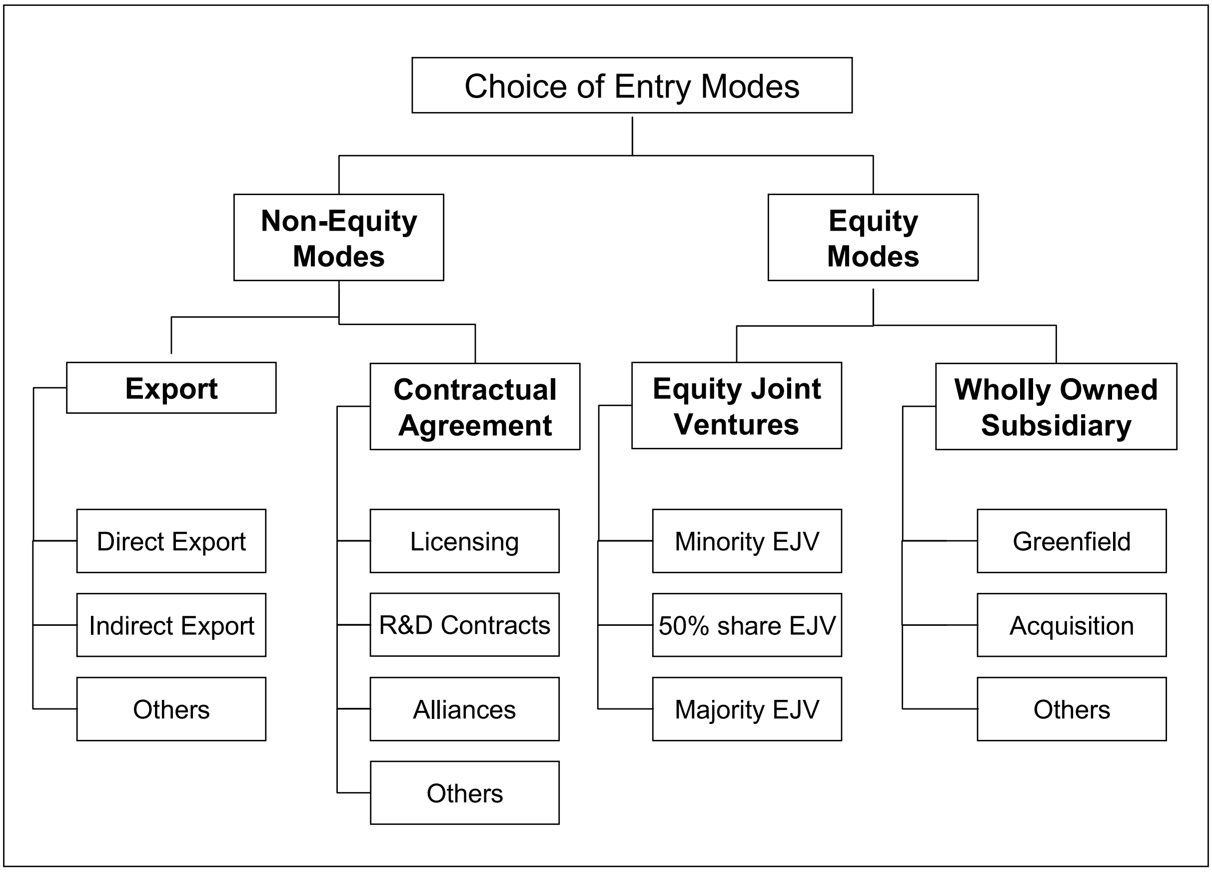

Figure 7: A Hierarchical Model of Choice of Entry Modes, Yigang Pan, and David K. Tse, "The Hierarchical Model of Market Entry Modes," Journal of International Business Studies, 31.4, (2000): 538.

The conceptualization of the choice of entry mode in the hierarchical model is appealing for a number of reasons. First of all, it recognizes the bounded rationality of human beings, managers, who have a limited analytical capacity and tend to decompose complex decision processes into small sets of critical variables. Thus, the decision-making process is made easier. The second argument considers the differences that exist between different entry modes and the choices to be made at each level. For example, circumstances in which a greenfield investment is an option are dramatically different from those that would favor indirect export. The circumstances are too different to be compared at the same level. Therefore, the splitting of entry mode decisions according to the hierarchical model by Pan and Tse proves useful.

Last but not least, equity and non-equity modes, the first level-differentiation, are significantly different in their call for the commitment of the company. Equity modes, such as wholly-owned subsidiaries and equity joint ventures require an active involvement of the top management, an investment of resources, careful screening of the market, the environment, investment risk and return, etc. Non-equity modes are significantly different in their requirements as no investment is made, no extensive screening has to take place and the risk is lower (Pan and Tse 538-539). Thus, a differentiation between equity and non-equity modes as proposed by Pan and Tse seems appropriate.

Based on the transaction cost theory and the Uppsala Internationalization Model, the hierarchical model of choice of entry mode by Pan and Tse offers a firm a coherent framework for the entry mode decision into a foreign market. The eclectic framework by Kim and Hwang is another framework that is at least partly based on the transaction cost theory as well as environmental factors influencing the entry mode choice and global strategic considerations which a firm faces.

1.3.3 An Eclectic Framework of the Market Entry Mode Choice

The eclectic framework has been developed by W. Kim and Peter Hwang. Kim and Hwang aim to incorporate existing entry mode explanations (and internationalization theories) in a comprehensive framework. As opposed to the hierarchical model by Pan and Tse, the eclectic framework integrates the environmental variables - as has been discussed above by Root in Chapter 1.2.1- the transaction cost theory/framework - based on Williamson's work described in Chapter 1.2.2 - and the RBV of the firm - based on Penrose and Barney illustrated in Chapter 1.2.2 - and further applies global strategic considerations of the company to the eclectic framework (Kim and Hwang 30).

Global strategic variables include global concentration, global synergies and global strategic motivations. Global concentration refers to the phenomena that ever more multinational companies (MNCs) find themselves in a number of different markets with a limited number of players of the same industries; the global industry has become highly concentrated. Thus, due to the oligopolistic circumstances, actions in one market can spill over in another market because national boundaries cannot prevent such events from taking place in a globalized context. The result is a competitive interdependence between the players. Competitive interdependence “implies that organizations can influence one another not only directly but also indirectly in any of the diverse national markets in which they compete.” (Kim and Hwang 32) Thus, global concentration influences the choice of market entry modes as the company is trying to limit or expand the ramifications of the choice of entry mode in a foreign market. Kim and Hwang posit that MNCs choose high control entry modes when there is a high concentration in the specific global industry (Kim and Hwang 34).

Global synergies arise, for example, from the deployment of one technology of one subsidiary or business division in for example, another business division or subsidiary in different countries. Thus, the company realizes global synergies by deploying, for example, a proprietary technology in several markets, thus, saving costs and bringing competitive advantages to several markets. Kim and Hwang propose that the higher the synergy between the home firm and its sister business divisions, the more probable is the choice of an entry mode with a high level of control for the foreign market entry (Kim and Hwang 34).

Kim and Hwang assert that “global strategic motivations can be defined as the motivation to fulfill strategic aims at the corporate level for the purpose of overall corporate efficiency maximization.” (35) In other words, when companies enter a foreign market they may not choose the entry mode that is most suitable for the particular market but which suits the company’s strategic considerations best. Consequently, it can be proposed that MNCs that apply global strategic motivations favor high control entry modes when making the decision about the choice of entry mode in a foreign market (Kim and Hwang 35). To summarize, global concentration, global synergies and global strategic motivations are global strategic variables that influence the entry mode decision.

Environmental factors include country risk, location unfamiliarity, demand uncertainty and intensity of competition. The risk of doing business in the chosen market, the physical and cultural distance of the foreign market compared to the home market, the difficulty of estimating the planned demand and the intensity of competition in the host market: all these factors determine and influence the choice of market entry mode. Kim and Hwang assert that the higher any of the environmental variables is, the lower the resource commitment of the market entrant will probably be (Kim and Hwang 35-36).

The value of the firm-specific know-how refers to the competitive advantage gained by firm-specific knowledge as also postulated by the resource-based view of the firm (see Chapter 1.2.3). Kim and Hwang propose that the higher the value of the firm-specific know-how, the more likely the business is to choose an entry mode with high control. The second variable of transaction-specific variables is the tacit nature of know-how the firm possesses. In other words, if a firm possess tacit know-how, this know-how is naturally hard to articulate. Kim and Hwang posit that the greater the share of tacit know-how of the firm's know-how is, the more likely it is that the company favors a high control entry mode when entering the foreign market. The company will try to incorporate and transfer the tacit know-how within the market entry mode which can be best achieved in a hierarchical entry mode because hierarchical entry modes rely on internal transactions. Figure 8 illustrates the eclectic framework of the choice of entry mode according to Kim and Hwang.

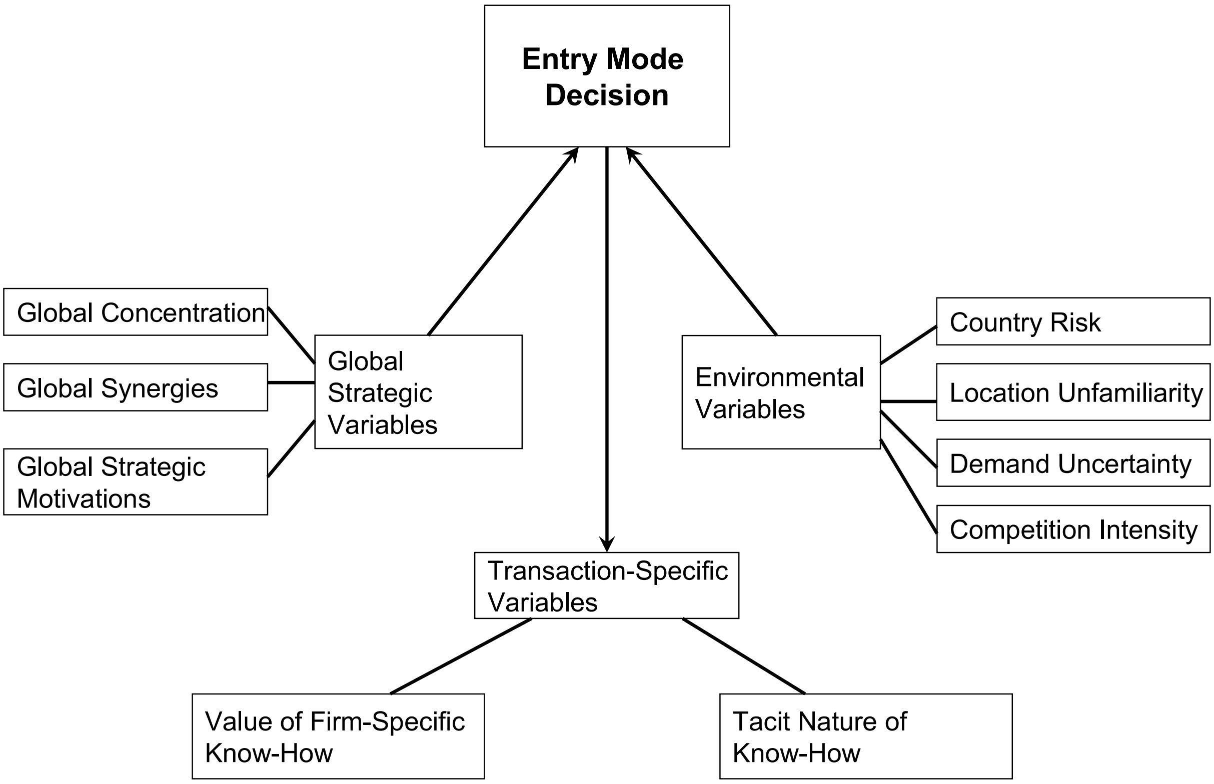

Figure 8: An Eclectic Framework of the Entry Mode Choice, W. Kim, and Peter Hwang, "Global Strategy and Multinationals' Entry Mode Choice," Journal of International Business Studies, 23.1, (1992): 33.

In conclusion, the eclectic framework by Kim and Hwang offers a comprehensive framework integrating environmental variables, transaction-specific variables and global strategic variables. The framework uses the indicators of control and risk to assert which kind of entry mode to assign to which situation. Thus, the eclectic framework offers some guidance towards the right choice of market entry mode based on risk and control. The choice of market entry mode based on the eclectic framework combined with the hierarchical model of Pan and Tse can be modeled along a continuum of risk and extent of investment as illustrated in the next part of this chapter.

1.4 Market Entry Modes

Previously, the different theories and views of the firm, which are integrated in the hierarchical model of Pan and Tse and in the eclectic framework of Kim and Hwang, were discussed. The hierarchical model of Pan and Tse relies on the decision about whether to use equity and subsequent decisions about the level of equity and, thus, the extent of investment in the process of entering a market. The eclectic framework of Kim and Hwang bases its choice of entry mode on the variables of global strategic considerations, environmental factors, especially risk, and transaction-specific characteristics. If one combines the underlying principles of the two models, then the resulting choice of entry modes can be shown on a continuum of risk and investment as illustrated by Bennet and Blythe in Figure 9. The illustration by Bennet and Blythe offers an overview about the different market entry modes according to degree of risk and investment. Subsequently, a description and discussion of each market entry mode is pursued.

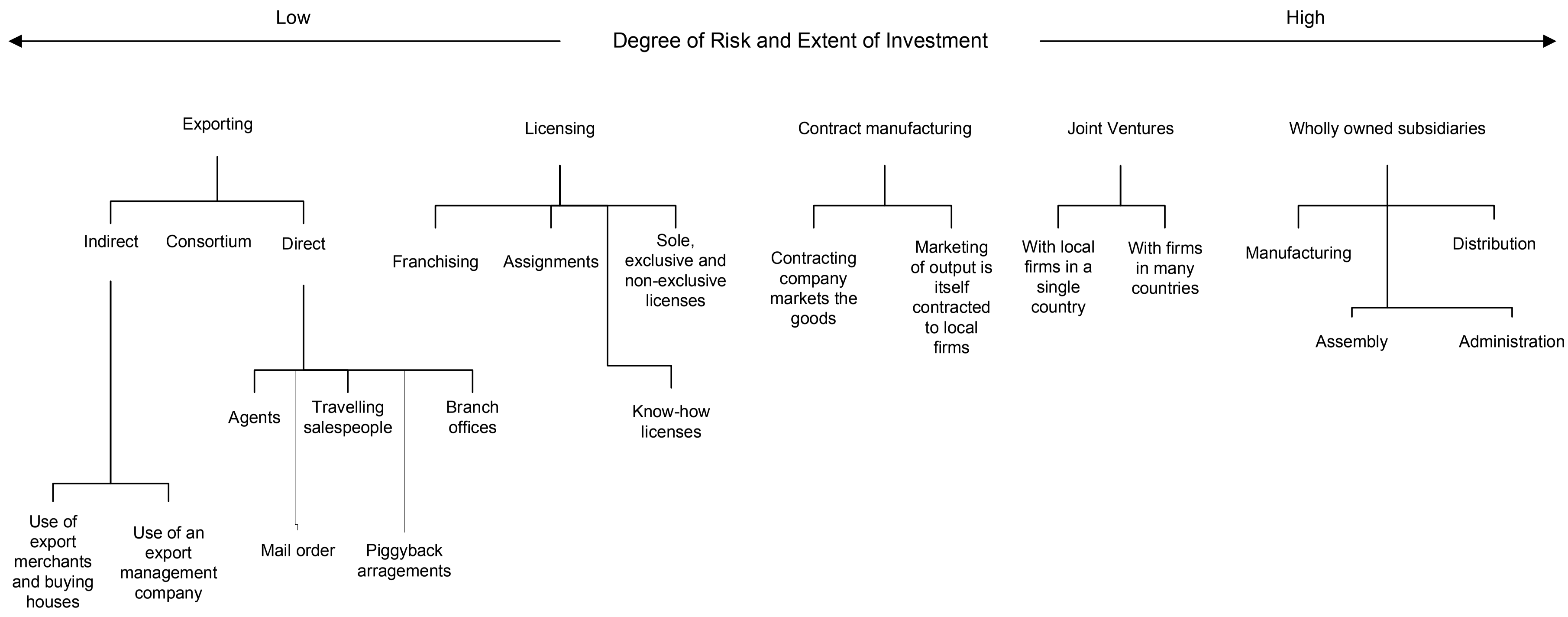

Figure 9: Degree of Risk and Extent of Investment, Roger Bennett, and Jim Blythe. International Marketing: Strategy Planning, Market Entry & Implementation, 3rd ed., London: Kogan Page Limited, 2002, 196.

1.4.1 Exporting

Exporting is an entry mode associated with low risk. Within the scope of this discussion, exporting through a consortium is neglected. Hence, exporting is conducted either by indirect or direct means. Indirect exporting occurs when the foreign merchant, buying house or the export management company actually buy the product from the exporting company (= distributors) and re-sell the product to the local market. Direct exporting involves agents, salespeople, sales by mail order, in branch offices or in piggyback arrangements (where existing facilities of other products are also used) and the product is still sold by the exporting company through the above described means (Bennet and Blythe 197).

While the indirect export by means of distributors reduces credit risks, requires less supervision by the exporting company and even puts a local image on the product, using agents provides more control to the exporting company and leaves the exporter with more flexibility as it might withdraw from arrangements easily. On the other hand, indirect exporting gives the exporting company less control, the distributor might distort the brand of the company and the distributor might easily go out of business or switch to the competition. Disadvantages of using direct exporting, for example, by employing agents, are the possible multi-operation of the agents for a number of companies, the amount of support required by the agent from the exporter and the lack of incentive for the agent to sell the exporter's product due to conflicts of interests or lack of commitment (Bennet and Blythe 198 – 199). Therefore, the company has to consider whether the advantages, for example, flexibility, exceed the disadvantages, for example, lack of incentive since the company has to heavily rely on foreign agents.

1.4.2 Licensing

Licensing is defined as "a business practice involving a contractual agreement between two companies whereby one business provides a product, technology or knowledge in exchange for a fee from the other company." (Trautmann) Licensing can include franchising, assignments of the licensee, exclusive and non-exclusive licensing and pure know-how licenses. An assignment means that the licensor is handing over all the intellectual property rights to the licensee. The licensee may then use the rights as the licensee wishes as there are no restrictions put upon him. In this case, the foreign company hands over all its property right to the local company or individual. A franchising license entitles the local company of the target market to adopt or copy the franchiser's (=foreign company) entire business format in the local market. The entire business format refers to the name of the product and/or business, the trade marks, the business methods, etc. In turn, the franchisee pays a royalty and lump sum fee for the business formats as well as for additionally services, such as training, technical advice, stock control systems. Thus, the franchisor keeps complete control of its business formats while the franchisee gains from the trademark rights, etc. and carries the financial and business risk in the local market. Advantages are the spreading of the business format at relatively low cost and consistent corporate identity. The disadvantages include the costs of monitoring the franchisee's behavior and securing the business format against copy infringement as well as franchise agreement violations (Bennet and Blythe 205).

1.4.3 Contract Manufacturing

The American Marketing Association (AMA) defines contract manufacturing as "a joint venture method by which work is contracted to a qualified manufacturer to produce the product(s) that the firm wishes to market." Contract manufacturing depends on local firms being able to fulfill the contracts, i.e. the local companies have the skills and capabilities to do the manufacturing. On the one hand, contract manufacturing offers a chance to enter a market faster with less risk and being able to withdraw fast if risks are too high. Furthermore, the foreign company does not have to make a substantial investment in the local market. On the other hand, maintaining and monitoring quality as well as protecting intellectual property and possibly training the local employees are disadvantages to be considered when opting for contract manufacturing (Marketing Association; Bennet and Blythe 212).

1.4.4 Joint Venture

A joint venture operating in a foreign country can be defined as an international joint venture. The terms international joint venture (IJV), joint venture (JV) and equity international joint venture (EIJV) are used interchangeably for the discussion. In regard to EIJV, the foreign company makes a financial investment in a local JV. Thus, the definition of an EIJV is (Newburry and Zeira 89):

> An equity international joint venture (EIJV) is a separate legal organizational entity representing the partial holding of two or more parent firms, in which the headquarters of at least one is located outside the country of operation of the joint venture. This entity is subject to the joint control of its parent firms, each of which is economically and legally independent of the other.

According to Brooke there are 4 main reasons for the formation of JVs (103):

(1) To acquire market knowledge/expertise/distribution channels in an unfamiliar market
(2) To expand with limited capital by sharing costs with a (local) partner in order to minimize the risk of international expansion
(3) To improve sales prospects, i.e. turnover and profit
(4) To overcome governmental restrictions on the market entrance and gain access to the market.

Basically, there are 3 different types of JVs as identified by Killing. First, the dominant-parent JVs which are entirely managed by one of the parent companies and display no actual difference to being a wholly-owned subsidiary. The second type of JVs are shared-management JVs in which both parent companies collectively lead the JV. These independent JVs are characterized by an extensive autonomy of the management towards the parent companies' management. However, it should be noted that independent JVs are mostly incompatible with the intent of JVs, i.e. the sharing of complementary resources and capabilities through collaboration of the two parent companies, due to the autonomy of the JV. Thus, the parent companies are actually only investors or shareholders (Dusage and Garette 84).

Selecting the right JV partner is indispensable for the foreign company to succeed in the local market. According to Bennet and Blythe, the JV-partner should (220):

- have proven knowledge, expertise and experience of local business conditions and practices
- be able to conduct or commission local market research
- posses extensive contacts with local banks, businesses and providers of specialist services
- be easy to contact

- provide precise and regular feedback on local market conditions
- have resources sufficient to undertake the collaboration (staff, technical facilities, management systems, etc.)
- have a successful track record and good business reputation.

Choosing the right partner for the local market is only the first step in ensuring the success of the market entrance of the foreign company. The performance of IJVs can be disappointing, for example, because of the incompatibilities of goals between partners. Since different factors influence the success of the JV, it can be ascertained that other variables beside the choice of the right JV partner have an effect the success of the JV depends. A study undertaken by Robson, Leonidou and Katsikeas found that the following factors contribute to the success of IJVs (408):

- Parent's positive attitude toward collaborative forms of business
- Avoiding partnerships with state-owned organizations
- Simultaneous development of additional ties with the partner
- Ensuring inter-partner goal congruence
- Clarify objectives and contributions
- Stress managerial adaptability
- Inter-partner variables, for example, commitment, trust, cooperation, satisfaction with agreement
- Product quality and strong distribution and sales network
- Incentives to employees
- Minimization of management turnover
- Industry profitability and realization of economic/tax incentives

The advantages of EIJV include the sharing of knowledge and resources, substantial control over production and marketing, the instant access to local expertise and distribution networks and last, but not least, the shared risk of failure and administration cost (Bennet and Blythe 218).

Disadvantages of EIJVs include the cost for searching and identifying an appropriate partner in the market and integrating the assets of the local partner into the JV (Pan, Li and Tse). Problems in regard to control and coordination, a lack of overall leadership and the need to share intellectual property may arise. Additionally, the local and the foreign partners may not have the same interests, targets and goals which leads to conflicts in the JV. Problems may also arise due to different cultures and strategic objectives. In general there is a high risk of failure which is why both partners should have an exit strategy in case the partners fall out over operative or strategic issues (Bennet and Blythe 218; John et al. 255). That is probably why most IJVs are unstable or perform unsatisfactorily (Sim and Ali 358).

1.4.5 Wholly-owned Subsidiary

The market entry mode associated with the highest extent of investment and risk, according to Figure 9, is a wholly-owned subsidiary. A wholly-owned subsidiary (WOS) is “a company that is completely owned by another company. A wholly-owned subsidiary is a registered company with board members who all represent one holding company or corporation.” (B. E. D. Economist.com, Wholly-Owned Subsidiary) Because the WOS is established in a foreign country, the term wholly foreign-owned enterprise (WFOE) is also used. A WFOE offers the foreign company full control over the establishment in the foreign country (Anonymous, "China Changes."). A WOS can be established or acquired. The investment in a newly-established subsidiary in the local market by a foreign company can be defined as being an international greenfield investment. An international greenfield investment (IGI) is “the establishment of a new affiliate in a foreign host country by a company headquartered outside the country where the investment is occurring for the purpose of producing a company’s product or providing a company’s service.” (Newburry and Zeira 89) Table 4 illustrates the advantages and disadvantages of entering a foreign market by an IGI. Therefore, the company has to decide whether it is willingly to accept the trade-off of higher control and faster access to the market for possible higher investment costs and a higher exposure to risk.

Advantages	Disadvantages
Faster access to local market and lower operating costs	Slow entry of new markets (time-consuming process)
Possible to build operation in an optimum format, i.e. in such a way that it fits best the interest of the parent firm (for example, integrating local production with home base production)	High investment costs
Possible to integrate state-of-the-art technology due to reduced risk of violation of property rights which results in increased operational efficiency	Lack of local partner, and thus, of local knowledge
Project local identity	Substantial requirements in terms of company's management and resources
Exercise close control over production, quality and marketing	Higher exposure to risk
	Long payback period probable

Table 4: Advantages and Disadvantages of International Greenfield Investments, compiled from: Svend Hollensen, <u>Global Marketing: A Market-Responsive Approach</u>, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 305; and Franklin R. Root, <u>Entry Strategies for International Markets</u>, Massachusetts: Lexington Books, 1987, 124-125.

The market entry by IGI is a sensible decision if a company wants to enter a market with proprietary technology and needs to protect the know-how as well as exploiting the competitive advantage on the company's own. A WOS can also be established/acquired though the M&A of a local company.

1.4.6 M&A

Another way of entering the market, although not described in Figure 9 by Bennet and Blythe, would be an international acquisition. Newburry and Zeira define an international acquisition (IA) as (89):

> The purchase of the trade name and assets of one company (an acquiree) by another company (an acquirer), headquartered outside the country where the acquired company has been located. Following the acquisition, the acquired company is subject to managerial, economic, and legal control of the acquiring company.

The acquisition may be defined as being horizontal when the product lines and the markets of the two companies are similar. The transaction can be classified as being vertical when the acquired company becomes a supplier or customer of the acquirer. Additionally, the transaction can be described as being concentric in which case the acquirer or the acquired company owns the same technology and serves a different market or vice versa (Root 143).

Closely related to the concept of acquisition is the concept of merger. A merger is (B. E. D. Economist.com, Merger):

> the union of two or more organizations under single ownership, through the direct acquisition by one organization of the net assets or liabilities of the other. A merger can be the result of a friendly takeover, which results in the combining of companies on an equal footing. After a merger, the legal existence of the acquired organization is terminated.

Thus, international acquisitions and mergers can be established in the concept of M&A. Reasons for the market entry of businesses by M&A, according to Dunning, are (247):

- Rising costs of innovation and of entry into unfamiliar markets
- Competitive pressures to be cost effective
- Growing need to tap into complementary technologies and to capture expected economies of scale and scope
- Desire to protect or advance global markets vis-à-vis oligopolistic competitors
- Need to encapsulate the time of the innovating or market entry process

Studies have shown that M&A perform disappointingly after the merger most of the time (Mattsson Merger Waves), destroy value (London 9) and that the majority of cross-border M&A fail (Finkelstein 1). The literature suggests three main reasons for the purchase of foreign companies (London 9):

(1) The purchase is a quicker and easier way to enter an overseas market than starting from scratch

(2) International diversification can stabilize cash flows and make the acquiring company appear less risky to financially markets

(3) Expanding into foreign markets increases on which companies can exploit intangible assets (for example, expertise and business processes) and technologies

According to Root, “the success of an acquisition depends critically on the selection of the acquired company. A poor selection – for whatever reason – can run any advantage into a disadvantage for the unwary firm.” (143) Besides the careful selection of the take-over target to turn the acquisition into an advantage for the acquirer, advantages and disadvantages of the market entry by M&A are to consider. The advantages and disadvantages for international M&A as an entry mode are shown in Table 5.

Advantages	Disadvantages
•Rapid entry into new markets	•Usually expensive option
Gaining quick access to: •Distribution channels •New product lines •Technology •A qualified workforce •Existing management experience •Local knowledge •Contacts with local market and government •Established brand names and reputations	High risk due to: •National interest of the host country and resulting resentment if take-over is seen as foreign absorption •National interests of the home country
•Shorter payback period for the investor by creating immediate income •Stabilise cash flows	Possible threats: •Lack of integration with current operation •Communication and coordination problems between acquirer and acquired firm
•Increase scale on which the firm can exploit intangible assets and technologies	•Locating and evaluating possible acquisition or merger candidates can be difficult → danger of ending up with poor prospect due to lack of qualified candidates, differing accounting standards and false or deceptive financial records

Table 5: Advantages and Disadvantages of International M&A, compiled from: Svend Hollensen, Global Marketing: A Market-Responsive Approach, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 305; Simon London, "Why Most Cross-Border Deals End in Tears." Financial Times 30. May 2005: 9; and Franklin R. Root, Entry Strategies for International Markets, Massachusetts: Lexington Books, 1987, 143-144.

Therefore, M&A are useful for a fast access to new markets and resources (technology, knowledge) but the advantages have to be considered against the disadvantages, for example, high risks and communication/coordination problems.

2 Culture

This chapter defines and describes the term culture and analyzes cultural dimensions suggested and illustrated, on the one hand, by Hofstede, Trompenaars and Wooliams, and on the other hand, by Barth. The chapter determines the model best suited for differentiated analysis of cultural differences between Germans and Chinese and, subsequently, describes the difference between the German and Chinese culture along the appropriate cultural dimension model.

2.1 Definition of Culture

A comprehensive and adequate definition of culture is needed for the further evaluation of cultural differences between Germans and Chinese. Lustig and Koester state that culture is “a learned set of shared interpretations about beliefs, values, and norms, which affect the behaviors of a relatively large group of people.” (30)

Samovar, Porter and Stefani define culture as “the deposit of knowledge, experience, beliefs, values, actions, attitudes, meanings, hierarchies, religion, notions of time, roles, spatial relations, concepts of the universe, and artifacts acquired by a group of people in the course of generation through individual and group striving.” (36)

Milton J. Bennett differentiates between objective and subjective culture. Objective culture encompasses social, economic, political and linguistics aspects of culture, i.e. institutions through which culture is expressed. Social culture refers to the “learned and shared patterns of beliefs, behaviors, and values of groups of people.” (3)

According to Jandt, culture is the “sum total of ways of living including behavioral norms, linguistic expression styles of communication, patterns of thinking, and beliefs and values of a group large enough to be self-sustaining transmitted over the course of generations." (499)

Culture has several distinct characteristics. According to Samovar, Porter and Stefani, culture is (8-11):

- Not innate, but learned. Culture is learned through observation and interaction with one's parents, family, friends and other people in one's society.
- Transmitted from generation to generation. The content and messages of a culture are communicated and passed from one generation to another generation and, thus, culture exists, endures and perpetuates one's generation.
- Based on symbols. Language, whether verbal or non-verbal, images or icons, allows one to package, transmit and store symbols and, therefore, to communicate and preserve culture to one another.
- Subject to change. Cultures are highly adaptive in order to help members cope with current problems and situations. But, the deep structure of culture, for example, values, attitudes towards gender and age as well as religious practices, are deeply entrenched into a culture, resist major alteration and are passed on from one generation to another.
- Ethnocentric[9]. One can only observe, interpret and judge other people and culture through one's own cultural perspective.

Lang observes that "culture is a system of widely accepted beliefs and internalized values that determine the actions and behavior of people. Culture – at the national level - reflects the socio-cultural background, the historical evolution and the ideological concepts of a country." (5) Figure 10 illustrates the different factors described by Lang that shape culture, i.e. the historical evolution of the particular nation/culture, the sociological background of the specific group of people and the ideological concepts underlying the society. The interplay of these factors creates a specific culture.

[9] Definition of Ethnocentrism: "The belief or feeling that a group's way of life, values and patterns of adaptation are superior to those of other groups. It may manifest itself in attitudes of superiority or hostility toward members of other groups and is sometimes expressed in discrimination, proselytizing, or violence." (TheFreeDictionary.com Ethnocentrism)

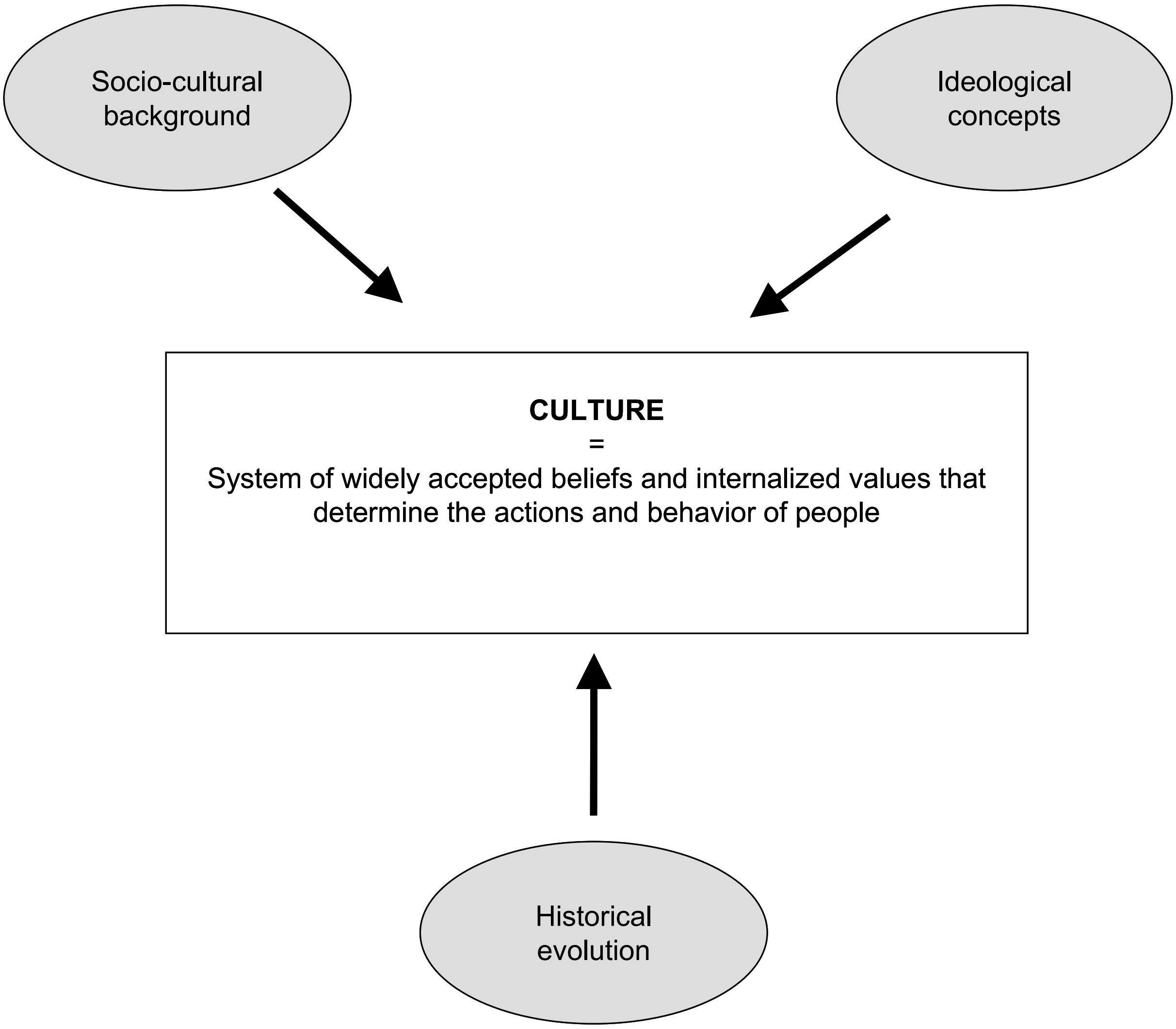

Figure 10: Definition of Culture, Nikolaus Lang, Intercultural Management in China, Wiesbaden: Deutscher Universitäts-Verlag, 1998, 5.

To conclude, culture is:

A system of beliefs and values which is learned through/within a group that affects/determines the behavior of the group members and is passed on from one generation to another.

2.2 Adequate Means for the Analysis of Culture

The part of the chapter above gave several definitions of culture. For the analysis of cultural differences in actions, behavior and values it is necessary to find the means to ultimately identify and analyze cultural differences between Chinese and Germans. First, this chapter-section describes the frameworks of cultural dimensions developed by Hofstede and Trompenaars and Wooliams and the relational approach favored by Barth. Subsequently, this chapter-section analyzes and compares these frameworks and decides which framework is used for further analysis of German and Chinese cultural differences.

2.2.1 Hofstede's 5 Cultural Dimensions

According to Hofstede, "culture is the collective programming of the mind which distinguishes the members of one group or category of people from another." (5) One is a member of a given culture and grows up in a certain environment which is, together with one's own experiences, the cause and source of one's mental programming. Hofstede refers to this mental programming as "culture."(4) The programming is shared with and amongst other people who also grew up in the same environment. Thus, "culture is learned, not inherited," since it is acquired through one's social environment, as opposed through genetic inheritance (Hofstede 5). But, one's own personality is not shared with other members of a culture as one's personality is a unique set of mental programming (Hofstede 6).

Hofstede states that each human being belongs to several different groups and categories, i.e. one is associated with, and has a mental programming for, each different layer of culture. These layers or levels can be, for example (Hofstede 10):

- national
- regional
- generational
- social class
- ethnic or
- organizational

In order to describe and illustrate cultural differences, Hofstede proposes the use of cultural dimensions. A dimension identifies and classifies a group of phenomena which are found to empirically emerge in combination. According to Hofstede, “a dimension is an aspect of a culture that can be measured relative to other cultures.” (14) Based on this premise, Hofstede identifies 5 different cultural dimensions that are relevant to all societies worldwide. (14):

(1) Power distance

(2) Individualism vs. Collectivism

(3) Masculinity vs. Feminity

(4) Uncertainty Avoidance

(5) Confucianism or long-term orientation vs. short-term orientation

The first four cultural dimensions were found using data obtained from employee attitude surveys conducted at IBM subsidiaries in forty countries and did not include Confucianism. Together with Bond, Hofstede developed a second instrument to alleviate concerns about Western bias in research. The study was conducted in twenty-two countries. Subsequently, Hofstede found a fifth dimensions which he initially labeled Confucian dynamism and later changed to “long-term orientation.” (Yeh and Lawrence 656) These five cultural dimensions identified by Hofstede are now explained further.

Hofstede defines power distance “as the extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally.” (28) Inequality is inherent in society as there is always a person who is stronger or has more power. Some societies do accept this as being something good and natural while other societies reject this construct and emphasize the thought of equality among all of its members (Hofstede 24-25). Consequently, one can expect countries with a high power distance ranking to emphasize the role of status as well as the power and influence one wields. Cultures in countries with a low power distance ranking accordingly emphasize the equality of all and disregard status and power differences.

In regard to the individualism vs. collectivism cultural dimension Hofstede writes that (51):

> Individualism pertains to societies in which the ties between individuals are loose: everyone is expected to look after himself or herself and his or her immediate family. Collectivism as is opposite pertains to societies in which people from birth onwards are integrated into strong, cohesive in-groups, which throughout people's lifetime continue to protect them in exchange for their unquestioningly loyalty.

Societies with a high individualism score are, therefore, characterized by individuals having loose relationships with other members of the same culture. In contrast, collectivist cultures with a low ranking on the individualism score are consequently characterized by people looking after each other while taking responsibility for fellow members of their group.

The cultural dimension masculinity vs. feminity refers to the desirability of assertive behavior vs. desirability of modest behavior (Hofstede 80). In masculine societies gender roles are distinct and reinforced with the male focusing on material success and showing an assertive behavior. In feminine societies the gender roles tend to overlap and both genders are expected to be modest, tender and concerned with the quality of life (Hofstede 82-83). Thus, societies with a high masculinity score are denoted by clear and distinct gender roles with the male dominating and controlling the female. Countries with a low score are denoted by the overlapping of gender roles and the equal treatment of females and males.

According to Hofstede, uncertainty avoidance is "the extent to which the members of a culture feel threatened by uncertain or unknown situations" (113). The resulting effect is a need for predictability, expressed through the establishment of written and unwritten rules (Hofstede 113). A high uncertainty avoidance ranking reflects the low tolerance of members of the specific country for uncertainty and ambiguity. In such a country, tight rules are established and deviant ideas are not tolerated. Weak uncertainty cultures are characterized by a tolerance for deviation and generally are comfortable with ambiguous situations and unfamiliar risks (Hofstede 125).

Confucianism, also described as long-term vs. short term orientation, refers to values such as persistence, thrift, having a sense of shame vs. personal steadiness, protecting your face, respect for tradition (Hofstede 165-166). To Western people these values either do not really make sense or puzzle them (Hofstede 168). The attributes actually refer to the way a society deals with virtue. The underlying survey has been developed by Eastern researchers; predictably, Asian countries generally score higher compared to Western countries (Hofstede 166). A possible explanation is the lack of appropriate concepts in the language of each country and the culture gap between Western and Eastern countries/cultures. The language differences and cultural gaps between Western and Eastern people may cause inconsistent and conflicting translations for the terms used and the questions asked in regard to the cultural dimension Confucianism and, thus, distort the results of this survey.

2.2.2 Trompenaars' and Wooliams' 7 Dimensions Model of Culture

Trompenaars and Wooliams compare culture to an onion with different layers which can be peeled off. There are three main layers. The outer layer of culture is the one most visible, for example, behavior, food, language, clothes, and is the explicit level of culture, i.e. the expressed manifestation of culture (Trompenaars and Wooliams 24). The middle layer consists of the norms and values of a culture. According to Trompenaars and Wooliams, "values are shared orientations of a group of people of what people define as the things they like and desire. Norms are shared orientations of what people believe should be done." (25) The deepest layer of culture consists of the unquestioned and implicit culture. The core of the onion refers to basic assumptions, routines and methods developed to deal with problems that regularly arise. The elements of the onion core are so basic that one is not aware of these elements, but nonetheless it affects all of one's actions and thoughts unconsciously (Trompenaars and Wooliams 27). Figure 22 illustrates the concept of culture as an onion as described by Trompenaars and Wooliams.

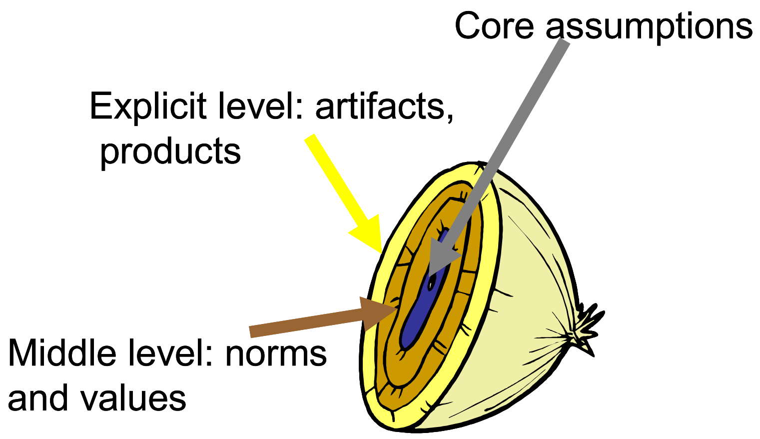

Figure 11: Trompenaars' Model of Culture, Alessandra Marinetti, and Patrick Dunn, <u>Designing Culturally Sensitive Elearning</u>, Brussels: European Foundation for Quality in eLearning (EFQUEL), 2005.

Trompenaars and Wooliams develop a 7 dimensions model that is meant to elicit, describe, and frame the resulting problems and dilemmas when people from different cultures deal with each other. The 7 dilemmas identified by Trompenaars and Wooliams (31):

(1) Universalism vs. Particularism. Do people in the organization tend to follow standardized rules or do they prefer a flexible approach to unique situations?

(2) Individualism vs. Communitarism. Does the culture foster individual performance and creativity or is the focus on the larger group leading to cohesion and consensus?

(3) Neutral vs. Affective. Are emotions controlled or do people display emotions overtly?

(4) Specific vs. Diffuse. What is the degree of involvement in personal relationships (high = diffuse, low = specific)? Does a specific business project come easily, out of which a more diffuse relationship may develop or do you have to get to know your business partners before you can do any business with them?

(5) Achievement vs. Ascription. Is status and power based on your performance or it is more determined by which school you went or your age, gender, and family background?

(6) Sequential vs. Synchronic. Do you organize time in a sequential manner, doing one task at a time, or in parallel, keeping many things active at once?

(7) Internal vs. External control. Are you stimulated by your inner drive and sense of control or are you adaptive to external events that are beyond your control?

One can observe that two of Trompenaars' and Wooliams' cultural dimensions are linked to Hofstede cultural dimensions. Individualism vs. Communitarism seems to be nearly identical to Hofstede's Individualism vs. Collectivism while Achievement vs. Ascription is linked to Hofstede's Power Distance, "at least if one accepts that status is accorded by nature rather than achievement, and that this reflects a greater willingness to accept power distances." (Dahl 15) In comparison, Hofstede designed and carried out his research with the focus on the evaluation of work values. Trompenaars' and Woolliams' work focuses more on preferred behavior in both work and private situations. Both researchers aim at discovering, analyzing and evaluating people's underlying values by asking questions about the outer layer of culture.

2.2.3 Frederik Barth's relational approach

Frederik Barth argues that the reality of people is socially constructed. Reality is reality because people by mutual consent agree that things are the way things are. The consent is embodied in collective representations: language, categories, symbols, rituals and institutions. Therefore, "cultural patterns are […] the result of social processes, understood as ongoing activity that constantly creates, upholds and transforms reality." (Gertsen, Soderberg and Torp 32) Barth emphasizes that the focus of the study of cultures should be on the subjectively experienced boundaries of the group, not on objective cultural content. Therefore, Barth suggests a relational and process-oriented approach to cultural analysis (Gertsen, Soderberg and Torp 32-33).

Hence, while Hofstede and Trompenaars stress the need for clear differentiation of cultures through national borders and the further differentiation of cultural characteristics through the introduction of cultural dimensions, Barth focuses on a relational and process-oriented approach to the analysis of culture. The relational and process-oriented approach by Barth belongs to the social constructivist concept of culture and criticizes the mainstream culture research which focuses on identifying and allocating culture classes. But social constructive concepts of culture are neither normative nor prognostic approaches, thus, are inadequate to be applied to certain cases or situations.

2.2.4 Conclusion

This dissertation focuses on evaluating, analyzing and predicting the behavior of German and Chinese businesses and individuals in business relationships and situations. The choice of Hofstede's cultural dimensions as an adequate tool seems appropriate because, first, Hofstede's cultural dimensions focus on the national level and the values and norms distinctly derivable from a national culture. "Culture level analysis always reflects central tendencies (…) for the country; it does not predict individual behavior." (Dahl 8) The analysis of the dissertation focuses on the cultural distinctions between Chinese and German nationals. Therefore, Hofstede's work is most adequate because it focuses on cultural differences on a national level such as between Chinese and Germans. Barth's relational approach of the social constructivist school has some kind of merit in regard to plausibility but is inadequate in being applied to cases and situations and, therefore, for the purpose of this dissertation.

Second, data for a wide number of countries is available, including China and Germany. Hofstede notes that "the usefulness of country scores is not for describing individuals, but for describing the social systems these individuals are likely to have built." (Hofstede 253) Thus, while the analysis of individuals and their behavior based on cultural dimensions for countries might be inaccurate or even wrong, the analysis of organizations coming from a certain culture and people acting within these organizations with Hofstede's cultural dimensions is to a large extent accurate. It should be noted that Trompenaars and Wooliams cultural dimensions are also useful for the analysis of cultural differences, but without noteworthy empirical data adequate for further analysis in the context of this dissertation, the adequateness for the proposed research is not present.

Third, Hofstede's theory about cultural dimensions has been applied by numerous researchers for a wide range of research interests. For example, Dywer, Mesak and Hsu used Hofstede to evaluate the influence of national culture on the cross-national product diffusion while van Everdingen and Waarts analyzed the influence of national culture on the adoption of innovation. Pan Fan and Zhang Zigang took a close look at the cultural challenges of doing business in China and relied on Hofstede's work. Huang, Lu and Wong analyzed the impact of power distance on the acceptance of e-mail. Numerous other studies could be named here, but the above mentioned examples underline the significance of Hofstede's findings and work for numerous research fields and especially for business economics. Therefore, this dissertation is following in the tradition of research by basing the research about the international expansion of Mainland Chinese business within the context of intercultural communication aspects on Hofstede's cultural dimensions work.

2.3 German and Chinese values on Hofstede's cultural dimensions index

Hofstede developed 5 different cultural dimensions which can be measured on an index. The following cultural dimensions indexes can be ascertained: Power Distance Index (PDI), Individualism Index (IDV), Masculinity Index (MAS), Uncertainty Avoidance Index (UAI) and the Long-Term Orientation. Table 8 shows the scores for China and Germany on the different cultural dimensions.

Dimension	PDI	IDV	MAS	UAI	LTO
Score for China	80	20	50	60	118
Score for Germany	35	67	66	65	31

Table 6: Comparison of German and Chinese Scores on Hofstede's 5 Cultural Dimensions, Gillian Oakenfull, Categorizing Countries Using Hofstede's Cultural Dimensions: Cultural Dimension Scores for 10 Countries, 2001, Available: http://www.sba.muohio.edu/oakenfg/homepage/Fall%202001/MKT%20471/Cultural%20Anlaysis/Countries%20scores.htm#CULTURAL%20DIMENSION%20SCORES%20FOR%20TEN%20COUNTRIES, 2 June 2004.

Chinese culture seems to be marked by a high power distance between those that hold power and those that do not. Privileges and status symbols for those ranking higher in status as well as unquestioning subordinance to the hierarchy by those ranking lower are expected by the members of the Chinese culture. The German score of 35 on the PDI illustrates that Germany is characterized by a relatively small power distance culture. The German culture stresses the need for providing all people with the same opportunities and access to goods. Inequality is not tolerated. Hierarchies are a means to get business done conveniently; otherwise the boss and subordinates are equal. Privileges and status symbols are not desirable, as are high gaps between the salaries of top and bottom employees of a company (Hofstede 35-37).

China is a strong collectivist society as the score of 20 implies. One belongs to a group, mostly through birth, which protects its members in exchange for unquestioning loyalty. Harmony and achieving goals in the group are the preferable order. Relationships are more important than tasks as one's identity is based on the social status in the group one belongs to. Germany's score of 67 is significantly higher on the individualism index compared to the Chinese which implies that German people do look after themselves and stress their own identity. Businesses manage individual people, not groups. The worth of the individual is stressed as are individual skills and achievements. In Germany, one speaks his/her mind and is not afraid of conflict, thus, self-expression is encouraged (Hofstede 67).

The Chinese Masculinity Index-score of 50 is a medium value. Thus, gender roles in the Chinese society are not strongly distinct. Because of the collectivist element in the Chinese society, one can expect the resolution of conflicts through negotiation and compromise. To Chinese, a consensus among all members of the group is preferable. Relationships are important, but so are success, personal progress and achievement. The relatively high German Masculinity Index-score asserts that German culture stresses the need for performance, material success and personal progress. Gender roles are clearly distinct with the man earning the money and the woman looking after the household and the children. In Germany, conflicts are fought out, competition is desired and there is an emphasis on working in life (Hofstede 96).

The Chinese Uncertainty Avoidance Index (UAI) score of 60 shows a medium value for uncertainty avoidance. The score implies that the Chinese stress the importance of not showing aggressions and feelings in public. Chinese people are motivated by belonging to a group. Lectures and teachings given by 'wise men,' such as teachers, are seen as superior and pupils do not question them. Furthermore, deviant ideas, ideas which differ from those held by the group, are dangerous and intolerable. Germany scores medium to high on the UAI which illustrates the German preference for written and unwritten rules. The emotional need for guidelines and rules results from the desire to prevent uncertainty and risk in life. Germans emphasize punctuality and precision (Hofstede 134).

China is ranked number 1 on the LTO index. The score of 118 displays the high value Chinese place on long-term commitment. Traditions within a changing society are adapted to a modern context. The Chinese have a high savings rate and are apt at subordinating themselves to a cause, for example, a group goal. The German LTO - score of 31 implies a rather medium to low commitment to long-term orientation. Thus, Germans tend to stick to their traditions, even in a rapidly changing society. Germans do expect quick results and believe in the "one" truth which leads to the conscious effort to preserve one's face and social status (Hofstede 173).

In conclusion, comparing the scores for China and Germany on the different cultural dimensions allows one to make several assumptions in regard to problems and conflicts that might arise between both parties. China scores significantly higher on the Power Distance Index than Germany. Thus, it can be expected that there might be conflicts caused by the different approaches Chinese and Germans tend to take toward power distribution and inequality. While Chinese may emphasize their role and status when dealing with Germans, the Germans may feel that the Chinese are overemphasizing their social and political status and try to defuse the inequality between members of different organizational and social status.

A sharp contrast between Chinese and Germans can be observed in regard to individualism vs. collectivism. While the Chinese society is distinctively collectivist, Germans value individualism. Chinese need to belong to a group which contrasts starkly to the German quest for self-fulfillment. It is reasonable to expect conflicts between Chinese and Germans when working and discussing topics in teams. While Germans speak their mind in the group, Chinese are likely to go with group opinion and not openly challenge the opinion of others. However, that does not mean that the Chinese agree with the opinion of the group, but that a Chinese might voice her/his doubts in talks with close colleagues after the meeting. This indirect approach might confuse and irritate the Germans. The example shows that there are numerous possibilities for serious conflicts between Chinese and Germans due to their different cultural imprint.

The Chinese Masculinity Index (MAS) –score of 50 is a medium value, while the German value with 66 is significantly higher. Gender roles are more distinct in Germany than in China. The medium value for China could be a side effect of the predominant collectivism in the Chinese culture. Thus, collectivist behavior results in the part-taking in jobs with no regard to gender. Although Germans and Chinese seem to have different values regarding the distinction of gender roles, the differences should prove to be not too significant when dealing with each other.

China and Germany have a medium value on the Uncertainty Avoidance Index (UAI). Both countries, therefore, stress the need for preventing uncertainty and risk. Due to different characteristics of China and Germany on the PDI, each takes a different approach to resolve problems arising from uncertainty and risk. Chinese tend to stress the importance of authority while Germans, with their focus on equality, emphasize the need for rules and processes to deal with uncertainty and risk. Therefore, considerable differences exist which can result in frictions and conflict between the Chinese and the Germans.

The Chinese score the highest on the Long-Term-Orientation Index (LTO). In contrast, German culture is relatively short-term orientated. The significant different scores lead to conflicting values and strategies. For example, the Chinese might focus more strongly on long-term results vs. the German's desire for quick results. Furthermore, while Chinese emphasize the need for harmony in the group and the adherence of its members to this standard, German stress the search for "one truth" and the preservation of one's face and social status. These conflicting values can lead to considerable frictions when dealing with business strategies as well in team discussions.

2.4 Distinct Chinese Culture Characteristics

2.4.1 Fundamental Beliefs and Values

To understand Chinese culture and communication, one has to understand the importance of the philosophical teachings of Taoism and Confucianism for Chinese culture. In the Chinese culture, there is no individual as in the Western concept of the individual. Rather, in the Chinese culture, the individual, i.e. the self, is incomplete. Redding observes that (The Spirit of Chinese Capitalism 95):

> life in a collectivist and group-dominated society means that the Chinese self is not isolated in the same sense as the Western one. Other people are bound up into the identity of any single Chinese person, and the relationships are carried round as part of the person. He or she is inextricable from that network and not really understandable in isolation.

Thus, the Chinese self, and, therefore, the cultural and communicative behavior, cannot be understood by analyzing the Chinese self alone, but rather by describing and analyzing the determinants of Chinese society. One has to understand the cultural matrix in which the Chinese self is embedded. The determinants are fundamental beliefs and values, social structures, relationship rules for dealing with in- and outsiders and the rules for action, particularly in business context. Figure 12 shows the cultural determinants of individual Chinese values according to Redding.

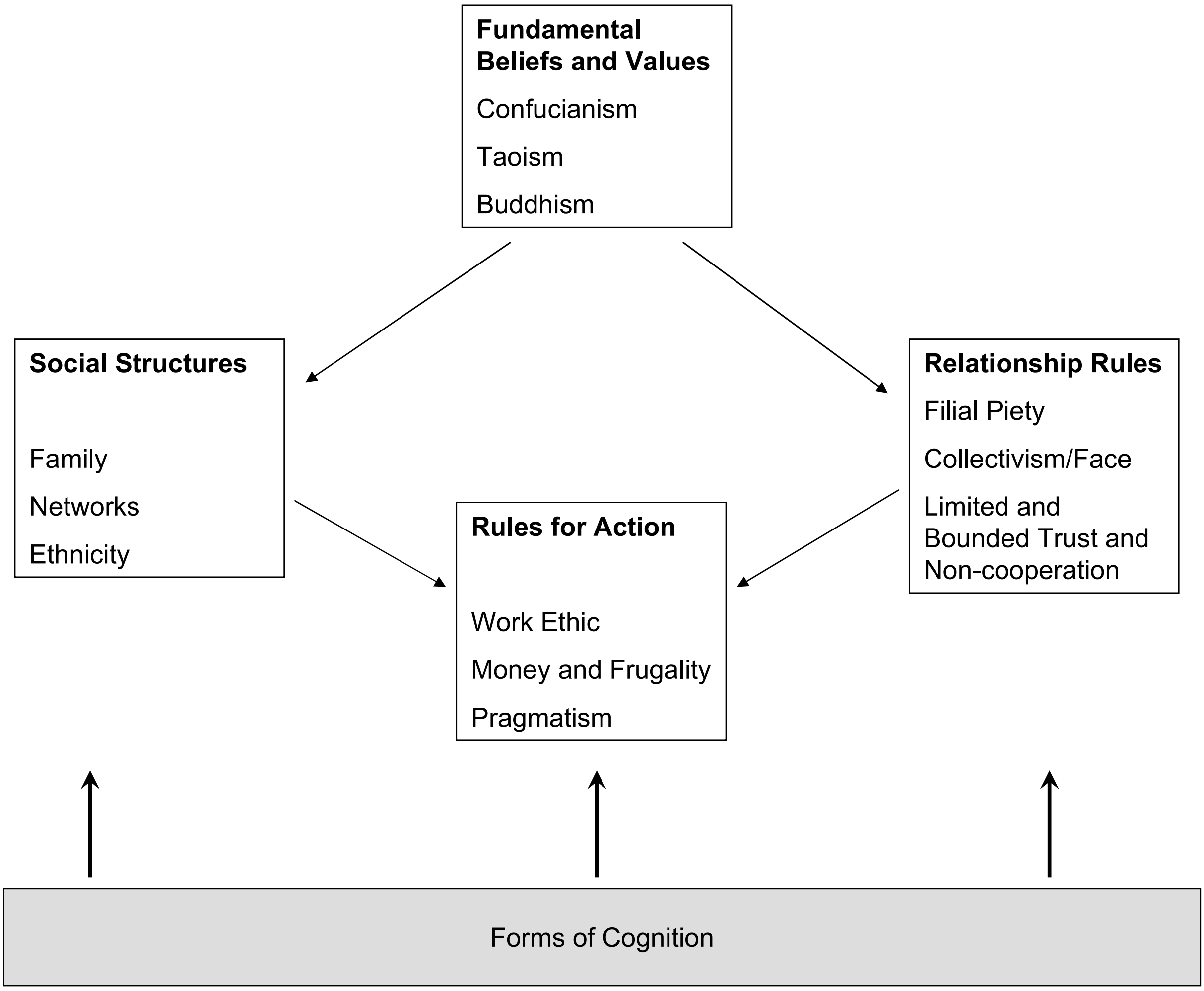

Figure 12: Cultural Determinants of Individual Chinese Values, S. Gordon Redding, The Spirit of Chinese Capitalism, De Gruyter Studies in Organization, Ed. Stewart Clegg, Vol. 22. Berlin; New York: Walter de Gruyter, 1990, 43.

In Taoism, the self is part of nature and together, self and nature, form a harmonious relationship. In the Confucian sense, the self is defined by the relations one has with others. For example, the relations one has with one's parents (G. Gao 83). G. Gao and Ting-Toomey observe that "Confucianism asserts that individuality and the true self do not belong together; rather, social and ethical responsibilities define the self." (8-9) The concept of the self in relations to others is supported by cultural values such as filial piety, loyalty, dignity and integrity. Thus, a Chinese is sensitive to his position as being above, below or equal to others in his/her relationship network (G. Gao 83). Confucius' fundamental teachings can be summarized into 4 lessons (Hofstede 165):

(1) The stability of society is based on unequal relationships between people
(2) The family is the prototype of all social organizations
(3) Virtuous behavior towards other consists of not treating others as one would not like to be treated oneself
(4) Virtue with regard to one's tasks in life consists of trying to acquire skills and education, working hard, not spending more than necessary, being patient and persevering.

Buddhism has been incorporated relatively easily into Confucianism since Buddhism is a wider philosophy of man's relation to the world and is complimentary to Confucian's thinking in regard to the practical ethics of daily life. Buddhism does not worship a god, but is more concerned about how one lives with his nature and seeks harmony of all nature's things (Redding, The Spirit of Chinese Capitalism 50-51).

The social structures which include the family, networks and ethnicity are also important to the Chinese self. A family is the basic survival unit and is basically focused on "protecting and enhancing the family resources on which they are in turn highly dependent." (Redding, The Spirit of Chinese Capitalism 53) In regard to the notion that Chinese self only exists in relational terms and that one is nothing without one's family, Redding notes that (The Spirit of Chinese Capitalism 53):

> One can see from this the way in which the person is perceived to exist only in terms of his immediate family network, and by extension that society is seen as comprising not individuals – who in themselves have no legitimate place – but families, around which life is formed.

Networks are useful when family's resources are inadequate and networks beyond family or kinship are utilized. The four main characteristics along which these networks form are those, first, based on kinship, second, defined by regional origin, third, based on dialect and fourth, derived from occupation or craft. These networks are especially significant and have proven useful for Chinese operations outside China where cooperation among Chinese is needed. Further social structures are based upon ethnicity which can also mean that Chinese communities deliberately isolate themselves from the native citizens in their new host countries in order to maintain group identity and solidarity. The Chinese language serves as a further deterrence against outsiders (Redding, The Spirit of Chinese Capitalism 56-58).

Chinese emphasize the skill of being able to deal with and conform to horizontal and vertical relationships. Filial piety is a cornerstone of the Chinese understanding of relationships. One has to obey the head of the organization or family. Challenging the formal authority is rare and not desirable. The Chinese individual understands and respects the superior-subordinate relationship which is taught to him by cultivation of filial piety in the family in which total obedience to the family head is paid. Collectivism has been discussed by Hofstede above in Chapter 3.2.1 and refers to the inextricable embedment of the self in relationships; ultimately the Chinese individual self cannot exist without the group. Face refers to the standing of the individual self in the group. The value or worth of the self is constructed by the group and expresses itself through the worth of the face (Redding, The Spirit of Chinese Capitalism 59-63). The concept of face is elaborated in detail in Chapter 3.3.2.

Limited and bounded trust is exercised by Chinese individuals as one only trusts someone else to the extent to which the person is a family member, a friend or otherwise connected. There is a limited amount of trust in others and, thus, non-cooperation is more likely than cooperation. In order for Chinese society to work, individuals form connections in order to be able do business or deal with each other (Redding, The Spirit of Chinese Capitalism 66-67). The Chinese term for establishing and maintaining connections is *guanxi*; the concept of *guanxi* is discussed later in this chapter.

The rules for individual Chinese economic behavior are work ethic, money and frugality and pragmatism. Chinese people are generally seen as hard-working which seems to be a direct result of filial piety turned into practice through one's fulfilling of duty of working hard for one's superiors. Chinese people know how to achieve and deal with money as illustrated by the success of Overseas Chinese businesses. But money has to be spent frugally. But the frugally generally tends to be rather self-directed and towards the own family than in terms of hospitality towards friends and business partners. Money-mindness and frugality can be seen as subsets of pragmatism as one does not feel obligation towards others except for money. The Chinese live in a network society which encourages the use of reciprocity. Thus, "the network society is designed for mutual exploitation," (Redding, The Spirit of Chinese Capitalism 72) and one acts pragmatically, not ideological in order to secure one's own and one's family survival.

The four cultural determinants, fundamental beliefs and values, social structures, relationships and rules for actions as described in Figure 23 illustrate the radical difference of Chinese thinking and culture from other, especially Western, culture. Chinese tend to perceive situations as a whole. If one looks at the various determinants one can conclude that “cause for the Chinese is a matter of ‘connectedness,’ of understanding the mutual, reciprocal interplays between a large array of forces.” (Redding, The Spirit of Chinese Capitalism 76). Thus, Chinese culture is not focused on the individual issue or person, but on the interplay between persons and issues and the ultimate harmony between all forces.

2.4.2 Guanxi

Guanxi translates literally with “connections”, but refers to a relationship based on mutual obligation and reciprocity (M.-J. Chen 46). The connection or *guanxi* “can be based on family or place of origin, as in the past, or on other associations, for example, working together in a particular organization in the past.” (Lockett 489) *Guanxi* is “a relationship between two people who are expected, more or less, to give as good as they get.” (Seligman 34) “*Guanxi* relationships are defined by a strict ethic of reciprocity and obligation” (Vanhonacker “When Good *Guanxi* Turns Bad” 18). The use of *guanxi* is one of the possibilities to come to terms with the highly personal and noncodified nature of Chinese culture (Ng 37).

Davis states that “there is a very broad and deep meaning in Chinese culture to *guanxi* that goes beyond just the definitions of relationships or friendships. It really goes deeper into the issue of trust, respect, care and [the] human relationships that relate to business.” (McClenahen 45) Vanhonacker adds, “*guanxi* is part of the fabric of Chinese society. Personal relationships are central to every aspect of Chinese society, including business.” ("*Guanxi* Networks,"49) Furthermore, “to most Chinese, *guanxi* has its own moral code and serves a necessary social function.” (Vanhonacker "*Guanxi* Networks,"45) For business, *guanxi* is “a form of social capital.” (McClenahen 40)

Guanxi can pave the way for individuals and organizations in various instances such as the fast issuance of a business license. *Guanxi* can make things possible which beforehand seemed to be impossible when dealing with Chinese. *Guanxi* can also offer protection and is the key to getting things accomplished within the complicated legal system of China (Seligman 34-35). One of the most important features of *guanxi* in the context of culture and communication is the ability of *guanxi* to be face-enhancing. The more *guanxi* one has and the more powerful the people are that one has *guanxi* with, the more face one has (Luo 14).

Luo summarizes the concept of *guanxi* by writing that *guanxi* (2):

> refers to the concept of drawing on connections in order to secure favors in personal relations. It forms an intricate, pervasive relational network which the Chinese cultivate energetically, subtly, and imaginatively. It contains implicit mutual obligations, assurances, and understanding, and governs Chinese attitudes toward long-term social and business relationships. Broadly, *guanxi* means interpersonal linkage with the implication of continued exchange of favors. […] What is special about *guanxi* is the fact that it is ubiquitous and plays a fundamental role in daily life. The Chinese have turned *guanxi* into a carefully calculated science. Constructing and maintaining *guanxi* is a common preoccupation for entrepreneurs, managers, officials, and even college students.

Luo also asserts that *guanxi* is (10-11):

- Transferable
- Reciprocal
- Intangible
- Essentially utilitarian
- Contextual
- Long-term oriented
- Personal

Guanxi is transferable since A can have a friend B and C and introduce B to C or vice versa. *Guanxi* is reciprocal, because favors are exchanged between A and B in order to establish and maintain *guanxi*. If the favor by A is not returned by B, B loses face which serves as a deterrent to opportunistic behavior by B. *Guanxi* is intangible, because it is an unspoken commitment of A to B by an invisible and unwritten code of reciprocity. *Guanxi* bonds through the exchange of favors and not through friendship which makes *guanxi* utilitarian and not emotion-related. *Guanxi* is contextual because giving the right and appropriate gift in the situation calls for a context-sensitive approach. Since every *guanxi* relationship is regarded as a kind of stock to be used when needed and not immediately, *guanxi* relationships are long-term oriented. Lastly, *guanxi* is personal; it cannot be attached to organizations but to a certain person in an organization which means that if the person leaves the organization, the *guanxi* leaves the organization with this person as well (Luo 12-13).

In conclusion, *guanxi* is a relationship between two persons who reciprocate favors and are obliged to each other. The *guanxi* between these two persons might have been established by common dialect, work, family- or clan network. *Guanxi* is transferable, long-term oriented and can help individuals to achieve results they would otherwise not have been able to achieve. Also, *guanxi* can be face-enhancing. Hence, *guanxi* is part of the fabric of Chinese society and plays an imminent role in daily Chinese life.

3 Communication

3.1 Definition of Communication

N. J. Adler observes (73):

> All business activity involves communicating. Within global businesses, activities such as leading, negotiating, decision making, problem solving, and exchanging information and ideas are all based on the ability of mangers and employees from one culture to communicate successfully with colleagues, clients, and suppliers from other cultures.

Thus, in order to be globally active and successful, it is necessary for one to understand what communication is and how to utilize it appropriately. Trying to define communication is harder than it might seem at first glance since more than 126 different definitions of the word communication have been found. Frey defines communication as “the processes by which verbal and nonverbal messages are used to create and share meaning.” (28) The Oxford Advanced Learner’s Dictionary defines communication as “the activity or process of expressing ideas and feelings or of giving people information.” (243) Jandt defines communication as the “process of intentionally stimulating meaning in other humans through the use of symbols” (498). Lustig and Koester define communication as “a symbolic process in which people create shared meaning.” (25) Samovar, Porter and Stefani state that communication “is a dynamic, systematic process in which meanings are created and reflected in human interaction with symbols.” (24)

Thus, drawing on all presented definitions, communication is

A process in which symbols are used in verbal and nonverbal messages to convey information and create shared meaning.

Shannon and Weaver developed the first model of communication which is illustrated in Figure 13. The model is linear and can be best understood by imagining that the communication process is similar to a movie. If one stops the film for a moment, one sees a frame with the communication taking place between the sender and the receiver. In fact, communication is more dynamic with a continuous flow of messages and changing roles of sender and receiver as is shown later in the transactional communication model.

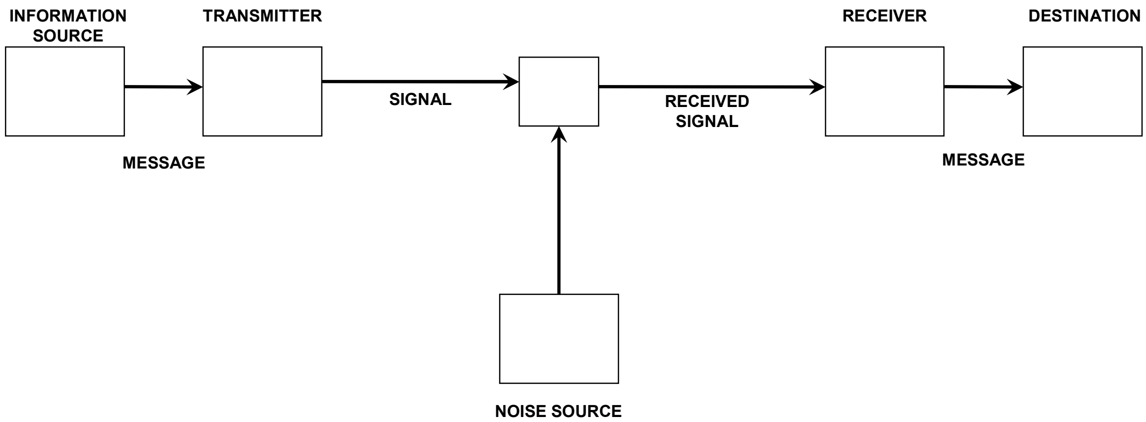

Figure 13: Model of Communication, Claude E. Shannon and Warren Weaver, The Mathematical Theory of Communication, Urbana: University of Illinois Press, 1949, 7.

A source formulates a message and uses the transmitter to send it. The transmitter generates a signal. The signal might be influenced or distorted by a noise source. Thus, the receiver receives the (distorted) signal and converts it into a message. The message is passed on to the destination by the receiver[10]. The model developed by Weaver and Shannon is a basic description of the communication process. It laid the foundation for the development of more enhanced models of the communication process.

Figure 14 displays the communication process in consideration of a more precise description of the several steps in the communication process. Figure 14 also allows for the introduction of the feedback process back from the receiver to the sender and the influence of context on both the sender and the receiver.

[10] A more detailed definition and descriptions of the terms used in the communication models follows later in this chapter.

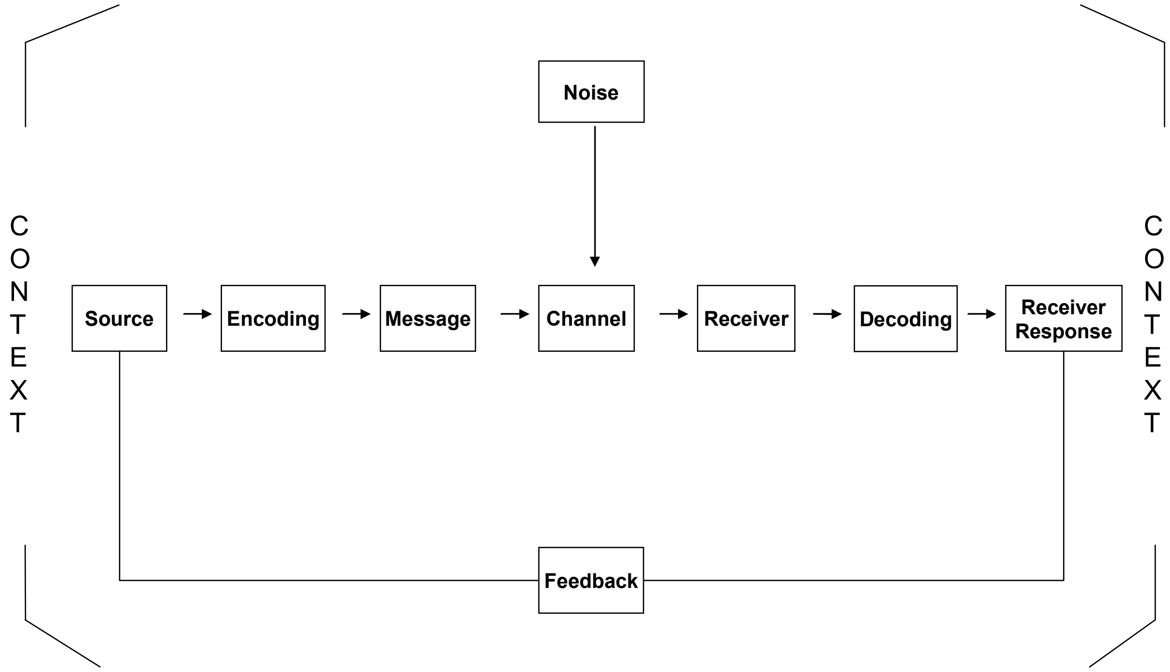

Figure 14: The Components of Communication, Fred E. Jandt, Intercultural Communication: An Introduction, 3rd ed., Thousand Oaks: Sage Publications, 2001, 29.

The source in the communication model refers to “some person or group of person with a purpose, a reason for engaging in communication” (Berlo 30). By encoding ideas and thoughts into symbols and words, the receiver translates the ideas and thoughts into a message. The message is created to supply information to the receiver and can be transmitted verbally and nonverbally (Heath and Bryant 70).

The term “message” can be defined further. Messages, according to McQuail, are “symbolic constructs that have a meaningful reference to sender, receiver, or environment.” (330) Complementing, a message can be seen as a stimulus whose meaning is defined by the receiver (Heath and Bryant 76). Thus, message and meaning are connected; a message creates a meaning for a person. Heath and Bryant observe that “meaning is the product that results as a person interprets behavior – verbal and nonverbal – of another.” (77) Therefore, the receiver deducts the meaning of a message from interpreting the encoded information in the message which has been transmitted through a channel.

The channel is the means by which the message is sent from the source to the receiver. The channel can be a letter, a speech or a TV commercial, for example. Some researchers have challenged the thought that a channel is only transmitting the message. Rather, these researchers allege that the channel – the medium – is the message. Due to the different kinds of channels, for example, TV and texts, the channel may influence or convey messages differently. Children are able to store and remember information more easily if they have obtained the information by watching it on TV, compared to receiving the same information by reading a book. Thus, a channel may enrich or amplify the message (Heath and Bryant 80-82).

The receiver in due time releases a response to indicate that he/she received (and possibly) understood the message. The feedback refers to the response of the receiver and of which the source has knowledge and can assign meaning (Jandt 32). To be more precise, feedback is the "information a person (or machine) receives and interprets that allows him or her to determine whether his or her action (such as message) had the desired effect to achieve a goal, such as to inform a receiver." (Heath and Bryant 75) Thus, the feedback is not receiver-centered, but source-centered. The source decides on the feedback received from the receiver whether the receiver understood the message, whether the source has to modify the messages or whether the source has to change the goal it was pursuing, such as persuading the receiver, for example.

The communication process may be disturbed or distorted by noise. According to DeVito noise can be "anything that distorts the message, anything that prevents the receiver from receiving the message." (Essentials of Human Communication 14) DeVito differentiates between 4 different types of noise (Essentials of Human Communication 15):

(1) Physical, i.e. external interference, for example, loud background noise during a conversation
(2) Physiological, i.e. physical barriers within the speaker or listener, for example, a hearing impairment of the listener
(3) Psychological, i.e. mental interferences or stereotypes, for example, a prejudice against the speaker
(4) Semantic, i.e. speaker and listener assigning different meanings, for example, speaker and listener speak different languages.

The last component of communication is context. One can distinguish between physical context (e.g. tangible or concrete environment), the cultural context (e.g. lifestyle, values, belief), the social-psychological context (e.g. status relationship among the speakers) and the temporal context (e.g. how does the message fit into the sequence of events?) (DeVito, Essentials of Human Communication 7). The context of a communication process also shapes the communication, its symbols, the message and the expected response (Jandt 32).

Singer offers a conclusive summary of the communication process (107):

> […] communication is a process. As such it is continually operating, through feedback, which the environment and with everyone and everything in that environment. It is an ongoing process […]. It is applicable regardless of the level analysis. The same process operates whether one considers intra-or interpersonal communication, intra-or intergroup communication, or intra-or international communication. Of course, the specifics of how that process operates change as one changes the actors and settings, but the process remains constant.

The transactional communication model in Figure 15 illustrates Singer's statement. Both participants continuously send and receive messages which are decoded and to which feedback is sent through one or more channels. A and B's environments overlap and noise is present at all stages of the communication process which influences the communication process between both participants. What has been labeled context in the Figure 15 is in fact the environment which in communication theory includes setting, cultural background, experiences, etc. that influence a person's communication behavior (Adler and Rodman 12).

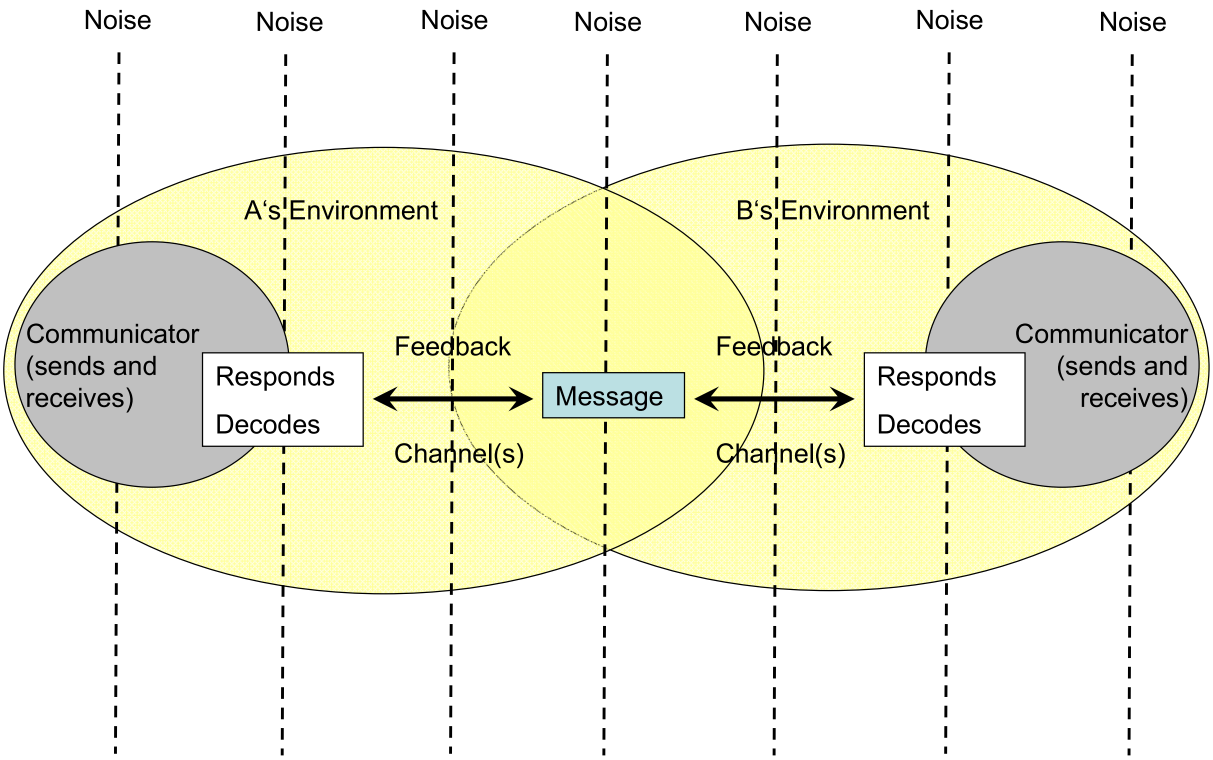

Figure 15: Transactional Communication Model, adapted from: Ronald B. Adler, and George Rodman. Understanding Human Communication, Oxford: Oxford University Press, 2003, 14.

Communication is not an activity that is used at certain times or at special occasions. It is an act that all human beings do all the time. Singer states that "it is simply not possible not to communicate." (103) This is because "all of us [human beings] are engaged in communication 100 percent of the time, twenty-four hours of every day." (Singer 103-104)

One does not necessarily have to be consciously communicating. Singer offers the example of a person walking down a crowded street. Because the person receives the messages sent by the people where they are headed and gives feedback through sending a message where he/she will walk, the person and the other people will not bump into each other. This communication happens without explicit and conscious thought or effort. Without being consciously aware of the communication, both the person and the people on the street have communicated with each other. Therefore, one is consciously unaware of the communication action, because one is not directly focus on sending and receiving the messages, but one does it without even being fully aware of it (Singer 104).

As seen, context in the communication process has been defined as the environment in which the communication process takes place. The concept of context needs to be elaborated further as it refers to more than just the environment in which the communication takes place. Borisoff and Victor observe that contexting is “the way in which one communicates and especially the circumstances surrounding that communication” (140). Thus, communication relies on the context in which that communication takes place. Therefore, if two people communicating share knowledge and experience, the need for extensively expressing what they want to convey decreases.

The case of shared knowledge and experience most likely occurs when both persons belong to the same culture. Victor states that “contexting is to a large degree culturally learned behavior” (138). Therefore, members of the same culture seldom have to make a conscious effort to bring forth the right level of contexting. From childhood to adulthood, the members of a culture subconsciously and effortlessly learn the appropriate level of contexting at the same as they learn language (Victor 138). Thus, it seems logical that members of one culture are nearly always able to access and grasp the meaning of the message communicated and react accordingly. Because the meaning of communication is always dependent on the context, Hall concludes that “the level of context determines everything about the nature of the communication and is the foundation on which all subsequent behavior rests.” (92)

3.2 Hall’s Low-Context and High-Context Communication Model

Hall differentiates between high- and low-context cultures. High-context cultures are characterized by the fact that most of the information is already in the receiver and in the setting. Only minimal information is transmitted in the course of the communication process (101). Victor complements Hall’s explanation by stating that “in highly contexted communication, what individuals choose not to put into words is essential to understanding the actual message intended.” (139) High-context cultures require an intensive programming of the individual to connect the sender and receiver at the same cultural level. High context cultures, even when the amount of information grows bigger, are becoming more predictable if one is familiar with the system (Hall 53). High-context communication is, therefore, once the individual is programmed over a long period of time, economical, fast and efficient (Hall 101). In high-context cultures authorities feel personally and truly responsible for their subordinates as opposed to low-context cultures (Hall 113). Also, actions in high-context cultures are rooted in the past, are highly stable and are slow to change. Therefore, a high-context culture can absorb activism without a threat to its institutions and foundations (Hall 93-94). Tubbs observes that (300):

> Members of high-context cultures are more skilled in reading nonverbal behaviors; and they assume that other people will also be able to do so. Thus, they speak less than members of low-context cultures and they listen more; in general, their communication tends to be indirect and less explicit.

In low-context cultures most of the information to be transmitted is in the message. There is not much context in either the receiver or the environment; therefore, any provided information has to be detailed to make up for the missing context (Hall, Beyond Culture, 101). Tubbs writes that "members of low-context cultures […] stress direct and explicit communication. They emphasize verbal messages and the shared information they encode." (300) DeVito contrasts the communication behavior of low-context and high-context cultures and finds that (Human Communication: The Basic Course 42):

> Members of high-context cultures spend lots of time getting to know one another interpersonally and socially before any important transactions take place. Because of this prior personal knowledge, a great deal of information is shared by the members and therefore does not have to be explicitly stated. Members of low-context cultures spend a great deal less time getting to know one another and hence don't have that shared knowledge. As a result everything has to be stated explicitly.

Low-context cultures are highly individualized, fragmented and characterized by relatively little involvement with people (Hall 39). Because the bonds are more fragile between the people, it is easier to see trouble or confrontations building up because people withdraw or move away. This contrasts with a high-context culture where, due to the strong bonds between members of the same group, problems and conflicts are suppressed and the system is bent until it explodes without warning (Hall 127). Furthermore, low-context cultures do not distinguish as clearly between insiders and outsiders as high-context cultures do. Because responsibility is diffused in low-context cultures, in case something goes wrong, the lowest-ranking official or member of the group is held responsible for what went wrong (Hall 108-113).

Table 7 shows the main differences between low- and high-context cultures.

	High Context	**Low Context**
Emphasis on written word	Weak	Strong
Governance of interpersonal behavior	Governed by individual perception	Governed by external rules and regulations
Agreements based on personal promises	Binding	Not binding
Agreements based on written words (contracts)	Not binding	Binding
Reliance on words to communicate	Low	High
Reliance on nonverbal communication	High	Low
Attention to detail	Low	High
Attention to intention	High	Low
Communication approach	Indirect; inferential	Direct; explicit

Table 7: Summary of Main Differences Between High- and Low-Context Cultures in Communication, based on: David A. Victor, International Business Communication, New York: HarperCollins Publishers, 1992, 149, 153.

The Chinese culture, on the one hand, ranks very high on the high-context culture scale. Evidence can be found in the fact that in order to understand the Chinese language, one has to understand context as there are over 214 radicals[11] in the Chinese language. Furthermore, the Chinese language can only be understood when being literate in Chinese culture, as well as knowing the right pronunciation due to the different meanings of words when emphasizing certain parts (Hall 91-92). Thus, one needs to do a significant amount of contexting in order to decipher and understand the Chinese language and the meaning being transmitted. Germany, on the other hand, ranks at the lower end of the high-low-context scale, along with Scandinavia and the German-Swiss culture (Hall 91). Figure 16 illustrates the gap in contexting between China and Germany on the contextual continuum.

[11] A radical (from Latin radix, meaning "root") is a basic identifiable component of every Chinese character. The name is an English translation of the characters □□ (bù shǒu), literally meaning "partial head", where "head" means "the most important (part)." Radicals are used in Chinese dictionaries, Kanji-Japanese dictionaries, and Hanja-Korean dictionaries to order characters in sets by the number of stroke s they contain. Full characters are ordered according to their initial radicals, which fall into roughly 214 types. Then these are subcategorised by their total number of strokes (TheFreeDictionary.com Chinese Radicals).

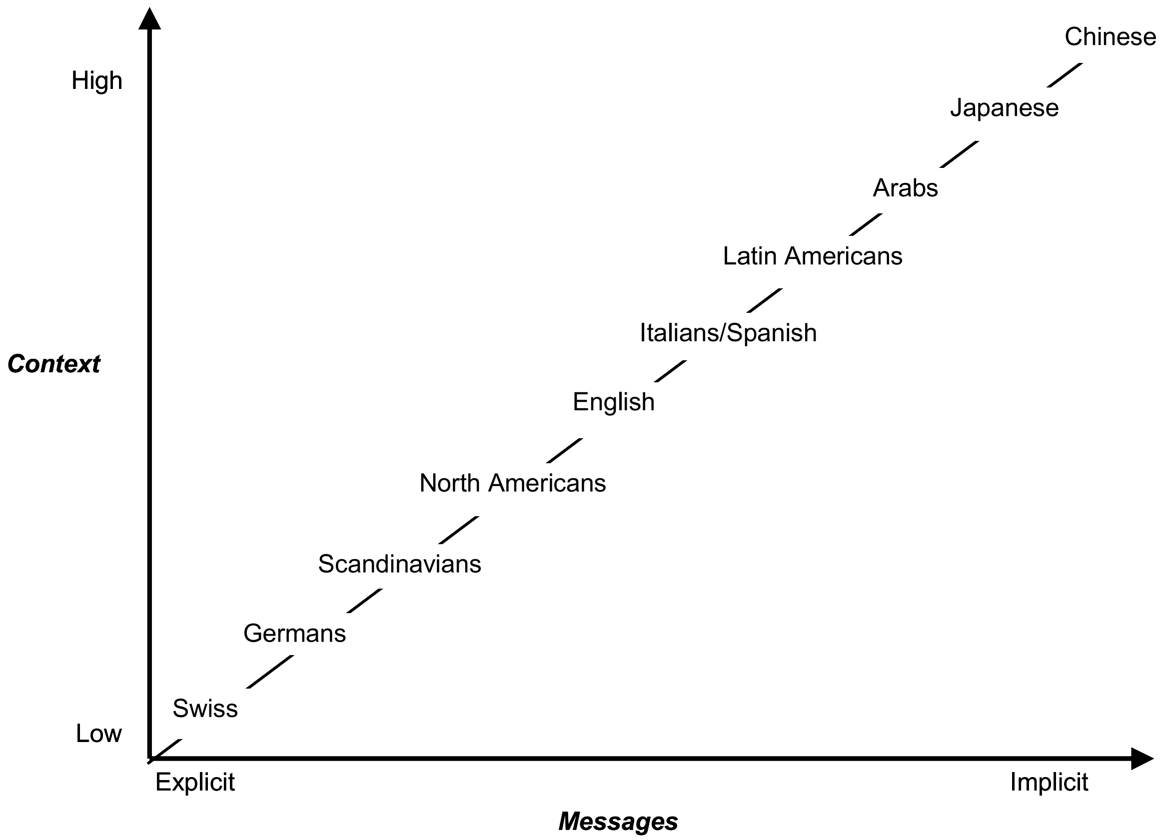

Figure 16: The Contextual Continuum of Differing Cultures, based on: Svend Hollensen, Global Marketing: A Market-Responsive Approach, 2nd ed., Harlow, England: Pearson Education Limited, 2001, 162; and Edward T. Hall, Beyond Culture, New York: Anchor Books, 1976, 91.

When looking at Figure 16, one can see that Germany ranks at the lower bottom of the contextual continuum while China ranks at the top. Thus, different communication behavior and ensuing communication problems between Chinese and German individuals can be expected. For example, Chinese might perceive the Germans as being too direct and too outspoken while Germans might view Chinese as being too indirect, close-lipped and vague. Therefore, Chinese and Germans should anticipate problems in their communication with each other and try to be aware of potential problems and misunderstandings that could arise.

3.3 Distinct Chinese Characteristics in Communication

G. Gao and Ting-Toomey assert that in Chinese, communication is a foreign concept as there is no single word that adequately translates the term "communication". (5) Thus, "the Chinese way of communicating can only be understood, explained and interpreted only in its cultural context." (G. Gao and Ting-Toomey 36) Consequently, "the primary functions of communication in the Chinese culture are to maintain existing relationships among individuals […] and to preserve harmony within the group." (G.Gao 96)

3.3.1 Insider vs. Outsider Communication Approach

As G. Gao observes, "Chinese make clear distinctions between insiders and outsiders, and this distinction exists on all levels of interpersonal interactions." (87) To become a *zi ji ren* (insider) one has to has to show the 5 characteristics niceness, trustworthiness, caring, helpfulness and empathy. Chinese seldom disclose personal information to *wai ren* (outsider), but tend to have honest and truthful conversations with insiders (G. Gao and Ting-Toomey 15). Thus, "the nature of a relationship determines what is communicated and how information should be communicated." (G. Gao and Ting-Toomey 50)

Transforming one's relationship from outsider to insider is a time-consuming and arduous process because in the Chinese context the development of personal relationship usually takes a long time (G. Gao 88). The Chinese insider vs. outsider communication concept identified by G. Gao and G. Gao and Ting-Toomey is also closely related to the concept of collectivist cultures as identified by Hofstede in his individualism vs. collectivism cultural dimension. The different treatment of insiders and outsiders in communication as well as in everyday life complicates the interaction of Chinese people with unknown strangers. Subsequently, Chinese intermediaries are chosen to introduce people to each other as well as to mediate between different parties to avoid the loss of face and preserve interpersonal harmony between the parties (G. Gao and Ting-Toomey 49,64). G. Gao concludes that “intermediaries both formal and informal play a very important role in Chinese personal relationships.” (97)

3.3.2 Mian Zi (Face)

Ho defines face as “the recognition by others of one’s social standing and position, and thus must be seen as situationally defined rather than part of personality.” (Lockett 488) Most cultures know the concept of face as “an intangible resource that is vital to a person’s reputation, dignity and prestige.” (Seligman 37) People in all cultures engage in communicative acts to maintain, negotiate and enact self-face, uphold, support or challenge other people’s face. The conceptualization of face includes (G. Gao and Ting-Toomey 56):

- A sense of one’s social self-worth or other’s assessments of our social “worthiness” or both and
- A vulnerable resource in social interactions given that it can be threatened, attacked, maintained, and enhanced.

In the context of Chinese culture, two concepts represent the notion of face. *Lian*, on the hand, means “face” and refers to the moral dimension of face and is internalized. *Mian* or *mian zi*, on the other hand, refers to the social and positional image and is externalized (G. Gao and Ting-Toomey 55) G. Gao and Ting-Toomey observe that “*mian zi* influences how we [the Chinese] perceive ourselves, how we relate to others, and how we speak to others. It is central to the Chinese self-conception and relational development.” (57) “Facework management hence is essential to various aspects of personal and interpersonal relationship development in the Chinese culture.” (G. Gao 96)

Seligman adds that (37):

- *Mian zi*, money and power are the three key motivators in China
- An affront to personal dignity causes a loss of face
- Chinese spend a lot of time thinking about face and put more relevance upon it
- Things that make others look up to you or envy you confer face on you

According to G. Gao, *mian zi* has at least three significant implications for Chinese’s everyday life. First, face and the fear of face-loss lead to the regulation of one's behavior. Second, due to the concern about face, one consciously decides what to disclose and not to disclose in personal relationships. Finally, face is a not only a personal concern, but also a group concern because face-loss also reflects on one's own family (G. Gao 95-96). Additionally, "how much face an individual has depends partly on his or her *guanxi* network. The larger one's *guanxi* network and the more powerful the people connected with it are, the more face on has." (Luo 14)

To preserve face, Chinese engage among other approaches in the following communication strategies (G. Gao and Ting-Toomey 60):

- Nonconfrontation
- Compliance strategies
- Provisional responses
- Using intermediaries

Chinese prefer the nonconfrontational communication style as Chinese see conflict and confrontation as unpleasant and undesirable as conflict and confrontation are contradictory to harmony. Subsequently, "Chinese cherish and nurture the belief that conflict should be approached with self-control and self-restraint " because "to construct and present criticism in a nonthreatening, face-saving and gentle manner is a highly desirable interpersonal skill." (G. Gao and Ting-Toomey 61-62) G. Gao and Ting-Toomey explain that (62):

> Concern for other face often leads to nonconfrontational style of conflict management, such as avoiding obliging and compromising. […] The relational self either avoids face-threatening situations or seeks some type of compromise so as not to make the interdependent parties lose face. This strategy of conflict management not only enables both parties to preserve harmony but also helps affirm the relational identity of the self.

Compliance strategies are also used in the Chinese cultural context to preserve and give face. Subsequently, Chinese do not argue or disagree overtly with one in public and, thus, do not negotiate the meaning of messages in public communication because negotiating messages would threaten interpersonal harmony and the authority of the communication partner. Therefore, "Chinese tend to adopt an unassertive style of communication in interpersonal interactions." (G. Gao and Ting-Toomey 63) Rather, the indirect and unassertive communication manners allow negotiations in private. "This style of communication enables them to accomplish their own agenda but also creates an amicable climate for future cooperation and negotiation." (G. Gao and Ting-Toomey 63)

Directly related to the unassertive communication style used in compliance strategies are the provisional responses given by Chinese in conversations. Without ever saying directly "no," Chinese label requests to be "inconvenient" and the implementation of requested tasks "to be difficult." Even when agreeing, Chinese leave room for retreat to make allowance for unforeseen developments. Thus, "Chinese communication is inherently negotiable. Compromise, intervention and mediation are an integral part of Chinese communication processes." (G. Gao and Ting-Toomey 65) Consequently, to preserve face, Chinese also use intermediaries to negotiate with other's in case of conflicts to avoid confrontation and loss of face of either party (G. Gao and Ting-Toomey 65). A nonconfrontational and unassertive communication style, thus, ensures the preservation of face and harmony amongst the Chinese communicators.

Table 8 illustrates the main distinctions between low and high face-saving cultures. One can observe that due to the opposite behavior of low and high face-saving cultures, Germans and Chinese who rank at the lower and top part of the face-saving continuum respectively might face serious problems in communicating with each other. For example, when communicating in a business situation, Chinese people probably favor an indirect communication approach to problems while Germans might rather forcefully push the topic in the conversation. This opposite type of communication behavior is probably going to cause irritation, frustration and mistrust on both sides.

	High Face-saving	Low Face-saving
Favored business communication approach	Politeness strategy; indirect plan	Confrontation strategy; direct plan
View of directness	Uncivil; inconsiderate; offensive	Honest; inoffensive
View of indirectness	Civil; considerate; honest	Dishonest; offensive
Amount of verbal disclosure	Low	High
Vagueness	Tolerated	Untolerated

Table 8: Characteristics of High and Low Face-saving Cultures, David A. Victor, International Business Communication, New York: HarperCollins Publishers, 1992, 160.

Jia writes that "communication is also a fundamental part of face. […] Whatever happens to face and however it happens, whether it is lost, regained, hurt, and torn apart, it happens in communication; it is an inseparable part of communication, a product of communication, and a motive and means for communication." (50) Thus, face without communication is not possible and one can only gain, lose or give face by communicating with someone else. The concept of face is closely interrelated with the concept of contexting in communication. According to Victor, "the more highly contexted a culture is, the more importance its members attach to face-saving." (160) Figure 17 shows the ranking of different countries on a continuum of contexting in communication. As one expects, the Chinese with a high degree of contextualization in communication (see Hall earlier in this chapter) rank at the top of the continuum. The Germans rank at the lower bottom of the continuum with low contexting skills and a low emphasis on face-saving. The profound contrasting values for both cultures might cause serious problems when Chinese and Germans deal with each. For example, Germans might inadvertly cause a loss of face to their Chinese counterpart by being too explicit in the communication process.

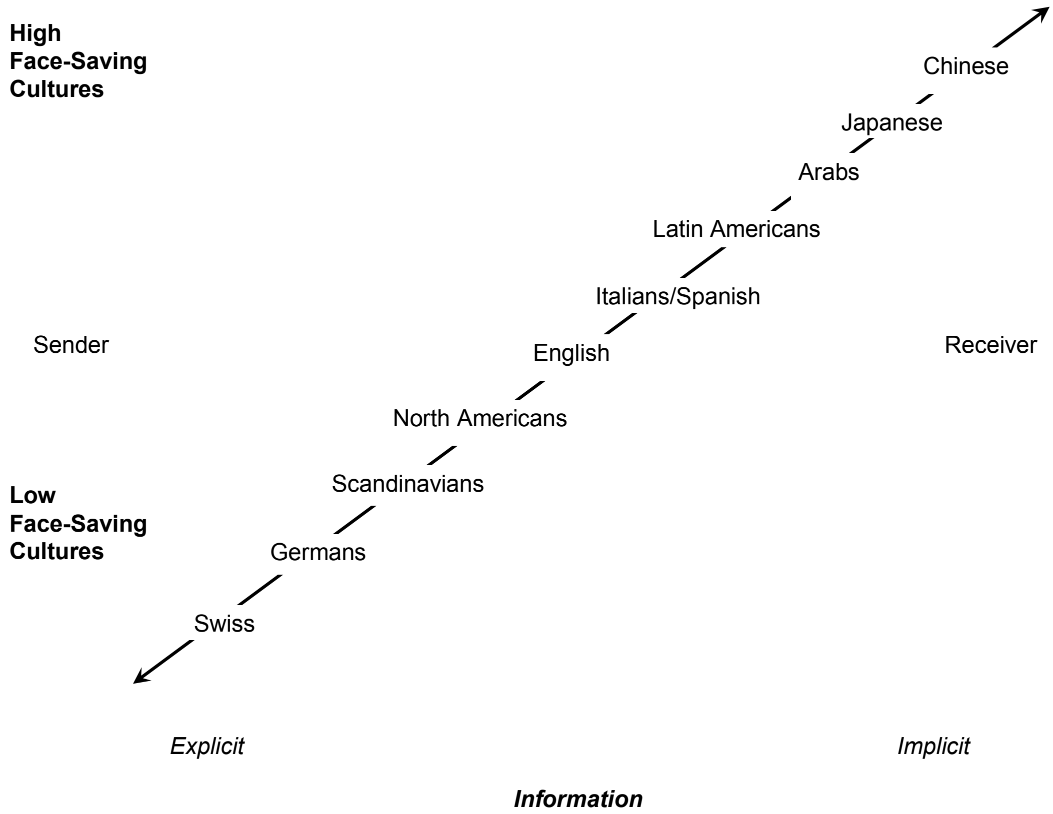

Figure 17: Face-saving Ranking of Cultures in Consideration of Cultural Contexting, based on: David A. Victor, International Business Communication, New York: HarperCollins Publishers, 1992, 160.

In conclusion, *mian zi* is the face; the external and social image of a Chinese person and can be gained, lost or given. To engage in facework, i.e. improve one's face or give face, one has to engage in communication. Thus, communication is an integral part of *mian zi*. The concept of face or *mian zi* is an essential part of interpersonal relationship of Chinese people and influences the way Chinese people think and act. Nonconfrontational communication and compliance strategies, as well as provisional responses and intermediaries are used to prevent conflict, preserve harmony and maintain *mian zi* for all parties engaged in the communication act.

3.4 Synthesis Chinese Culture & Communication

Confucianism, Taoism and Buddhism lie at the heart of Chinese culture fundamental beliefs and values. The fundamental beliefs and values in turn influence the social structure of Chinese society, i.e. family, networks and ethnicity. To understand Chinese culture, one has to understand the interdependence of these different philosophies and their effects on Chinese behavior and communication.

In Chapter 3.2.1 the different cultural dimensions according to Hofstede were analyzed. The cultural dimensions power distance, uncertainty avoidance and individualism vs. collectivism are chosen for further analysis because these cultural dimensions are able to make a significant contribution in regard to the subsequent analysis of the role of culture in the understanding of the uniqueness of Chinese culture as well as the choice of market entry mode.

By combining the positions of China and Germany on the cultural dimensions power distance[12] and uncertainty avoidance[13] with the configurations of organizations according to Mintzberg, one can observe the differences between China and Germany in their approach to organizational models in Figure 18. The difference is significant despite the relative similarity of both countries scores on the uncertainty avoidance index. The Chinese model of organization stresses the need for a simple structure with one supervisor at the top of the hierarchy. The supervisor gives the orders and expects subordinance by those who rank lower than the supervisor. By practicing direct supervision over all levels and processes of the organization, the strategic apex of the organization becomes the most important part of the organization. The organizational model is a direct result of the Chinese cultural characteristic/preference for a large power distance and the need for clear and decisive leadership in ambiguous situations as exercised by a leader on top of the organization (Hoecklin 67).

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[12] Power Distance Index (PDI): China: 80 and Germany: 39
[13] Uncertainty Avoidance Index (UAI): China: 60 and Germany: 65

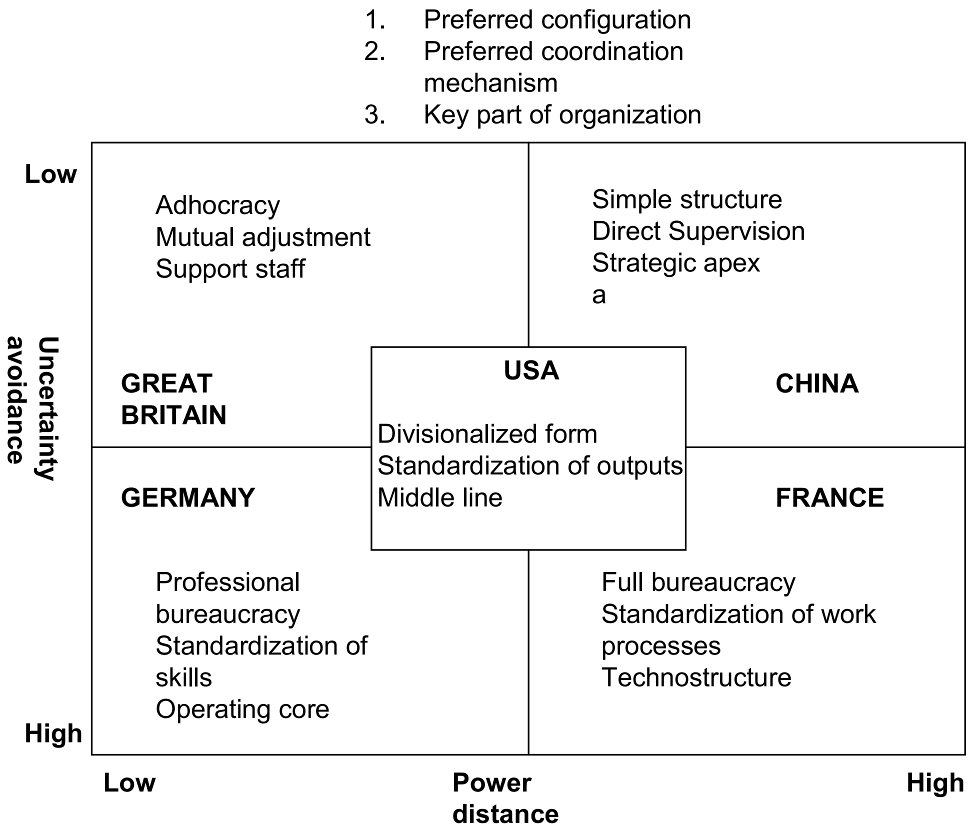

Figure 18: Preferred Organizational Configuration and Coordination Mechanisms, adapted from: Lisa Hoecklin, <u>Managing Cultural Differences: Strategies for Comparative Advantages</u>, Harlow, England, Pearson Education Limited, 1995, 67.

In contrast, German culture prefers the organizational model of a professional bureaucracy. The cultural preference for equality among members of the German culture expresses itself through the standardization of skills among the members of the organization. As opposed to the Chinese culture, the sole direct supervision by one person is undesired. The emphasis lies on the standardization of skills; resulting in the operating core of the company as being the key part of the organization. The focus of the German model of organization does not lie on the personal level, as is the case in China, but on the impersonal performing of organizational tasks and processes by a highly trained and professional bureaucracy. The bureaucracy is supported by detailed and explicit guidelines and rules for processes in the organization. Other countries, such as France, the USA and Great Britain have different organization forms due to differing power distance and uncertainty avoidance index values (Hoecklin 67).

The highly differing values of Chinese and Germans on the individualism vs. collectivism index (IDV)[14] are liable to disrupt interactions between Chinese and Germans. Collective societies place the welfare of the group above the welfare of the individual and group members look after each other and individual, from the group opinion dissenting beliefs are not tolerated. Germans express their opinions openly in a discussion and thereby reach group consensus. The declination of Chinese to speak out in the group and in presence of the superior is due to the need to preserve the harmony within the group and the authority of the group leader. The respect for the authority of the group leader is related to the powerful status ascribed to authorities in high power distance culture.

Indeed, Hofstede notes that there is a negative correlation between IDV and PDI, i.e. a country that scores high on the IDV has a low score on the PDI and vice versa. Adds Redding, "those culture with high power distance also exhibit high levels of collectivism, those with low power distance are characterized normally by individualism." (The Spirit of Chinese Capitalism 62) The assertions by Hofstede and Redding apply for China (high power distance; collectivistic) and Germany (low power distance; individualistic) as can be observed by their rankings on the PDI and IDV. Hofstede writes that "in cultures in which people are dependent on ingroups these people are usually also dependent on power figures. Most extended families have patriarchal structures with the head of the family exercising strong moral authority." (55)

Another relation exists between the cultural dimensions power distance by Hofstede and filial piety as taught by Confucius. The filial piety concept as discussed in Chapter 3.4.1 shows that the "individual has a built in sense of the legitimacy of the superior-subordinate relationship," (Redding The Spirit of Chinese Capitalism 61) that the superior is to be obeyed at all times and an open challenge of authority is discouraged. The definition is nearly identical to the one given by Hofstede for the cultural dimension power distance (Redding The Spirit of Chinese Capitalism 61). Thus, it seems appropriate to view these cultural determinants as one.

Chinese communicate differently with insiders and outsiders as they usually are conscious about what to disclose to outsiders as opposed to relative honesty

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[14] IDV: China: 20 and Germany: 67

towards insiders. Whoever is in the ingroup has access to resources and information and can expect a truthful and honest communication style as well as limited and bounded trust by other members of the group. Whoever is outside the group cannot expect to obtain the same treatment of amount of information or trust as an insider. The differential treatment of insiders and outsiders is akin to the loyalty, respect and trust group members place on other group members in collectivist societies as identified by Hofstede.

The concept of *guanxi*, connection or relationship, is closely connected to the concepts of and collectivism and the insider vs. outsider communication approach. In collectivist cultures, people belong to groups and are taught the values and goals of the group which creates a bond between the members. *Guanxi* is established within the closed group (collectivism) through the sharing of confidential information (insider vs. outsider communication approach). The pervasiveness of *guanxi* in Chinese society is rooted in the fact that Chinese do not trust outsiders and only trust those they know or have been introduced to. The same holds true for the establishment of networks outside of China which are founded upon Chinese ethnicity and networks of friend- or kinship.

Face or "*mian zi*," is central to the Chinese concept of communication and social status derived from the group. The more face one has, the higher one's status and role within the group is. Therefore, one's status depends on the group, on the *guanxi* and the communication one shares with other group members. Thus, face is an essential part of a collectivist society since face can only be of great significance if the judgment or opinion of the group is of vital important to one's self and social status as is the case in China.

China is a high-context culture while Germany ranks at the lower end of the context scale. According to Victor, "the more highly contexted a culture is, the more importance its members attach to face-saving." (160) The need for face-giving or -saving results, for example, in the obedience of superiors or the group leader, a characteristic also known in high power distance and collectivist cultures. The relationship between face and contexting has been illustrated in Figure 17 and shows that China ranks at the top of the contextual continuum while Germany ranks at the lower bottom of the continuum. Because contexting is high in Chinese culture, the need to establish, preserve and increase face is more pronounced in Chinese society. In contrast, German culture is characterized by a low degree of contexting and, subsequently, a low need to preserve face. Thus, it is important to recognize that Chinese individuals place great emphasis on one's status in the group and the proper flow of information through shared codes embedded in contexting and differentiating communication behavior towards in- and outsiders.

Consequently, If in a communication setting both persons are from a high-context culture and share the same background, information flows smoothly and efficiently and helps to establish a connection, *guanxi*, between both parties. Also, they are more likely to be able to trust each other; using an insider communication approach when communicating with each other. High-context cultures can be expected to be collectivist cultures since one has to interact and spend a significant amount of time within in the group to achieve the necessary level of contexting to be able to exchange information and meanings with other members of the high-context communication culture.

Figure 19 shows the three different dimension levels of Chinese communication and culture. The fundamental beliefs of Chinese culture are Confucianism, Taoism and Buddhism. These fundamental beliefs influence the social structures of Chinese society, i.e. family, networks and ethnicity. The area in which these three social structures overlap form the core cultural and communicative behavioral characteristics of the Chinese individual. The communicative and cultural variables/dimensions *guanxi*, high contexting, insider vs. outsider communicative approach, collectivism, face, and filial piety/PDI influence each other.

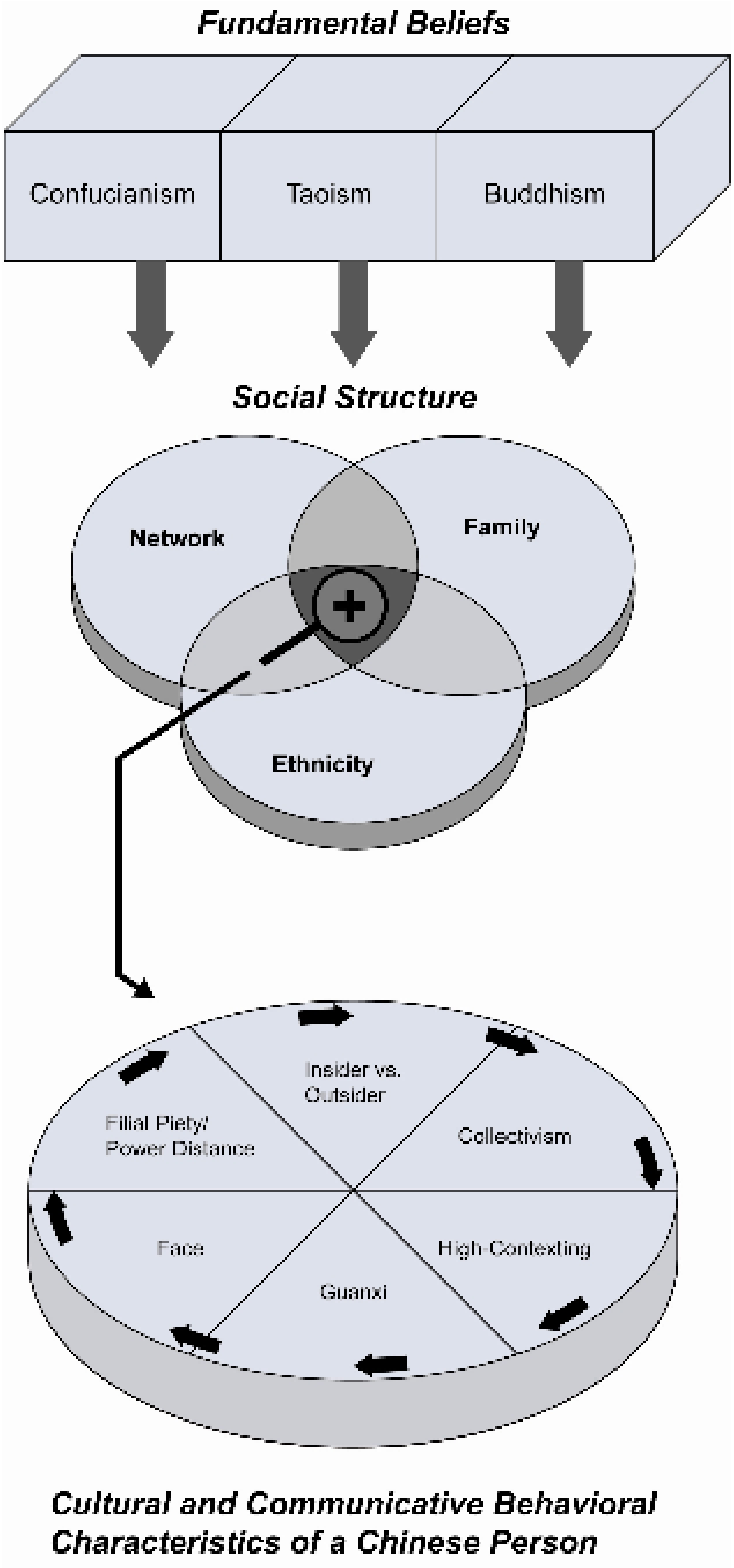

Figure 19: Dimensions of Chinese Cultural and Communicative Characteristics

Insider vs. Outsider communication means the different treatment of people known and unknown in the communicative behavior of the Chinese speaker. The different treatment of outsiders is also a distinctive feature of groups and collectivist societies. Collectivism requires a shared language and behavior; hence, it is anticipatable that high-context communication is a feature of the collectivist Chinese society. Collectivism expressed through high-context communication also leads to or is a result of *guanxi*; the establishment and maintaining of reciprocity-connections. By giving as good as one can give, one enhances the face of the other person.

The concept of face is especially important in highly contexted cultures as well as in collectivist societies since it relates to the worth of one's self. Face can be gained through *guanxi* but it is also to be maintained through the strict adherence to subordinance towards superiors and the family head, i.e. filial piety and the related cultural dimension of power distance. Each of the listed Chinese communicative cultural behavioral features is interdependent or related to another Chinese behavioral feature or characteristic. These variables and determinants illustrate and explain the Chinese individual behavior. This behavior is rooted and demonstrated in the social structures of family, networks and organizational structures based on ethnicity (for example, Chinese trade chamber). The underlying forces for the social structures and the behavior of Chinese are the beliefs and values conveyed by Confucianism, Taoism and Buddhism.

This chapter has shed light on the underlying principles and values that govern Chinese cultural and communicative behavior. As one can see in the following chapters, these principles and values guide ethnic Chinese business behavior; from the management style over to organizational features to the utilization of networks in the process of the internationalization of ethnic Chinese businesses.

4 Internationalization of Ethnic Chinese Business

When looking at the international expansion of Chinese businesses, one has to distinguish between the expansion of ethnic Chinese businesses from outside Mainland China, e.g. Hong Kong, Taiwan, Macao, etc., also called Overseas Chinese, and the expansion of Mainland Chinese businesses. This chapter analyzes the international expansion of ethnic Chinese businesses from outside China. The analysis might be able to offer valuable explanations, insights and suggestions for the expansion of Mainland Chinese businesses which is addressed in Chapter 6 because Mainland Chinese businesses are likely to emulate the expansion behavior of overseas ethnic Chinese businesses in the internationalization process.

4.1 Origins and the Internationalization of Ethnic Chinese Business

The expansion of Chinese abroad looks back at a long history. In the 10th century the first Chinese emigrated to the Indian Ocean region. In the following centuries the Chinese established themselves as merchants between the colonial administrators from Europe and the local economies. The first, real emigration wave setting the foundation for the worldwide spread of Chinese business was due to political factors. During and after the civil war in China that resulted in the communist revolution 1949, thousands of well-to-do Chinese families sought refuge in Hong Kong and Taiwan. Approximately 50,000 families fled and brought with them the equivalent of $8 billion to their new host countries. After World War II and the subsequent abandonment of the colonies by the European powers, Chinese businesses filled the gap left by the former colonial powers and extended the Chinese operations in Southeast Asia (M.-J. Chen 7-8).

For the purpose of the discussion of overseas and ethnic Chinese people the terms Overseas Chinese and ethnic Chinese are used interchangeably in this dissertation and refer to all persons of Chinese ancestry, including Chinese who adopted the citizenship of a host country, Chinese who still hold the Chinese nationality and those Chinese who are descendants of Chinese parents. (Dudley L. Poston). As of today, more than 90 percent of ethnic Chinese are adopted citizen of their chosen country. However, the attachment of Overseas Chinese to the mainland is still strong. Most Overseas Chinese consider themselves more Chinese in terms of traditional Confucian values than Mainland Chinese (M.-J. Chen 9). Lai Tjin Tong is an example of the strong bond ethnic Chinese feel toward Mainland China. Lai Tjin Tong was born in Jakarta in 1914 and spent altogether more than 31 years in Indonesia, lived in Hong Kong for 11 years and in Singapore for 14 years, and finally died in Jakarta in 1995. Altogether, Lai Tjin Tong lived only approximately 15 years in Chinese Meixan, the hometown of his family. Although Lai Tjin Tong was born in Jakarta and his family lived in Hong Kong; nonetheless, a shrine was erected in Meixan to honor Lai Tjin Tong and to celebrate Meixan as the place of origin of his family (Krüger and Kwok 122-123).

Today, approximately 50 million ethnic Chinese live abroad. Although ethnic Chinese are a minority in their adopted home countries, Chinese control a disproportionate share of the corresponding economy. For example, ethnic Chinese own up to 80 percent of Indonesia's corporate assets and run 160 of the 200 largest companies. Ethnic Chinese control 90 percent of all manufacturing in Thailand. Also in Thailand, Chinese represent only 1 percent of the population, but control over 80 percent of the listed firms by market capitalization. Ethnic Chinese who live and conduct business overseas account for an annual output of about $500 billion (Yeung, "Globalization of Chinese Business Firms" 8; Ahlstrom et al. 264). Thus, "as a group, Overseas Chinese businesses are a major economic force around East Asia." (Bruton, Ahlstrom and Wan 521)

When venturing abroad, Chinese were often discriminated against in their new home countries and were isolated in the local community. The isolation laid the foundation for closely-knit networks of Overseas Chinese communities. These networks, observes M.-J. Chen, "extended to friends and relatives in other regions of the world, creating a globally interconnected social and business community of Chinese – both on and off the mainland." (9) These business communities are based on networks developed and maintained by trade organizations, unions, family names, birth place and secret societies (Krüger and Kwok 123). Overseas Chinese developed business networks in order to cope with the hurdles and challenges in host societies. A business network is (Yeung, Transnational Corporations 65):

> An integrated and coordinated structure of ongoing economic and non-economic relations embedded within, among and outside business firms. Actors in business networks are motivated by both economic goals (e.g. profit, market share, market control) and non-economic goals (e.g. power, sociability, approval, status, recognition, moral justification).

Another definition is offered by Chen and Chang who state that "a business network encompasses the set of relationships of a firm – both horizontal and vertical, including strategic alliances, joint ventures, long-term buyer-supplier partnerships and similarly collaborative relationships." (237) Edith Penrose (1996, XX) ascertains in regard to the characteristics and analysis of business networks that:

> [A] business network is very different from a cartel of independent firms in its structure, organization and purpose. It is clear that this type of organization is likely to spread for some time and continue to engage in a competition very different from that analyzed between firms in so-called free markets.

A business network is different from a simple accumulation of firms because a business network consists of actors who pursue economic and non-economic goals and are in relationships with each other. Ethnic Chinese business networks, thus, encompass ethnic Chinese who through relationships try to pursue business opportunities as well as try to enhance their social reputation. Ethnic Chinese business networks, for example, help overcome bureaucratic barriers and trade protection when a business expands into foreign markets. Furthermore, ethnic Chinese business networks reduce risks by making the expansion into different countries possible, thus, business networks make hedging against negative developments in host countries possible. Also, transaction costs of doing business are lowered by the informal and trust-based conduction of business (Peng 239). Carney even claims that "networks are cost-efficient relative to managerial hierarchy because they provide costless coordination." (142)

Complementary business networks tying entrepreneurs, business executives, trades and financiers together across national boundaries result in, as Weidenbaum and Murray describe it, a “bamboo network.” (69)[15] These bamboo networks connect the Chinese community across nations and continents and enhance the cohesion of the ethnic Chinese community. The expatriate Chinese rely on kinship, dialect or common origin – clan, village or county – to build mutual trust and engage in business transactions regardless of distance (Weidenbaum and Hughes 69).

Kao uses the term “Chinese commonwealth” (24) to describe the networks of ethnic Chinese based on family and clans links connecting businesses and individuals across national borders. The Chinese commonwealth is primarily a web of entrepreneurial relationships and consists of many individual enterprises that share a common culture. These networks and relationships are private and informal capital markets which Chinese entrepreneurs can access without the need for commercial banks, professional venture capital companies or government investment agencies. Furthermore, the Chinese commonwealth provides the members of the network with local resources, e.g. information, business connections, raw materials, low labor cost, etc. in different environments (Kao 24). Thus, the international network of Chinese, the Chinese commonwealth, provides Overseas Chinese businesses with the means and support to expand internationally.

The role of culture in the establishment and maintaining of these business and social networks is evident. As has been discussed in Chapter 3 and 4, Chinese cultural determinants such as Confucian teachings, face, high-contexting, *guanxi*, insider vs. outsider communication approach and collectivism have a profound effect on the behavior and communication of ethnic Chinese and, eventually, on the engagement of Chinese in networks. Networks are one of the three social structures of Chinese society, the other ones being family and ethnicity. Hence, Overseas Chinese networks are founded upon ethnicity, upon *guanxi* and networks established in the host or home country.

[15] “Bamboo is the Chinese symbol for durability; it is flexible and constantly developing. In the words of the old [Chinese] saying, ‘Bamboo bends; it does not break.’” (Weidenbaum and Hughes 69)

4.2 A Definition of Ethnic Overseas Chinese Business

4.2.1 Organizational features of Overseas Chinese Business

Peng writes that Chinese “tend to develop their businesses among family lines and expand business networks based on personal connections.” (230) Consequently, according to Ahlstrom et al., Overseas Chinese businesses display six main characteristics (266):

(1) Family control
(2) Simple organizational structures, networks and information control
(3) Centralized governance and decision making
(4) Internal financing
(5) Lack of advertising and branding
(6) Little or no Research and Development (R&D)

Following the definition given by Ahlstrom et. al., Chinese businesses are usually family-owned and operated; even if the company is publicly traded and large in size. The Chinese business is typically centered on a family patriarch and, thus, relatively simply organized around the ruling head of the business. Authority is centralized at the top; delegation of authority is minimal and most transactions are informal. The Overseas Chinese business relies on friends and family members in the business' network to staff key positions and to finance ventures. Also, Overseas Chinese focus on the supply of goods and services to others and shun promotion and advertising in order to maintain a low profile and keep the value chain maintainable and controllable. Additionally, the Overseas Chinese tend spend only limited amounts on R&D and instead concentrate on the core-functions of their operations in order to stay competitive and minimize costs (Ahlstrom et. al 266).

Overseas Chinese take high risk by entering and opening up new and developing markets which in turn enables them to earn high profits. The Overseas Chinese businesses concentrate on low cost factors in order to be competitive. The focus on low-costs neglects spending on brand names and high technology. The decision to neglect technology does not mean that Overseas Chinese businesses do not understand the importance of technology. Rather, Overseas Chinese businesses focus on offering complimentary services to multinational enterprises (MNEs) entering countries in Southeast Asia, for example as original equipment manufacturer (OEM). By combining the technology and the brands of the MNEs with the low-cost production factors of Overseas Chinese business, both the MNEs and the Overseas Chinese businesses win. The win-win situation applies not only for the market entrance in Southeast Asia but for the general outsourcing of production to Chinese business by MNEs in different countries (D. Long and Han).

Overseas Chinese businesses show their adaptiveness by finding business niches and specializing in them. Also, Overseas Chinese businesses are skilled in seeking out local demands and satisfying the demand (M.-J. Chen 10). The owner and the family members often decide to diversify the business into unrelated business activities by establishing subsidiaries with trusted friends or family members at the top; the diversification is characterized by opportunism and imitation. The reliance on personal authority and trust in the Chinese family business leads to elaborate networks of personal obligation and interdependent networks with other firms (Whitley 59). These networks ensure the diversification of risks and the integration of family members and friends into the Chinese family business

To conclude, Ahlstrom et. al. and Whitley assert that Chinese businesses are family-run with a central planning and execution system in a relative simple organization being led by the family head. In general, a family-business is characterized by the fact that the chief officer is also the owner, family members are employed in key positions, the business strategy lies within the family, networks of obligation and interdependence are existent, a low formalization within the enterprise and a transition problem between generations. M.-J. Chen even states that Chinese actually have a “family business.” The difference to a business family being “that family, not business, is the focus: family concerns drive business decisions. This paradigm holds true in Chinese businesses of all sizes, from small retail stores to massive multinational organizations, in all Chinese overseas communities.” (M.-J. Chen 29)

There are three distinct qualitative features to the family business which are the managerial dedication of the family to the business (which relies on the success of business for the family’s security), the efficiency in decision making and the lower transaction cost when dealing within a network of family businesses with less contractual and formalized needs (Redding, "Chinese Family Business” 36-37). In the above mentioned characteristics, Chinese businesses do not differ from other small and medium-sized enterprises (SMEs) in other parts of the world, for example, German SMEs. So what makes Chinese businesses unique?

Redding identifies two characteristics which make Chinese family-businesses distinct from those of Western family-businesses ("Chinese Family Business" 37):

- The Chinese family enterprise has not so far entered the transition to professionalism and public ownership which is such a common feature of Western economic evolution, even though arguably it has had plenty of time to do so
- The personalism used in cementing stable market relations between enterprises, in general conditions of mistrust, seems to reflect norms and values about co-operation that are distinctly Chinese and highly developed in the secular culture of Confucianism.

Redding elaborates his findings by writing that "the distinctiveness of the Chinese family business lies in the combination of internal features and external circumstances" and that "in its development towards modern forms of Chinese capitalism, it has learned how to grow and still retain family control; it has also developed the art of alliance building to an unusually high level." ("Chinese Family Business" 38) According to Whitley, "the firm is typically regarded as a family possession and its major function is to increase family wealth and prestige." (59) Western family businesses raise money in the public equity markets as the business grows larger and, consequently, the management of the business becomes consistent with the management of other publicly listed firms. The change to professional management leads to a decreasing role of the family in the business. "Overseas Chinese firms, however, […] function essentially as family business, whether they are publicly listed or no." (Bruton, Ahlstrom and Wan) Hence, Chinese business displays and retains its key characteristics, for example, remaining family-run, even when growing organizationally very large (Yeung, Transnational Corporations 135).

The organization of Overseas Chinese businesses into family businesses can also prove to be disadvantageous. The limitations of the Overseas Chinese business lie within the restriction of the management of the business to family members and trusted friends. The restriction to family and clan limits the access to human resources, capital, business information and marketing webs. Subsequently, bright managers may leave the business to start a new enterprise themselves, due to lack of loyalty towards and occupational perspectives in the Chinese family-led business. The diversification of the family business in unrelated activities with small subsidiaries run and headed by the head business can also prove unfavorable. The small scale of each business, furthermore, prevents the building of world-level companies and brands to compete internationally. Another danger is the inherent intransparency of the business with its numerous subsidiaries which opens the door to bribery and corruption and which is commonly perceived as "crony capitalism." (Peng 245; D. Long and Han) Table 9 gives an overview about the strengths and weaknesses of Chinese family business organizational form according to Redding.

Organization Domain	***Strengths***	***Weaknesses***
Vertical Cooperation	Identity with goals of boss and organization Compliance by subordinates via work diligence and perseverance Long-lasting and stable key relationships	Danger of factions and cliques lower down Lack of innovation and initiative from below Limitations as to how far legitimate authority stretches
Horizontal cooperation	Low transaction costs in economic exchanges Reliability of networks and linkages Maneuverability of linkages	Limited field for cooperative relations, therefore tendency on small scale Mistrust and urge to control lead to capital starvation Technical limitations caused by scale restrictions
Control	Intensity of managerial commitment Cost efficiency by reducing bureaucratic control	Lack of neutrality and professionalism Goal displacement possible when control is unclear Coordination problems due to lack of focus
Adaptiveness	Strategic flexibility Speed of response Personal vision can be operationalized	Danger of non-rational opportunist leaps Possible diffraction of organization Lack of creative tension and debate on strategic issues

Table 9: Strengths and Weaknesses of the Chinese Family Form of Organization; S. Gordon Redding, The Spirit of Chinese Capitalism, De Gruyter Studies in Organization, Ed. Stewart Clegg, Vol. 22, Berlin; New York: Walter de Gruyter, 1990, 207.

The regular up-breaking of firms and conglomerates to divide the parts between heirs of the family business is another feature of Chinese family businesses and keeps the size of the company small. Redding states that if the Chinese family business is compared with the typical Western enterprise according to textbooks, the Chinese family-business probably does not look ideal, but because of the embedding of the family-business into a network of other firms, the flexibility, efficiency and dynamism of the Chinese enterprise model persists in being competitive ("Chinese Family Business" 45).

Redding asserted that due to the constant break-up of the firm, family-run businesses cannot grow large and tend to be small-scale. Hamilton challenges Redding's view and states that "Chinese family-owned firms do grow very large, that they do undertake sizeable and serious projects" and that "there is a gap between theory and fact." (Hamilton 56) When the business grows, ownership is spread, management is segment and control is centralized. While an owner of a business might hold the total nominal capital of the business, a shared model is more common. According to the shared model, the owner holds a little more than half the capital of the Chinese business, while the rest of the stake in the business is spread among family members, friends and distant kinsmen. The ownership of the Chinese enterprise is, thus, spread among the social landscape and is based on the norms of reciprocity and leads to the founding of networks based on mutual indebtness. Networks develop due to the mutual reciprocity of conducting transactions and the establishment of trust among the network's members. (Hamilton 64-65). The conclusion in regard to ownership and control of Chinese businesses is that ownership does not result in property right, but that it lays "the relational foundation for creating very complex networks that are themselves useful for other business purposes." (Hamilton 66) Whitley cautions that these "networks of interdependent firms […] are based on personal contacts and reputations, and so these are crucial to [Chinese family business] survival, but are not very stable and often change." (59)

4.2.2 Business Expansion & Decision Making

The expansion of Chinese businesses in interwoven networks as described above is akin to the building of separate conglomerations; although one might call it more appropriately “opportunistic diversification” (Hamilton 70) of each Chinese family business. Overseas Chinese businesses take advantage of the personal and informal networks and start new firms and form new alliances when opportunities by means of personal contacts and information arise. Because the investment is usually done by personal investment and transacted by the business owner, the owner’s family or close friends of the family, the development of very large family holdings is possible. The web of subsidiaries consists of stakes and investments in numerous other companies through the alliances and networks among Overseas Chinese businesses and is controlled centrally by the holding company. The owner of the family-business, i.e. the holding company, is likely to pursue a strategy of investment diversification by investing in different projects in different locations. The owner’s investment strategy resembles the careful management of a portfolio of distinct investments (Hamilton 70-73). By integrating all critical resources and activities under the authoritative control of the family head or owner of the holding company, and furthermore diversifying into unrelated business activities, the business deals with the threat of uncertainty and reduces its exposure to risk (Whitley 68). Figure 20 illustrates the development of a Chinese business from being a trade company to diversified conglomerate.

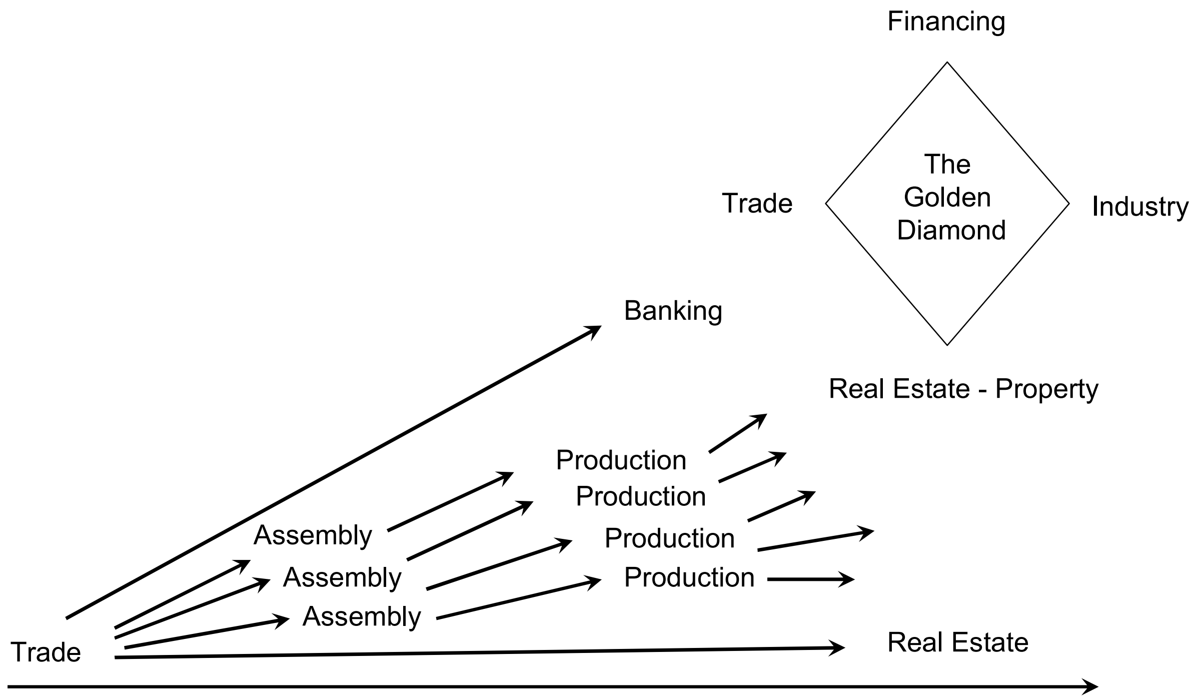

Figure 20: Typical Development of an Overseas Chinese Conglomerate, Hellmut Schütte, and Philippe Lassere, Management-Strategien für Asien-Pazifik, Stuttgart: Schäffel-Poeschel Verlag, 1996, 85.

Overseas Chinese businesses have tended to follow diversification by starting as merchants, moving to the assembly of low-tech products and later on to the production of goods. Further expansion aims at the entrance in the banking, real estate and industrial production markets which Schütte coined "the golden diamond" (Schütte and Lassere, 85-86). Overseas Chinese businesses expand from trade to real estate and then into any business which seems to offer substantial profits. The Overseas Chinese focus on service industries, such as real estates, hotels, financial services and trade since these industries do not require brand names and technological knowledge. The investment in real estates, hotels, financial services and industrial product leads to the establishment of diversified enterprise groups or conglomerates (D. Long and Han). The main characteristics of successful, diversified conglomerates and business networks are (Haley 587):

- The companies appear highly diversified with unrelated diversification, thus contravening Western theoretical notions about synergy-generating diversification into related branches and activities
- Sustain good relationships with the public sectors in the country

- Possess strong familial and informal networks
- Use subjective information as inputs to decision making.

The characteristics of these Overseas Chinese businesses contravene common Western notions of corporate governance. Overseas Chinese businesses place a strong emphasis on the informal side of business by involving friends and family members and maintaining ties to the public sector as well as trying to minimize business risks by diversification as opposed to the Western notions of objective management and synergy creation.

The decision making in the Chinese businesses relies heavily on the input of personal, thus, subjective information, i.e. managers/owners of Overseas Chinese businesses use information from friends, business associates, government officials and trusted sources to make their decisions because Overseas Chinese managers prefer to trust personal sources as opposed to neutral information, for example, statistics (Haley 589). Peng offers a good summary of the decision making in Chinese businesses and the according organization structure of Chinese businesses (232):

> The decision making of the family is centralized. In many ethnic Chinese enterprise groups, a core parent company controls the main subsidiaries through shareholding. Those subsidiaries in turn control other peripheral subsidiaries through loans and personnel arrangements. The leading circle and the top management are all family members and close relatives.

4.2.3 The Role of Guanxi Networks

The sustaining of good relationship with the public sector, the establishment of informal networks with friend and formal networks with other firms require the use of *guanxi*. *Guanxi*, as has been discussed in Chapter 2.4.2, translates literally with “connections”, but refers to a relationship based on mutual obligation and reciprocity. *Guanxi* emphasizes family ties and shared experiences and is the basis for Chinese to do business with each other. Thus, the Chinese commit significant efforts to establish and maintain relationships with people they find respectable. *Guanxi*, for example, in the People’s Republic of China, was and is used to go around the bureaucracy. *Guanxi*, therefore, can open doors, but *guanxi* can also protect from uncertainties and threats in risky environments. Consequently, "for the Overseas Chinese, *guanxi* has provided a safety net in their host societies where, although citizens, they are treated as outsiders and often regarded with suspicion." (M.-J. Chen, 46-47)

According to Luo, "a *guanxi* business network is an organizational form that is neither a market nor a hierarchical and formal inter-organizational alliance." (44) It is a loosely structured network established through interpersonal relationships based on trust and favor exchange (Luo 44). *Guanxi* is a form of value-added social capital[16] which means that *guanxi* is an intangible asset based on social transactions which can create value. The economic benefits of a *guanxi* network include the lowering of transactions costs, information costs and competitive threats as well as reducing uncertainty in the operation. *Guanxi* enhances the institutional support (through other members in the network), adds a strategic capability to the firm and, thus, enhances the economic return (higher revenues) as well as increasing the business effectiveness and the organizational legitimacy of the operation. Figure 21 summarizes the economic benefit of *guanxi*.

[16] Definition of social capital: The value of social networks that people can draw on to solve common problems. The benefits of social capital flow from the trust, reciprocity, information, and cooperation associated with social networks (AGTRADE.ORG).

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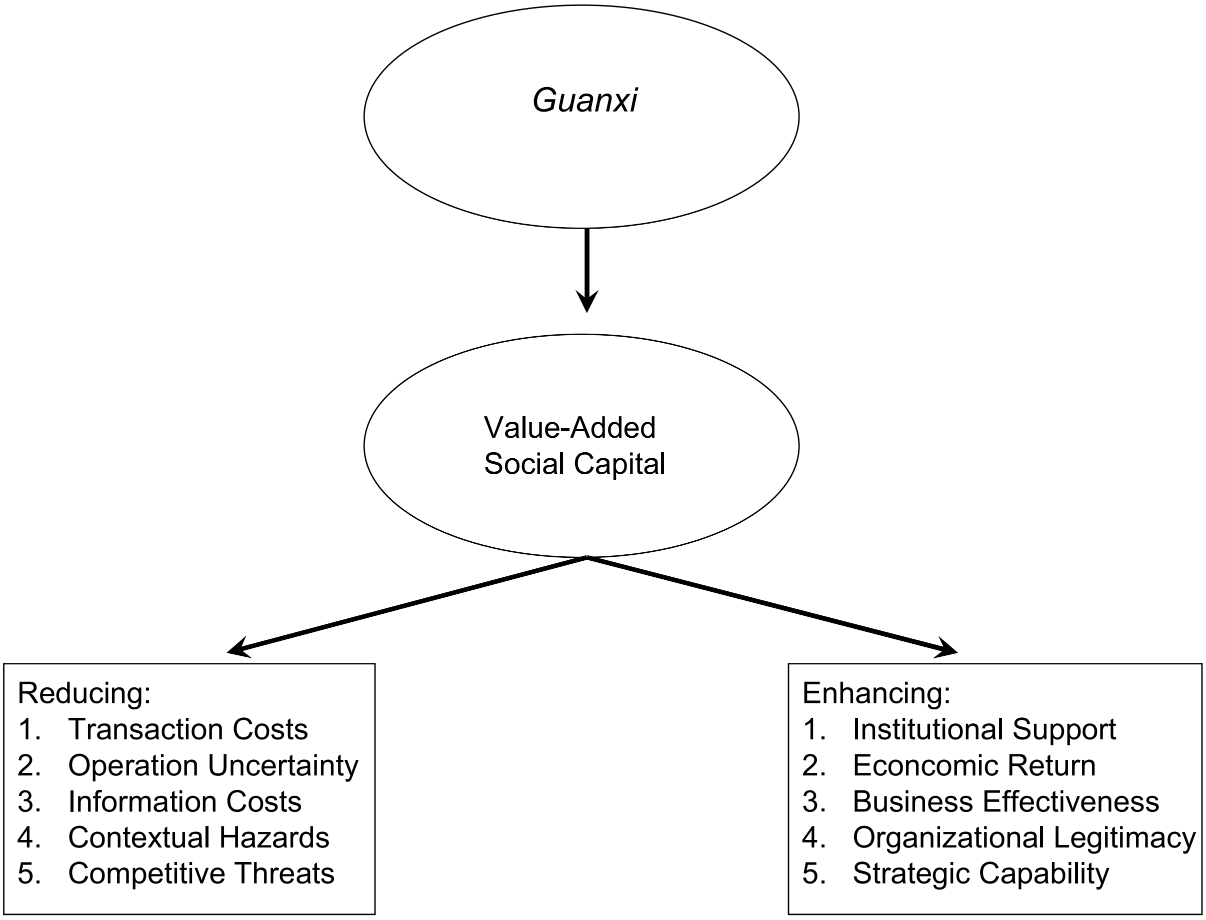

Figure 21: Economic Benefits of *Guanxi*, Yadong Luo, *Guanxi* and Business, Asia-Pacific Business Series, Eds. Richard Brislin and Lane Kelley, Vol. 1, Singapore: World Scientific, 2000, 48.

As described above in Figure 21, *Guanxi* networks enhance, for example, the institutional support and reduce, for example, transaction costs of the participating parties. In regard to organizational structure and firm performance, Luo writes (81):

> The *guanxi* network is more than just a symbolic representation of personal and organizational ties. It is a utilitarian mechanism for Chinese firm; resource exchanges occur independently of the active, conscious participation of the organizations and individuals involved. […] As organizations continue their interactions with other firms and government officials through the *guanxi* network, there is a deliberate diffusion of information and accumulation of resources and capabilities. Cooperative firms in the *guanxi* network basically act as resources to each other, contributing to enhanced survival and growth

through planned and unplanned exchanges of personnel, market information, money, facilities and political favors.

Therefore, firm in a *guanxi* network are able to access other firm's resources and share information and resources with each other. The exchange is based solely on utilitarian resources in order to enhance each firm's strategic capabilities and lower costs, thus, enhancing the firm's ultimate performance.

The previous paragraph shows that the establishment and maintenance of ethnic Chinese networks based on *guanxi* can be used as a competitive advantage for ethnic Chinese businesses. In general, competitive advantages of ethnic Chinese businesses are two-fold; the obvious, for example, quality of products, and the hidden competitive advantages, for example, lower transaction costs because of trust and mutual reciprocity. Here, these two differentiating advantages are demonstrated at the example of ethnic Chinese enterprises from Hong Kong. A survey among multinational ethnic Chinese businesses from Hong Kong revealed that these ethnic Chinese businesses enjoyed obvious competitive advantages in regard to the quality of products and the reputation of services, the integrated networks of operations and the possession of specialized materials and resources (Yeung, Transnational Corporations 206).

Hidden competitive advantages result from the embedding in networks of personal and business relationships which help ethnic Chinese companies to generate sustainable advantages. The networks help to protect members against encroachment by outsiders as well as providing members with organizational capabilities to enter foreign markets. The mutual reciprocity and trust lower uncertainty transaction costs within the network. Information resources are made available to all members and business opportunities are maximized through giving network members exclusive access to bidding or participation in projects. Access to capital is easy as each member in the network is willingly to provide and access resources to other members of the network. Finally, networks tend to emphasize the membership of its actors and, therefore, create a closeness of the network system which guards and continues to serve the interests the interests of its members (Yeung, Transnational Corporations 214-218). Yeung concludes that "the inherent competitive advantage of HKTNCs [Hong Kong Transnational Corporations] is not technology or capital or even products/services *per se* [original italics], but their intangible network relationships and cooperative synergy." (219)

4.2.4 Conclusion

In conclusion, according to Yeung, Chinese family firms' distinctive organizational characteristics are ("Globalization of Chinese Business Firms" 79-80):

- Strong personal owner control
- Managerial specialization and entrepreneurial diversification
- Risk management by minimizing commitments and maximizing flexibility
- Limited inter-firm commitments, for example, limited or no supplier-buyer relationships between firms at all
- Personal links between firms
- Highly personal authority and low formalization of procedures
- Limited commitment to, and low mutual dependence on, employees
- Centralized decision-making and control, and weak middle management
- Paternalistic and aloof management roles

Furthermore, Overseas Chinese businesses are embedded in informal and familial networks. These networks work on a mutual basis of reciprocity and trust. The embedment provides ethnic Chinese with competitive advantages through the access to material resources, for example, capital and immaterial resources such as, for example, information. Overseas Chinese businesses pursue a strategy of asset diversification in regard to their investment strategy when the business grows larger. Furthermore, the Overseas Chinese businesses rely heavily on the family to conduct business and make decisions. The business is led autocratically and decisions are based on subjective information gathered from friends and family because Chinese prefer information from trusted sources. Subsequently, Overseas Chinese establish and rely on *guanxi* to explore new business opportunities, extend the network and survive in the host environment because Overseas Chinese benefit from the employment of *guanxi* networks as these networks protect and serve its members.

The conclusions made in this chapter follow the findings established in Chapter 3 and 4. In chapters 3 and 4 it was shown that Chinese cultural is minted by a clear understanding of the subordinate-superior relationship due to the Confucian ideal of filial piety. The finding is supported by Hofstede's assessment of China as a high power distance culture, i.e. people know their place in life, pay respect to superiors and do not challenge authority openly. If one applies the findings on these cultural determinants and variables in a business specific context, it becomes clear that these cultural determinants and variables are the reason why ethnic Chinese businesses are lead by a head of the firm who commands authority and subordinance by its employees. Likewise, the use of networks and *guanxi* by ethnic Chinese businesses can be explained as typical features of the Chinese collectivist society as well as the need for trust which is mirrored in the different attitudes and communication approaches towards insiders and outsiders. The above mentioned different cultural determinants and variables are evident in Chinese culture and explain why ethnic Chinese businesses behave and expand the way they do as well as why Overseas Chinese businesses are structured and managed the way they are. Thus, Chinese cultural determinants and variables are able to offer explanations for the characteristics of ethnic Chinese businesses.

4.3 The International Expansion of Ethnic Chinese Business

As has been written at the beginning of Chapter 4, the economic success of ethnic Overseas Chinese business is being illustrated, for example, by the fact ethnic Chinese own up to 80 percent of Indonesia’s corporate assets and run 160 of the 200 largest companies. Overseas Chinese control 90 percent of all manufacturing in Thailand while Chinese represent only 1 percent of the population of Thailand, but also control over 80 percent of the listed firms by market capitalization. Finally, ethnic Chinese who live and conduct business overseas account for an annual output of about $500 billion (Yeung, "Globalization of Chinese Business Firms" 8; Ahlstrom et al. 264). Therefore, the success of the internationalization of Overseas Chinese businesses their economic power, especially in Southeast Asia, is evident.

The globalization and internationalization of Overseas Chinese businesses has accelerated in recent years. Overseas Chinese businesses have become major regional forces in Southeast Asia and are preparing to become global players. Chinese overseas businesses have consolidated their presence in Asia and are beginning to penetrate North America and Western Europe by investment and international production rather than trading (Yeung, "Globalization of Chinese Business Firms" 77-78). Table 10 shows a selection of internationally active

Overseas Chinese Family businesses and leaders with the appropriate country in which they are most active.

Family/leader	Primary businesses
Hong Kong	
Li Kai Shang	Ports and infrastructure, retailing, manufacturing, telecommunications, property development, energy, finance and investment
Peter Woo/Pao family	Real estate, cable television, infrastructural development, transportation
Indonesia	
Liem Sioe Liong	Cement, processed foods, flour milling, steel, banking, real estate, investments
Eka Tjipta Widjaja	Diversified
Oei Hong Leong	Beer, tires, consumer products
Mochat Riaddy	Property, banking, insurance
Suhargo Gondokusumo	Agri-industries, property
Prajogo Pangestu	Timber, car assembly
Malaysia	
Robert Kuok	Plantations, sugar and wood processing, media, hotels
Quek Leng Chan	Finance, diversified
Lim Goh Tong	Casinos, real estate
Vincent Tan	Leisure, manufacturing investments
Philippines	
Lucio Tan	Beer, tobacco, banking, investments
Henry Sy	Retailing, cement, investments
Alfonso Yuchengco	Banking, insurance
Antonio Cojuangco	Telecommunications, real estate
John Gokongwei	Real estate, diversified investments
Singapore	
Kwek Leng Beng	Real estate, hotels, financial services
Lee family	Banking, plantations
Thailand	
Chearavanont family	Agri-business, real estate, telecommunications
Kanjanapas family	Real estate, transport, finance
Ratanarak family	Cement, banking, telecommunications
Sophonpanich family	Banking, real estate, investments
Lamsam family	Banking, real estate

Table 10: Some Families and Businesses in the Overseas Chinese Business Networks, Haley, George T., et al., "Boxing with Shadows: Competing Effectively with the Overseas Chinese and Overseas Indian Business Networks in the Asian Arena," <u>Journal of Organizational Change Management</u>: Emerald, 1998, Vol. 11, 304.

The most recent spectacular move of an Overseas Chinese business was the take-over of the mobile phone business unit of German technology conglomerate Siemens by Taiwanese BENQ in June 2005. The deal gives BENQ the Siemens mobile phone trademark for the next 5 years as well as key technology and patents. The deal exemplifies the drive of Overseas Chinese businesses to move from the role of an OEM supplier to an independent producer and provider of high-technology consumer electronics. Companies such as BENQ utilize the cost advantages of producing, among other things, in China and strive to become a leading global consumer brand like Samsung (Deckstein, Kerbusk and Wagner).

Another kind of business, original design manufacturers (ODMs), is also trying to expand internationally by developing their own brand. ODM use the cash flow from the work as contract manufacturer and designer to build their own brand and pay for the marketing expenses. Examples for ODMs are TSMC, Acer, Hon Hai Precision Industry, ASUSTEK Computer or BENQ. These ODMs face the challenge of reducing their costs by making their processes ever leaner and lower labor costs. The ODMS try to fight declining profits from their businesses by building their own brands and, thus, create another revenue stream. However, these efforts can cause trouble as the ODM work for customers can interfere with one's own brands if products overlap too much. A point in case is BENQ which lost a supplier contract to Motorola when it began to compete head-to-head in the mobile phone market with Motorola after buying the mobile phone unit from Siemens. Finally, it is not clear if Overseas Chinese possess the ability to make the mental shift from cost-control to marketing and brand-building (Anonymous, "The Man with Two Daggers" 52).

In the domestic development of Chinese business firms, business networks were the predominant form of organization. When expanding abroad, *guanxi* and networks become the institutional foundation for the internationalization of Overseas Chinese business firms because these networks help Overseas Chinese businesses when expanding abroad through various means by the local Chinese community (Yeung, „Globalization of Chinese Business Firms" 80).

However, in the global context, outside the Asian region, the role of *guanxi* and networks may decrease because here the focus lays on the cooperation with Western multinational enterprises which results in the increasing incorporation of Western management practices and organizational structures. The Overseas Chinese businesses can help Western corporations by providing business contacts, the reduction of economic risk and uncertainty, and easing the market entrance of the Western businesses by employing the Chinese’s *guanxi* and business networks. Due to saturated home markets, the growth of the businesses to a considerable size and related government regulations, Overseas Chinese businesses begin to expand from their home countries. As Yeung observes, these “leading Chinese business firms have outgrown their domestic economies.” ("Globalization of Chinese Business Firms" 81-82)

Weidenbaum and Murray developed a 3 stage model of the expansion of Chinese businesses in China. Because the model is only applied to Overseas Chinese investing in China, Yeung proposes to add another 2 stages in order to make the model more comprehensive, coherent and applicable for the expansion of Chinese businesses worldwide. Table 11 shows the stage model as postulated by Yeung.

Stage	Development
Stage 1	Phase of firm formation and expansion. Chinese businesses go „from rags to riches“.
Stage 2	Internationalization of Chinese business firms through duplication of business in the region on common grounds in family ties, lanuage, culture and ethnicity.
Stage 3	Engagement of Chinese businesses in Greater China by extending investments and penetrating the market more forcefully than competitors from the West.
Stage 4	Beginning of globalization of Chinese businesses beyond the Asia Pacific Region. Integration of various network operations and activities on low-scale. Utilizing of home country advantages and cooperation with Western MNEs.
Stage 5	Emergence of global networks of Chinese business firms with integrated operations in sophisticated networks. Financing through the global network of Chinese business networks. Decision-making lies not anymore with the patriarch of business, but is made by the consensus of global executives from the network.

Table 11: The Internationalization Stage Model of Overseas Chinese Businesses, compiled from: Henry Wai-chung Yeung, "The Dynamics of the Globalization of Chinese Business Firms," Globalization of Chinese Business Firms, Eds. Henry Wai-chung Yeung and Kris Olds, London: Macmillan Press, 2000, 85-86.

Yeung cautions that only a small number of ethnic Chinese operations have yet reached stage 4 of the internationalization process of Overseas Chinese businesses. Yeung does not expect the evolution of ethnic Chinese business to the final stage 5 to be easily achieved and anticipates several more years of globalization processes by Overseas Chinese enterprises until ethnic Chinese businesses have truly globalized their operations because so far ethnic Chinese business lack the experience and skills to act globally (Yeung, „Globalization of Chinese Business Firms" 87).

The most chosen entry modes for the market entry into international markets and international production are JVs and acquisitions. Other modes used extensively are informal networks and alliances. Figure 22 shows a network spectrum of different market entry modes available to Overseas Chinese business wishing to enter international markets.

	Licensing	Alliances	Joint ventures	Family business	
Markets	←			→	**Hierarchies**
	Franchising	Co-operative agreements	Subcontracting	Conglomerates	

Figure 22: A Network Spectrum of Different Forms of Organizing International Production, Henry Wai-chung Yeung, "The Dynamics of the Globalization of Chinese Business Firms," <u>Globalization of Chinese Business Firms</u>, Eds. Henry Wai-chung Yeung and Kris Olds, London: Macmillan Press, 2000, 97.

In the institutional context, Chinese businesses prefer to enter international markets by acquisitions rather than greenfield investments, i.e. family-led business-subsidiaries, due to speed and risk factors. The discrimination in some host countries forces Overseas Chinese businesses to act decisively and forcefully. In the Western hemisphere, due to an open business environment, acquisitions are also preferred because of the competitive nature of the market and the need to acquire local knowledge and market access quickly. In the firm-specific context, the acquisition of a foreign business gives the business a competitive advantage which it might lack. If the competitive advantage is already present, then Overseas Chinese businesses are likely to engage in JVs and cooperative agreements in order to gain market information and prepare the grounds for an eventual establishment of the Chinese parent firm. Thus, alliances and informal networks are utilized in the framework of the market entrance of the ethnic Chinese business in order to gain market access and knowledge as well as competitive advantages quickly (Yeung, „Globalization of Chinese Business Firms" 97-101). Table 12 gives an appropriate summary and overview about the aspects and characteristics of the globalization of Chinese business firms according to H. Zhang and Bulcke.

Aspects of globalization	***Characteristics***
FDI motivation	• risk diversification • production cost driven • following customers
Location and partner selection	• existence of ethnic connections and networks • preference of kinship or friendship
Business strategies and production structure	• low degree of multinationalization • no clear sequence in overseas operations • low physical integration between parent company and subsidiaries • special business arrangements with low transaction costs
Ownership and control	• wholly-owned subsidiary or majority joint-ventures • dualism in organizational structure and control system • highly centralized decision-making • tight financial control • promotion of kinship for top and key management positions

Table 12: Characteristics of Chinese Business Firms in Their Globalization Process, Daniel H. Zhang and Van Den Bulcke, in: Henry Wai-chung Yeung, "The Dynamics of the Globalization of Chinese Business Firms," Globalization of Chinese Business Firms, Eds. Henry Wai-chung Yeung and Kris Olds, London: Macmillan Press, 2000, 98.

As Table 12 shows, ethnic Chinese businesses choose to invest overseas in order to diversify risks, to lower production costs or to follow customers. When selecting the location and partner of the investment, ethnic Chinese prefer to select partners which they already know or are kin or friends with. Although these ethnic Chinese businesses expand internationally, the true degree of internationalization or multinationality is restricted. One cannot discern a clear pattern in the internationalization process as the choice of investment is driven by opportunism in the search for lower transaction costs. A low integration between subsidiaries and headquarters underlines the minor importance and focus on a coherent internationalization strategy but rather on minimizing costs and opportunistic diversification.

Ethnic Chinese businesses strive for the control of their operations in foreign countries and prefer wholly-owned subsidiaries or JVs with a controlling majority. The quest for control is also visible in the high centralization of decision-making in their operations and the tight control of financial matters. The organizational structure is identically to the structure of the control systems. Finally, family members are posted and promoted to key positions in the operation in order to have managers which are reliable.

In conclusion, overseas Chinese have become a major economic force, especially in Southeast Asia. The overseas Chinese business is family-led and centered around the head of the family. Ethnic Chinese businesses internationalize in order to diversify risks, lower costs and follow customers. The choice of location and business partners is dependent on personal connections, kinship or friendships. Still, although the ethnic Chinese businesses operate globally, they choose not to integrate the various subsidiaries with the headquarters. Control of the subsidiaries takes place through the installment of family members in key management positions, a tight control of decision-making and finance as well as the choice of wholly-owned subsidiaries and majority-owned JVs.

4.4 A Framework for the International Expansion of Ethnic Chinese Business – Chinese Business Networks

How can the Chinese business network, also known as the bamboo network (Murray and Weidenbaum) or the Chinese commonwealth (Kao), be integrated into a comprehensive (theoretical) framework in order to understand the internationalization of ethnic/Overseas Chinese in Asia and worldwide?

Transaction cost economics (TCE) (as discussed in Chapter 1.2.2) is a popular approach to the internationalization of the firm. The transaction cost model as postulated by Williamson relies on the premise that transaction costs, costs incurred by using the market instead of internalization, force the firm to choose the corresponding modus operandi. Thus, the "difference between relative benefits and costs leads firms to choose either a market approach or internal vertical integration, or possibly horizontal diversification." (G. R. Jones and Hill 160) H. Zhang and Bulcke identify three critical limitations of the TCE based theory in regard to the internationalization of the firm. First, the limitation of the firm's choice to the selection of either markets or internalization for a transaction is too constricting. Other hybrid modes of organizing transactions are possible; for example, co-operative supply and production are not adequately explained by the TCE theory. Networks across national boundaries that encompass both market transactions and hierarchical administrations are also hybrid forms of organization and are becoming more and more common among international companies (H. Zhang and Bulcke 128).

Second, as has been argued by the RBV of the firm, the TCE theory neglects the value-generation process of the transaction (Madhok 49). Applied to the internationalization of the firm, competitive advantages that result from conducting transnational business are not considered by the TCE theory. Therefore, TCE theory is inadequately equipped to explain transitional ownership advantages as opposed to asset-based ownership advantages (H. Zhang and Bulcke 128). Third, as H. Zhang and Bulcke observe, "[TCE] does not sufficiently appreciate the social context and cultural dimensions that could affect international business transactions. A link between the cultural context and the technical concept of transaction cost is generally absent in TCE." (128) Therefore, TCE neglects the aspects of social and cultural interaction taking place between the actors of a transaction. Because networks are formal, informal and socially constructed webs of relationships and are significant for the internationalization of firms (Coviello and Martin 59), the internationalization of Overseas Chinese business networks can not be adequately explained and analyzed by the TCE theory. TCE theory does not offer a comprehensive and suitable tool for the analysis of network relationships (Johanson and Mattsson "Interorganizational Relations" 43-48) as required for the analysis of Overseas Chinese business networks. Castells concludes that "the market- and firm-based TCE is too limited to explain the business networks of Asian corporations, because it is too strongly rooted in the Anglo-Saxon experience." (190) Subsequently, a network-based approach to the internationalization of Overseas Chinese businesses is chosen because as has been shown in Chapter 4.2, Chinese businesses prefer networks and *guanxi* for the internationalization of ethnic Chinese firms.

In a market economy, economic activity can be organized by price or hierarchy and take place in three possible institutions: the market, the network and the firm. From an institutional point of view, wholly-owned subsidiaries as well as JVs together with the parent firm can form a network (Yang 189). According to the network model posited by Johanson and Mattsson (Chapter 1.1.2), firms can access not only the internal resources of the firm, for example, product technology, but also external resources, i.e. resources that other companies in the network possess, for example, market information and local distribution networks. Although becoming a member in the network and gaining access requires a significant amount of time and investment in terms of cooperation, the final embedment in the network justifies the efforts because being a member of a business network creates a value for the company in that the resources of other network members are also available to the firm. The emergence of a co-operative network is a value-generation process because it enhances the resources of the firm with the accessible resources of other firms. Additionally, the network approach, as opposed to the TCE theory, allows for the encompassing of hybrid modes of organization, for example, co-operative agreements such as JVs and licensing. A network does not function solely on hierarchy and market transactions, but considers trust and reciprocity norms as important factors in the development and facilitating of the network (H. Zhang and Bulcke 130).

In the context of network theory, internationalizing businesses deal with three different sets of relationships. The first set of relationships is at the intra-firm level where the company deals with the operations in different countries, for example, choosing a location or country for a subsidiary. The second set of relationships can be found on the inter-firm level in which the company engages with competitors, for example, in joint research and development of products on a global or local scale. This cooperation with competitors in inter-firm networks can enable companies to finance and carry out expensive R&D projects as well as to produce expensive goods. Extra-firm networks relate to relationships between the firm and the nation/state or local institutions. For example, a nation can support local companies to go abroad with financial subsidies and streamline governmental procedures and regulations (Yeung, Transnational Corporations 60-62). Thus, a company can and should employ, use and control all three sets of relationships in the internationalization process in order to achieve the most ideal entrance into the international markets.

A firm's participation in networks is a dynamic process and can significantly explain the internationalization of businesses, especially for SMEs because networks can provide SMEs in the internationalization process with resources which they, due to their size, lack (Bell 62). Furthermore, business and social networks can help in overcoming informal trade barriers between countries as long as these networks operate across national borders, for example, if they are based on ethnicity (Rauch 1177). Drawing on the findings of Johanson and Vahlne in regard to the gradual internationalization of firms (see Chapter 1.1.1) and the network model by Johanson and Mattson (see also Chapter 1.1.2), T.-J. Chen elaborates the importance of networks for the internationalization process of firms further (1108):

> We find that internationalization propelled by the leverage of external resources is typically a gradual process in which the investor slowly expands its network reach from the home base. The investor often chooses a location close to the home base before gradually moving to more distant locations. Wherever it goes, the investment location is always in the areas where network resources are abundant. In the process of internationalization, the investor makes maximum use of network resources that it can access,

including human skills, financial resources, market opportunities, technological capabilities and so on.

Relevant network relationships can be preserved, strengthened and enhanced through FDI. FDI alters the network relationships between members of the network by introducing new activities and actors to the network. However, in order to ensure integration and minimize possible failure and adversarial effects such as losing one's own network relationships, one has to be careful with the integration of foreign network relationships into one's domestic network. A network enables even small and weak companies to expand abroad. But, "internationalization is possible only if the investor accumulates new and distinct network resources during the process of FDI." (T.-J. Chen 1109-1111)

FDI is undertaken in order to establish a lasting presence in the country and is characterized by the influence of the investor in the management of the operation set up through FDI in the host country. According to T.-J. Chen, "from a network perspective, FDI is viewed as an effort by investors to forge linkages with foreign networks by establishing a presence in the foreign country." (1107) Furthermore, the FDI improves an investor's position in the network by offering "a broader range of products, at a lower cost, in a more flexible fashion, and from a location closer to consumers than before." (T.-J. Chen 1108) Furthermore, the FDI ties not only different networks of the firm's global operations together, but also connects the firm's networks with market networks of the country (Yang 163).

Tong analyzed bilateral FDI in 54 economies using a standard gravity model to analyze the role of ethnic Chinese networks in promoting FDI. Tong found that ethnic Chinese networks facilitate FDI between different economies. The ethnic Chinese networks facilitated the FDI between countries from developing as well as of developed/industrial countries. In countries which are characterized by weak institutions, networks can ensure the threat of enforcement of sanctions against other members in order to prevent fraud of business partners. Furthermore, networks can be utilized to promote investment in the local economy. Ethnic Chinese networks help network members to overcome informational barriers in countries with strong institutions where the rule of law is respected (Tong 28).

Wu and Choi analyzed the role of synergy and synergy creation in the context of networks for the success of Overseas Chinese businesses. Repeated transactions between partners (which are members of the same network) lead to the creation of synergy; hence, managers should try to maintain long-term relationship with key business partners. Further synergy creation, directly and indirectly, can be achieved by establishing and maintaining close ties to host governments and financial institutions as the government and institutions can facilitate additional business through proving opportunities and integrating the Chinese business in the local network through referral to other network members (Wu and Choi 339-340). Wu and Choi conclude that "Synergy creation achieved through networking may be an alternative explanation for the success of Overseas Chinese businesses." (340)

The concept developed by H. Zhang and Bulcke tries to provide a framework for the internationalization of the Overseas Chinese business firm by integrating the characteristics and features of Overseas Chinese business within the network theory. According to H. Zhang and Bulcke, Chinese businesses can be classified into 4 different categories in regard to their organizational form and market orientation (H. Zhang and Bulcke 134-135):

(1) Paternalistic firms

(2) Mobile exporters

(3) Entrepreneurial alliances

(4) Global networking

The first organizational form is defined by the paternalistic management of the firm and the focus on the local market and is the dominant form of Overseas Chinese businesses. The Chinese businesses invest heavily in creating mutual obligations, developing personal ties and extending their networks. Therefore, the business is creating a network that helps the Overseas Chinese business to access cheap capital and local information. These paternalistic Chinese firms are hindered in the internationalization process by a lack of specific ownership advantages and rely mostly on the comparative advantages provided by the host country (H. Zhang and Bulcke 134-135).

The second type of enterprise is the entrepreneurial Chinese conglomerate and an enhanced version of the paternalistic organization. The leveraging of resources provided by the network in which these Overseas Chinese businesses are embedded facilitates the internationalization. The entrepreneurial Chinese enterprise establishes especially close ties to government officials and institutions to ensure the continuing success in the local environment. The expansion takes the form of acquiring or establishing subsidiaries in different industries, therefore, inter-firm relationships between subsidiaries are small and the subsidiaries remain small. Thus, the original business functions as a holding company. The holding company provides internal capital markets and the pooling of financial resources among the subsidiaries for further investment or expansion (H. Zhang and Bulcke 135-136).

Mobile exporters are the third kind of possible organizational form of Overseas Chinese businesses. The mobile exporters are able to access a highly international production and market network. By having worked together with MNEs as subcontractors or exporters to foreign markets, these Chinese businesses have fostered an exclusive position in the international production network by turning their function as an interface and facilitator between MNEs and international markets into the Chinese businesses' main ownership advantage.

Regional and global players are the fourth type of Chinese-owned organizations. The regional and global players are often diversified conglomerates or integrated industrial groups and have committed themselves to strategic alliances with Western MNEs in order to establish regional and global operations. The alliance works two-fold. On the one hand, Overseas Chinese businesses can facilitate the market entrance of Western MNEs in the Asian region. On the other hand, the technology and management know-how of the Western MNEs enables the transformation of the Overseas Chinese family-run businesses to develop more open structures and integrate into the production networks of developed countries (H. Zhang and Bulcke 135-136).

The 4 different forms of Chinese businesses are illustrated in regard to possible investments scenarios of the businesses' from a network perspective in Figure 23. The M-form of an organization refers to the organization of the firm in different business units, for example, product A, product B, etc. The U-form of the organization refers to the organization by function, for example, finance, marketing, etc. (McGraw-Hill/Irwin). Local market orientation refers to the home market of the Chinese business while the foreign market orientation refers to international markets.

		Market orientation	
		Local	Foreign
Organization structure	U-form	I Inward alliances *(Paternalistic firms)*	II Outward alliances *(Mobile exporters)*
	M-form	III Multiple alliances *(Entrepreneurial conglomerates)*	IV Global networking *(Regional/global players)*

Figure 23: Investment Scenarios of Chinese-owned Multinational Enterprises from a Network Perspective, Haiyan Zhang, and Daniel Van Den Bulcke, "Internationalization of Ethnic Chinese-Owned Enterprises: A Network Approach," <u>Globalization of Chinese Business Firms</u>, Eds. Henry Wai-chung Yeung and Kris Olds, London: Macmillan Press, 2000, 140.

Inward alliances are the recommended choice for paternalistic firms as these Chinese businesses own competitive advantages through the business's networks and are able to offer the network's resources to MNEs or Mainland Chinese wishing to enter the local host market (H. Zhang and Bulcke 140). The inward alliance between the local Chinese family-owned business and the inward investor enables the foreign investor the access to the market and the local Chinese business to decrease the business's reliance on local sources of support and increase political and financial leeway of the business (Mackie 183). The co-operation with the foreign investor strengthens the comparative advantage of the Overseas Chinese business in terms of technology and marketing expertise, and introduces the Chinese business to the foreign investor's network. The transaction between the Overseas Chinese business and the MNEs or Mainland Chinese leads to an internationalization of the Overseas Chinese business and the business' networks and “has contributed to the dynamic interaction between, and gradual switching from, inward to outward internationalization of Chinese enterprises.” (H. Zhang and Bulcke 142)

The outward alliance-scenario concerns the mobile exporters. Due to changing circumstances in the business environment, these Chinese businesses were forced to restructure the business’ activities. Because of the inability to do so in the home market, the Overseas Chinese family business moved the production to Southeast Asian countries which enabled the business “to avoid or delay transformation by providing location specific advantages that prolong their firm’s specific advantages and enable them to continue with their traditional business practices.” (Lim 21-22) The advantages of the mobile exporter lie in the business’ position in the highly internationalized network. The characteristic of the mobile exporter’s outward investment is the follow-up operation. Having worked together internationally with MNEs in JVs, as suppliers or subcontractors, these mobile exporters are now basically being “pulled out” from their home country. Although the mobile exporters take part in the outward alliance in host countries in Southeast Asia while conducting business in the local market, the mobile exporters build and rely less on local network connections as on the international markets and networks established in the home countries of the business’ international (Western) alliance partners (H. Zhang and Bulcke 143-144).

Multiple Alliances represent the multiplication of business networks of large Overseas Chinese business in a variety of markets. These large Chinese businesses have diversified into the manufacturing sector abroad and at the same time also diversify the ownership structures of their businesses by establishing foreign JVs with MNEs and inward ethnic Chinese investors in the host market. In this process, these Chinese businesses also become multinational conglomerates with extensive local ties to companies and governments and the further enhancement of resources. These Chinese conglomerates take advantage of the further liberalization of FDI and markets in Southeast Asia and invest in neighboring countries. The Chinese conglomerates duplicate the conglomerate’s’ networks by entering JVs, cross-directorship and cross-shareholding with other ethnic Chinese businesses in host economies. Thus, the conglomerate’s network expands and accessible resources significantly increase (H. Zhang and Bulcke 144-145).

Global Networking by Overseas Chinese businesses takes the described internationalization through multiple alliances even further. Global networking by Overseas Chinese results in global alliances between Overseas Chinese conglomerates and indigenous, ethnic Chinese and Western MNEs. These global alliances consist of cross-border alliances between Chinese and non-Chinese business groups in order to establish a regional presence in a chosen country, expand ethnic Chinese business in the Western hemisphere and create worldwide value-adding networks. The global alliances provide the Chinese companies with much needed management expertise, global production networks and access to technology. The results of global alliances so far have been mixed. Most Chinese global companies acquired knowledge of operating in different environments; nonetheless, the lack of firm-specific advantages and highly structured markets in the Western hemisphere which lack Chinese networks means that the ventures of the Chinese's conglomerates on a global scale have been unsuccessful (H. Zhang and Bulcke 146). H. Zhang and Bulcke conclude (147):

> Globalization is a big challenge for ethnic Chinese-owned enterprises and requires more linkages between Chinese, indigenous and foreign enterprises because of the growing scale and complexity of their business operations. It is expected that the more advanced Chinese enterprises will incorporate and rely more and more on non-Chinese capital, on non-Chinese and non-family members as employees and in managerial and professional positions as well as on non-Chinese partners.

Thus, the internationalization of Overseas Chinese businesses requires the integration of non-Chinese financial and human capital to achieve success on the global stage. The integration of local and internal resources into the hierarchy of a globally operating business has so far not taken place. Therefore, "few Chinese business firms are really *global* [original italics] in their cross-border operations, despite the fact that some ethnic Chinese entrepreneurs have built truly global networks of social relationships (Yeung and Olds, "Epilogue" 275). Nonetheless, states Peng, "the emergence of 'connected Chinese enterprise groups' […] is a new trend in international business development. […] The connected Chinese enterprise group can enjoy the integral power of the whole group while retaining the flexibility of individual firms." (245) Hence, one can expect Chinese businesses to accelerate expanding internationally within a globalized network of individual firms in the next years and take advantage of the embedding in this network.

4.5 Conclusions and Propositions for the International Expansion of Ethnic Chinese Businesses

The ethnic Chinese business is generally family lead and managed by the patriarch of the family. Decision-making is centrally organized and key positions of the firm are occupied by family members. Overseas Chinese family businesses are integrated into familial, informal and formal networks of relationships. When Overseas Chinese businesses start to expand from the core business into other business activities, new ventures are regularly financed by family members, friends and business partners. The diversification takes mostly place into unrelated industries and activities because of the focus on low cost business opportunities. The characteristics and behavior of ethnic Chinese businesses can be traced to distinctive cultural variables and determinants, for example, filial piety/power distance, face, high-contexting and *guanxi*.

Overseas Chinese businesses expand internationally to minimize the risk of the investment in just one market. Furthermore, the engagement of Overseas Chinese business which paved the way for MNEs in the host societies with the MNEs in JVs and other co-operative forms enabled the Overseas Chinese business to gain valuable knowledge and access to Western technology, management know-how and marketing expertise.

Overseas Chinese businesses prefer M&A and JVs when entering new markets. The acquisition of foreign local knowledge and expertise as well as the speed of the transaction are key factors for the Overseas Chinese business in the consideration for the right market entry mode. JVs also give the Overseas Chinese business access to foreign, mostly Western, technology and know-how and paved the way for a further expansion in the chosen market. The market entrance through acquisitions or JVs is followed by the set-up of a new venture supported financially and immaterially by other ethnic Chinese businesses. Other modes of expansion are generally neglected by Overseas Chinese businesses.

Which exemplary conclusions can be drawn from the expansion and the internationalization of Overseas Chinese business for the internationalization of Mainland Chinese business? Two selected propositions are made from the analysis of the expansion of Overseas Chinese business. First, Mainland Chinese businesses are culturally very similar to Overseas Chinese businesses since both are ethnic Chinese businesses. Organizational forms of Mainland Chinese business, due to the communist rule and the transitional economy, can not be expected to feature the same characteristics as do Overseas Chinese business. However, Chinese cultural determinants and variables are able to explain characteristics and behavior of ethnic Chinese businesses. Thus, features and characteristics of Overseas Chinese businesses which can be traced to the Chinese ethnicity are probably also applicable to private Mainland Chinese businesses because these features and characteristics are due to the cultural heritage of being an ethnic Chinese business. Therefore, it can be expected that private Chinese businesses from Mainland China are similarly structured and led as Overseas Chinese businesses. Subsequently, if the Mainland Chinese businesses are family-led, then these businesses are also centered on the patriarch of the family and are centrally led, managed and controlled. A strong reliance on the family for the management of the business, including the leadership of the business by the family head and, thus, the lack of professional management, as well as the diversification with unrelated subsidiaries can be expected, too.

Second, Mainland Chinese businesses, similar to Overseas Chinese businesses, establish, use and maintain networks based upon, for example, ethnicity, friend- or kinship. Overseas Chinese businesses rely heavily on the use of network and relationships when expanding abroad. Regardless of the chosen or classified mode of enterprise as described by H. Zhang and Bulcke, the firms make extensive use of networks to expand internationally. It is reasonable to expect that Mainland Chinese business in the internationalization process choose to and be able to rely on ethnic Chinese business networks due to ethnicity, cultural similarities, the Chinese heritage and the close connection Overseas Chinese business feel toward the Mainland. Mainland Chinese SMEs are able to utilize the same economic benefits of business networks based on *guanxi* (see Figure 21) as overseas/ethnic Chinese, for example, access to organizational resources, capabilities, provision of capital and information, lower transaction because of mutual trust and reciprocity, closeness of the network and protection of network members. Mainland Chinese SMEs probably utilize the networks already available in most countries to accelerate the internationalization of Mainland Chinese's business activities.

5 International Expansion of Mainland Chinese Business

This chapter analyzes the international expansion of Mainland Chinese business. First, a short overview about the development of the Chinese economy in recent years is given. Subsequently, the second section of the chapter features the different types of enterprises in China. The third section of this chapter deals with the challenges Mainland Chinese firms face in the context of their internationalization. Chapter 5.4 presents a synthesis of the conclusions drawn in Chapter 4.5 and the findings of Chapter 5 so far. Subsequent Chapter 5.5 deals with conceptual frameworks available to explain the internationalization of firms. In conclusion, Chapter 5.6 summarizes and examines the findings of Chapter 5.

5.1 The Chinese Economy

The Economist observers that ("From T-Shirts to T-Bonds" 65):

> China is behind almost everything […] going on in the world economy. […] Uniquely, China combines a vast supply of cheap labor with an economy that (for its size) unusually open to the rest of the world, in terms of trade and foreign direct investment.

Figure 24 illustrates how China's importance to the world economy is set to grow in the coming years. In 2004, China was contributing just 4 percent to the world gross domestic product. This number is to increase nearly fourfold by 2025 and sevenfold by 2050. Consequently, China will overtake the USA as the world's biggest economy sometime between 2025 and 2050. Thus, by looking at the projections one can observe a significant shift of economic power from the EU, USA and Japan to China and India in the next decades.

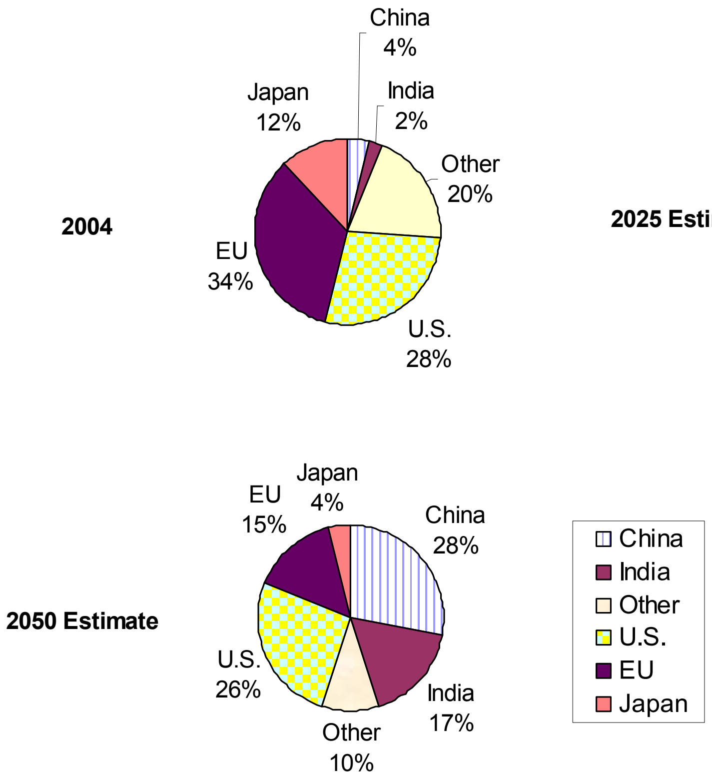

Figure 24: Percentage of World Gross Domestic Product, Pete Engardio, "A New World Economy," BusinessWeek, 22. August 2005: 38.

Additionally, China could become the world largest exporter by 2010 and Chinese goods and services could account for as much as 10 percent of global trade (OECD, China). Thus, in essence, China is probably to become the most important player on the global economic stage and will continue to dominate the world economy within the next decades. Add Child and Tse, “China is the most singular of the transition economies. It is the largest, the fastest growing and the most heavily engaged in international business and investment.” (5) The transition of China from a command to a market economy with social characteristics is unusual since the transition is planned and executed by the state with a strong involvement of the Chinese government in the country’s social and economic affairs (Child and Tse 5-6). The goals of institutional reform in China are (Child and Tse 7):

- Introduction of a market economy with socialistic characteristics
- Withdrawal of the government from direct business governance

- Strong and globally competitive Chinese firms
- Open and competitive industrial structures
- The achievement of economies of scale and scope
- Favored development of pillar industries

Child and Tse state that “decentralization and privatization signal the diminution of central government involvement in business governance and ownership.” (8) Thus, the state relaxes its grips on businesses, reforms state-owned enterprises (SOEs) and supports the development of private enterprises.[17] The Chinese government plans keep some SOEs under governmental control in strategic industries; the rest of the SOEs are to be reformed, privatized or closed. The market reforms undertaken by the Chinese government have taken place in incremental steps to ensure political and social stability in China (Child and Tse 5-8). A short overview of the most significant steps of the reforms of China’s enterprises in the move from a centrally planned economy to a market economy with social characteristics is given below in Table 13.

[17] In accordance to the definitions used by IBM(3), the term SOE refers to companies in which the state owns more than 50 percent of the shares, while the term private enterprises refers to enterprises in which the state has less than 50 percent of the shares and has no or limited managerial influence.

Time-Frame	Stage	Enterprise Reform Measures
1978 – 1984	The Initiating Stage	- Delegation of power and sharing profits - Limited autonomy in regard to production, pricing, material procuring, etc.
1984 – 1991	The Exploring Stage	- Introduction of “go-out strategy” - Collaboration with foreign enterprises - Introduction of joint-stock ownership - Insolvent enterprises may apply for bankruptcy - First Enterprise Law since founding of PRC introduced - Separation of ownership and management introduced
1992 - present	The Standardizing Stage	- Expansion of the rights in management of state-owned enterprises - The goal of a “socialist market economy” is stipulated - Passing of Company Law which made all companies regardless of their ownership equal - Abolishment of governmental administrative ranks in enterprises - Establishment of a modern enterprise system

Table 13: Overview of Market-Oriented Reforms of China’s Enterprises, compiled from: Anonymous, Market-Oriented Reforms of China's Enterprises in Retrospect, 7. November 2003, China.org.cn, Available: http://www.china.org.cn/english/2003chinamarket/79520.htm, 4. February 2005.

Thanks to the undertaken reforms, China has experienced a massive and impressive growth in the last years on its way to a market economy. In 2005, China’s real GDP grew at 9.9 percent, up from 9.2 percent in 2004. With its population of approximately 1.3 billion people it is the largest market on earth and continues to attract foreign investors (HKTDC). Figure 25 illustrates the growth of China’s gross domestic product during the last five years and China’s projected growth in the near future.

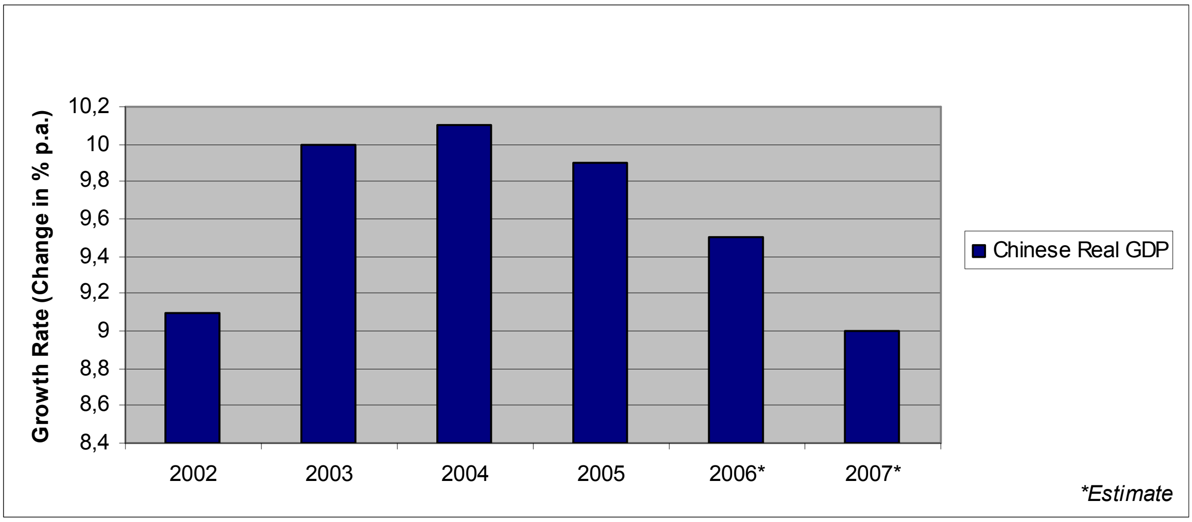

Figure 25: China's Real GDP Growth for the Period of 2002-2007, compiled from: IMF, World Economic Outlook: Globalization & Inflation, Washington: International Monetary Fund (IMF), 2006.

The growth of the Chinese markets leads to the creation of wealth among the consumers since a real increase in the gross domestic product translates into a higher income for most households in China. The higher household income in turn encourages consumers to spend more money and, thus, enhances the revenues and profits of enterprises in the local market. Consequently, the Chinese market attracts a steady and rising share of FDI of companies wanting to enter and expand in the Chinese market. Figure 26 displays the growth of FDI in China for the period of 2000-2005.

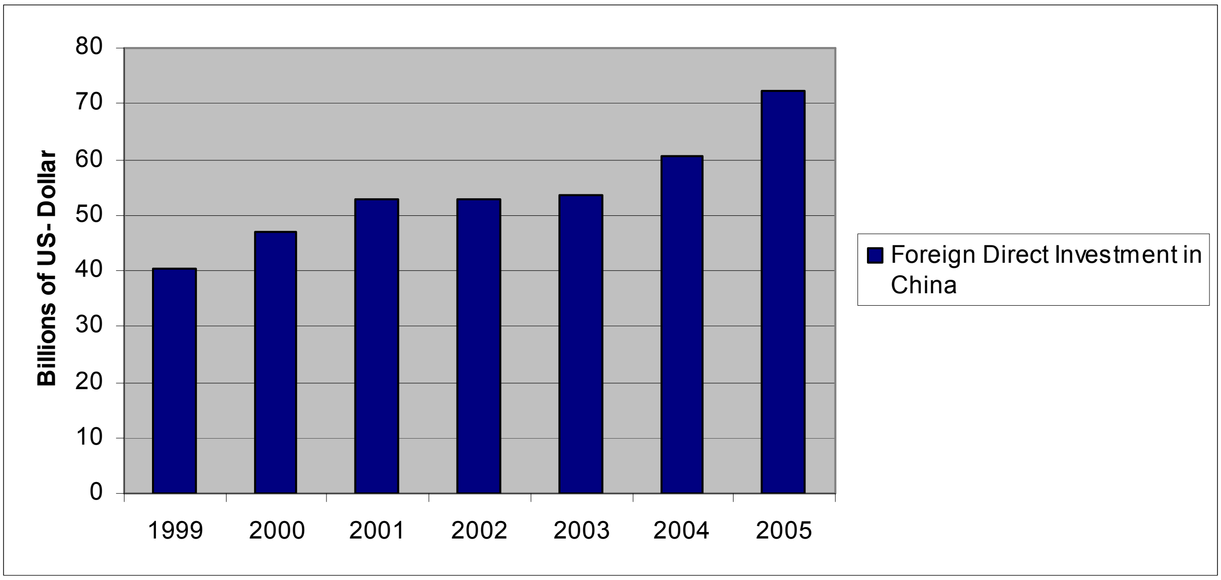

Figure 26: FDI in China for the period of 1999-2005, compiled from: UNCTAD, United Nations Conference on Trade and Development, "World Investment Development - Country Profile: China," New York and Geneva: UNCTAD, 2004; Anonymous, China's FDI Witnesses 13% Growth in 2004, 14. January 2005, People's Daily Online, Available: http://english.peopledaily.com.cn/200501/14/eng20050114_170596.html, 12. February 2005, and Anonymous, China's Actual FDI in 2005 Reaches 72.4 Billion U.S. Dollars, 9. June 2006, People's Daily Online, Available: http://english.people.com.cn/200606/09/eng20060609_272420.html, 10. June 2006.

The continuous flow of high FDI into China is a sign for the confidence foreign investors display for the domestic Chinese market. The total FDI stock, compared to 1990, has increased over 30-fold. Thus, the Chinese market has become one of the most heavily-invested economies in the world. Figure 27 illustrates the development of FDI stocks in China for the period of 1990-2005.

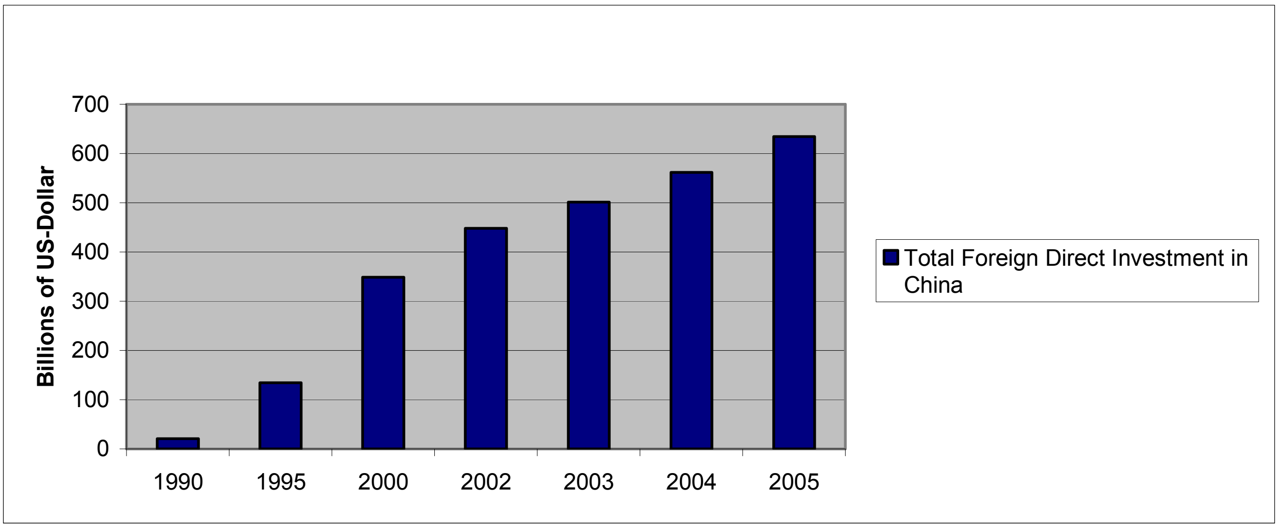

Figure 27: Total FDI in China for the period of 1990-2005, compiled from: UNCTAD, United Nations Conference on Trade and Development, "World Investment Development - Country Profile: China," New York and Geneva: UNCTAD, 2004, Anonymous, China's FDI Witnesses 13% Growth in 2004, 14. January 2005, People's Daily Online, Available: http://english.peopledaily.com.cn/200501/14/eng20050114_170596.html, 12. February 2005, and Anonymous, China's Actual FDI in 2005 Reaches 72.4 Billion U.S. Dollars, 9. June 2006, People's Daily Online, Available: http://english.people.com.cn/200606/09/eng20060609_272420.html, 10. June 2006.

A total of $634,50 billion in FDI flowed into China in the period of 1979-2005 and much of it during the last few years. The investment boom in China was driven by Overseas Chinese who from 1985-1996 alone accounted for two-thirds of all investment in China (S. Long). The FDI from Overseas Chinese in China helped build up a significant number of Mainland Chinese companies. Now, these Mainland Chinese companies have accumulated substantial amounts of capital and have access to of one of the world’s lowest-cost manufacturing markets (Roberts et al.). As a result, Chinese companies are increasingly turning towards foreign markets to apply the competitive advantages gained in their home country. The next section of this chapter analyzes which types of enterprises conduct business in the Chinese market and can be considered for an analysis in regard to a possible international expansion abroad.

5.2 Types of Chinese Enterprises

The National Bureau of Statistics (NBS General Survey Indicators) in China distinguishes between 3 different types of enterprises in the Chinese economy. The first are domestic enterprises, followed by enterprises funded through investments from Hong Kong, Macau and Taiwan and lastly, foreign-invested enterprises. Domestic enterprises are further differentiated into state-owned enterprises, collective-owned enterprises, cooperative enterprises, joint ownership enterprises, limited liability corporations, share-holding corporations Ltd., private enterprises and other enterprises. Foreign-invested companies and enterprises from Taiwan, Hong Kong and Macau consist of joint-venture enterprises, cooperative enterprises, sole investment enterprises and share-holding corporations Ltd (NBS General Survey Indicators). For the scope of this dissertation, a further analysis of the domestic enterprises is conducted with the focus on SOEs and private enterprises while other types of enterprises are neglected. Other types of enterprises are neglected because they are not relevant within the scope of an analysis of the expansion of Mainland Chinese businesses since these enterprises either do not qualify as being purely ethnic Chinese Mainland companies with the capital solely coming from Mainland China or have an organizational structure that makes labeling or analyzing them too complicated or even impossible.

5.2.1 State-Owned Enterprise (SOE)

SOEs are run directly by either the central authority or by local governments at the provincial, municipal or county level. Since China is basically still a planned economy (albeit one which is in transition to a market-based economy), SOEs are managed at the macro- and micro-level. At the macro-level, SOEs are run by the corresponding bureaucracy within the framework of the centrally-planned economy. At the micro-level, SOEs are run by the government-appointed management of the enterprise in regard to the day-to-day affairs of the company (Jackson 16). Figure 28 illustrates the hierarchy in the planned economy of China with regard to the management of China’s enterprises.

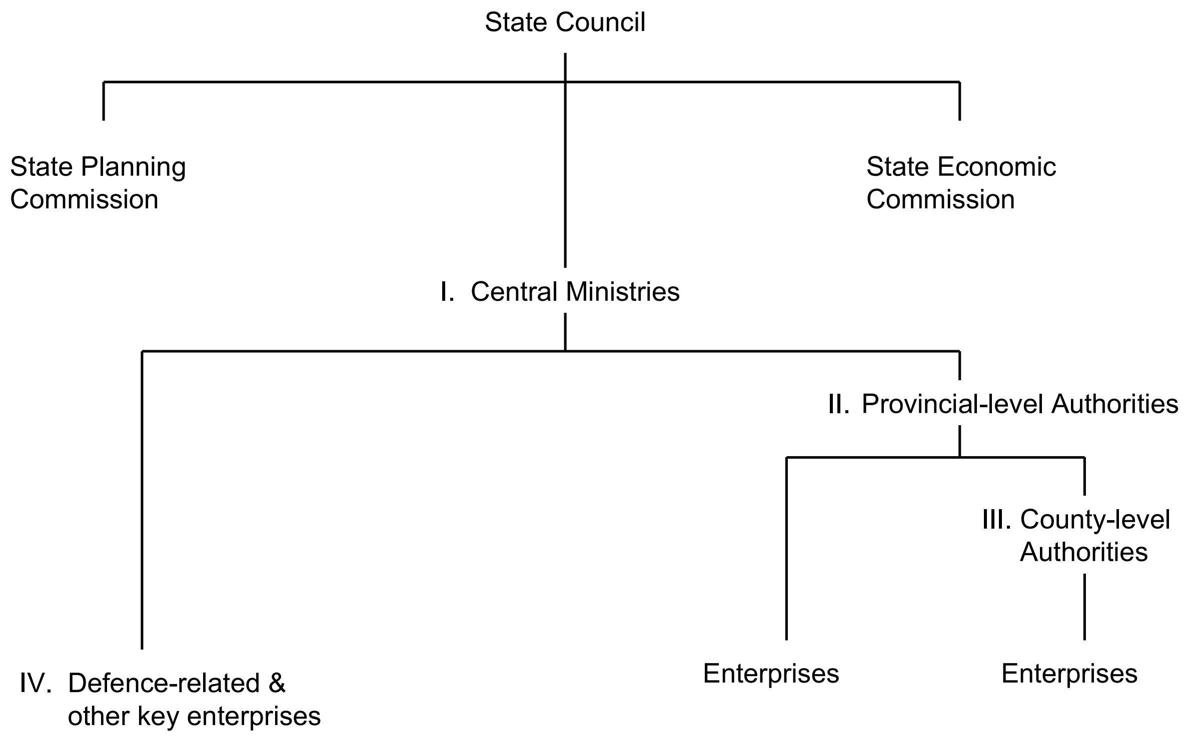

Figure 28: Industrial Management and Planning Hierarchy in China; Sukhan Jackson, Chinese Enterprise Management Reforms in Economic Perspective, De Gruyter Studies in Organization, Ed. Stewart R. Clegg, Vol. 41, Berlin; New York: Walter de Gruyter, 1992, 17.

Wang describes SOEs as ("Reforming State-Owned Enterprises in China"):

> A social unit in that, besides providing life long employment to its employees, it also provides all the necessary social services to its employees and their family: housing, healthcare, child care, education, grocery, to a name a few. In some sense, a unit takes care of its employees "from the cradle to the grave."

Therefore, SOEs not only served their primary function, which is the production of goods and services, but fulfilled a larger role encompassing that of a care-taker of the SOEs' employees and the employee's families. At one point of time in the past, SOEs performed these social obligations to more than 112 million people. The social obligations and the notoriously weak performance of the SOEs led to the decision to reform the SOEs since they would not survive in a market-oriented economy (Wang).

In the early 1980s the Chinese government started to implement SOEs reforms. The reforms entailed the separation of ownership and management of the enterprise.

The Contract Responsibility System and the Enterprise Law aimed to make a more efficient management of the SOE possible while the ownership of the enterprise still remained with the government. The decentralization of decisions to the enterprises, for example, the actual amounts of goods produced, were encouraged. Furthermore, JVs with foreign companies were also encouraged. The measures were aimed at increasing efficiency and productivity and proved successful. Still, serious problems and challenges persisted in the 1990s for the SOEs (Wang) which include, according to Lee, Wong and Ka-ho ("The Decline of State-Owned Enterprises"):

- Declining profitability
- Mounting losses
- Debts
- Stoppage and bankruptcy
- Drain of state assets
- Over-staffing
- Poor competitiveness
- Excessive government interference

SOEs have continuously performed unsatisfactorily in the past. Further increasing their troubles were the comparatively higher tax burden on SOEs as compared to private businesses. In 1996, 37.5 percent of all SOEs were officially loss-making (Lee, Wong and Ka-ho). Estimates by other institutions hold approximately 70 percent for a more accurate number. The ensuing cash drain led to labor disputes in regard to pay and pensions, causing social unrest. Furthermore, the SOEs had to borrow money from the banks and, thus, increased their debts (Lee, Wong and Ka-ho). “In fact, some enterprises maintain production by swallowing up large amounts of bank loans, consuming their materials reserve funds, and resorting to loan defaults and non-payment of taxes” which do “not go towards investments, but to the payment of wages, current inputs and employees’ health costs.” (Lee, Wong and Ka-ho) The non-payment of debts significantly weakened the banking system. Adding to the problem of non-payment was the policy of the Chinese government not to let SOEs go bankrupt because the bankrupt enterprises would not have been able to pay the settlement of the unemployed which, in turn, could have resulted in political instability and social unrest. Also, bankruptcy was emotionally or ideologically not acceptable. Banks also did not want

SOEs go bankrupt, because the debts would become non-collectible and, thus, the banks themselves would face a serious crisis (Lee, Wong and Ka-ho).

A further drain of state assets by SOEs was due to the declaration of false bankruptcies, on the one hand, and the misappropriation of state assets and pilferage by workers, on the other hand. False bankruptcy allowed the enterprise to shed its debts, but the conditions and structures of the enterprise normally did not change, so that the vicious cycle soon began again. The misappropriation of state assets was performed by managers and officials who took advantage of the underdeveloped financial accounting and governance structures and redirected assets into their own private pockets. The same holds true for workers who, due to the ideology of communism, believed that they also own the factory/company and take whatever they wanted or needed. The theft of assets, therefore, was widespread (Lee, Wong and Ka-ho).

Most products of SOEs were low grade and low quality. Old equipment and unmotivated staff contributed to the poor competitiveness of SOEs. Overstaffing of enterprises led to low economic efficiency. In general, it was estimated that SOEs had a surplus workforce-capacity of 20 percent (Lee, Wong and Ka-ho). The overstaffing increased the financial burden on SOEs twofold. One the one hand, it had to pay more for wages. On the other hand, the enterprise also had to make more contributions for social services, health care plans, etc. Additionally, the excessive government interference troubled the day-to-day management of the enterprise. In general, government and enterprise can have different goals and targets which result in different preferences, e.g. the number of the workforce. While the enterprise would like to reduce costs and, thus, prefers an adequate workforce, the government/local authority wants to ensure political and social stability, ensured through the employment of as many people as possible. It was difficult for enterprises to exercise the management's autonomy as local government refused to grant them authority for business matters due fear of losing the decision making and power (Lee, Wong and Ka-ho).

In recent years attempts have been made to change the structure, governance and management of state-owned enterprises. The number of SOEs has been greatly reduced to about 150.000 at the end of 2003, down from 233.000 in 1998 and 305.000 in 1996 (Anonymous, <u>Initial Success Achieved in State-Owned Economic Restructuring;</u> Lee, Wong and Ka-ho). The number of SOEs which are loss-making was reduced to 74.000, 88.000 less than in 1998. Between 1998 and 2003, SOEs increased their annual profit by 44.2 percent (Anonymous, Initial Success Achieved in State-Owned Economic Restructuring). In 2004, the sales revenues of major SOEs were more than $671 billion generating a profit of $58 billion (Anonymous, State-Owned Enterprises Perform Well in 2004). Therefore, the reforms undertaken to address the problems of profitability and overstaffing of enterprises as well as letting SOEs go bankrupt seem to have proven successful. To this end, *The Economist* observes, that "after two decades of reform and privatization, only about a third of China's economy is still directly controlled by the government through state-owned enterprises (SOEs)." (Anonymous, "The Myth of China Inc.") The massive lay-offs of workers and employees have been cushioned by the accelerated hiring of private enterprises which have gained momentum and economic power in the Chinese economy is illustrated in the next section of this chapter.

5.2.2 Private Enterprises

Most private enterprises, whether family-held or collective-owned, are primarily registered as wholly-owned enterprises, partnership enterprises and limited-liability companies. The most basic characteristic of the private enterprise is the private capital used for the foundation of the enterprise which accounts for 92 percent of the stock of all private enterprises. A high ratio of over 83 percent of the capital stock is brought in by the proprietors of the business; i.e. founder and owner as well as family-members. The rest is held by managers, staff, collective stocks and township governments. Thus, "private companies show the typical characteristics of family-dominated enterprises:" (Jia-gui and Qun-hui) In 2001, 68.02 percent of all private enterprises were in the form of limited liability companies. A further 6.44 percent were registered as partnerships; and proprietorships accounted for 25.5 percent of all private enterprises (Anonymous, Development of Non-State Owned Sector). In a report published in 2005 by the All-China Federation of Industry and Commerce, it was found that over 90 percent of private enterprises are family owned and "among such enterprises, the vast majority are operated according to family style management." (Anonymous, 90% of China's Private Business Are Family Owned)

Additionally, collective-owned enterprises which are supposedly owned and run by the township government, can also be either government-controlled or are family-run. Joint stock enterprises replaced the former collectives with stocks being held by the government, the collective and the individuals. The increasingly multi-polarization of ownership of enterprises in China has led to varying degrees of ownership in enterprises among all different types of enterprises (Anonymous, Development of Non-State Owned Sector). The reforms introduced by the Chinese government emphasized the separation of management and ownership and led to, for example, enterprises with the government, the township-government, management and staff as shareholders. For private companies, Jia-gui and Qun-hui assert that "many private companies have been registered in the name of collective-owned enterprises. This phenomenon is called wearing a 'red cap.'"[18] ("Governance Structures of Chinese Enterprises") These 'red cap' enterprises may also be enterprises with dormant governmental partners. However, when these 'red cap' companies become successful, local governments decide to interfere which has lead to bankruptcy and failed realization of growth opportunities (Anonymous, "The Myth of China Inc."). Thus, these 'red cap' enterprises may not be well positioned in terms of organizational structure to survive the intensifying competition in China as well as on the global stage.

The internal governance of family-dominated private enterprises is based on the distribution of power and balance among the family members. Although, private enterprises are gradually moving closer to corporate standards, such as management board, board of directors and shareholder meetings, the characteristics of family control persist. These characteristics also define the managerial incentives in the company. Non-family members are given high pay in order to bind the employees to the enterprise while family members are bound and committed through their holding of the company (Jia-gui and Qun-hui).

Family-run businesses are also known as *getihu*. The *getihu*s were the first type of individual business and were introduced by the communist government in the 1980s to encourage the development of jobs for the unemployed. *Getihu*s are not allowed to employ more than 7 people. In the past, if the *getihu* had more than 7

[18] In China, firms that `wear the red cap' are actually capitalist businesses under the disguise of public ownership (Cheng).

employees, the *getihu* was classified as a private business which was banned until the late 1980s and, subsequently, closed. From 1999 to 2003 the number of *getihu*s decreased from 62 million to 46 million. The decline results from heavy fees and the focus of authorities on the need of large firms as opposed to the need of small family-run businesses. Furthermore, a substantial number of *getihu*s have been classified as private businesses and non-function, but registered *getihu*s have been eliminated from official statistics (Anonymous, "The Bulldozing of Silk Alley" 51).

By mid-2004, China had more than 3.44 million private companies according to a survey conducted by the Research Association on the Private Economy. The 3.44 million enterprises employed approximately 47.14 million employees. By the end of 2004, the number of private enterprises had grown to more than 3.8 million. One cannot underestimate the progress private business have made in China. In 1989 the production value of all private enterprises was a meager $5.1 billion. In 2003, the value had risen to an astonishing $241 billion. This represents an increase of nearly 5000 percent. The growth of private enterprises is expected to be well above 10 percent annually for the next 5-10 years and, subsequently, to be responsible for 60 percent of the increase in the national economy. Furthermore, another 10 million entrepreneurs are expected to emerge (Anonymous, <u>Private Enterprises Expanding Quickly</u>). The economist Fang Gang estimates that 70 percent of the Mainland Chinese GDP is produced by private enterprises (Engardio, <u>China Is a Private-Sector Economy</u>).

Based on the organizational features of the mainly family-led private businesses which are relatively small, the introduction of the term Mainland Chinese SMEs for private Mainland Chinese business is proposed as a classification. Although the development of Mainland Chinese SMEs has been impressive in the last years, the SMEs are nonetheless still discriminated against. For example, Mainland Chinese SMEs are denied access to the state Foreign Aid Fund that is reserved only for SOEs (A. Zhang). A further 87.4 percent of Chinese private entrepreneurs worry about the reforms in the taxation system, the implementation of property rights in regards to private assets in the constitution, the shift of governmental functions and the establishment of a social credit system. Despite the granting of access to Mainland Chinese SMEs to engage in hitherto closed business fields, more support by government departments and financial institutions to the Mainland Chinese SMEs is recommended (Anonymous, <u>Private Enterprises Expanding Quickly</u>).

The problems of Mainland Chinese SMEs are consequences of politically motivated reforms by the Chinese government which was afraid of the development and power of the private sector. Therefore, the government gave SOEs privileged access to capital technology and markets. But foreign nationals with advanced technologies were also treated preferentially and invited to invest in China. The Western MNEs took advantage of the preferential treatment, and in the process the foreign investment transformed the landscape of the market and accelerated the competitive pressure in the Chinese market. The result is, as *The Economist* observes, “a corporate landscape of a few big private companies such as Huawei, a mass of lumbering state-owned firms and increasingly powerful foreign multinationals.” (Anonymous, "The Struggle of the Champions" 60)

A second unintentional result is the focus of Chinese managers on short-term profit. The inconsistency and opacity of regulations lead Chinese managers to pursue a strategy of short-term returns and excessive diversification. Long-term investment, such as in technology, is neglected and the development of horizontal networks among customers, suppliers and trade bodies - needed to establish technology standards - are shunned (Anonymous, "The Struggle of the Champions" 60). Subsequently, 85 percent of high-technology goods produced in China are controlled by foreign firms. Additionally, China runs an annual $10 billion trade deficit in technology. Thus, essentially, “China has a low-tech economy.” (Anonymous, "I Spy Spies" 60)

In general, one cannot even be really sure whether a Chinese business is a truly independent (private) enterprise or a government-controlled company. The mix-up of ownership as discussed above in regard to collective-owned enterprises can be applied to private businesses in general as well. The assumedly private company Huawei, one of China’s biggest companies and a maker of routers and telecommunications equipment is suspected of being actually government-controlled, i.e. by the military. The founder of Huangwei, Ren Zhengei, was in the People’s Liberation Army and staff members of the company’s overseas offices are even allegedly spies for Chinese consulates. Consumer electronics producer Lenovo which appears to be a private business expanding worldwide and aggressively selling its computer and consumer technology products is, in fact, state-owned. The company was founded by - and is majority-owned by - the Chinese Academy of Sciences. Apparently Lenovo uses the company’s excellent government connections to boost revenues (Anonymous, "The Struggle of the Champions" 58-59). Table 14 gives an overview over a selected number of SOEs which are aggressively expanding and behaving the same way private enterprises do, but in which the government owns a significant part of the shares.

Company	Business	Share owned by Government (in %)
Sinopec	Oil production and distribution	84
PetroChina	Oil production and distribution	90
China Mobile	Cellular operator	75
First Auto Works	Auto maker	100
Shanghai Automotive (SAIC)	Auto maker	100
CNNOC	Oil exploration	71
TCL	Consumer electronics	25
Lenovo	Computers	50
Haier	Appliances, consumer electronics	30
Konka	Consumer electronics	24
Sinochem	Petrochemicals	43

Table 14: Mainland Chinese Businesses and Government Ownership, compiled from: Frederik Balfour, "The New Corporate Model: State Ownership," BusinessWeek, 22. August 2005: 52-54.

Most aspiring companies in which the state is still heavily invested are, nonetheless, managed like private enterprises. Kurtenbach acknowledges the progress in the iterative separation of ownership and management of SOEs by concluding that, "the state holds controlling stakes in many companies, but Communist Party bureaucrats no longer fill management posts." (Chinese Business Begins to Expand Overseas) However, intransparency with regard to certain business practices of companies is still rampant. Although companies might be listed at the stock-exchange, the dealings between the state-owned parent and the subsidiary listed at the stock exchange remain murky. The problem of intransparency coupled with the lack of independent boards makes the control of actions and dealings of Chinese companies nearly impossible. The problem of control in turn enhances the risk of fraudulent activities by companies and their managers. Table 15 lists some scandals of Chinese firms during the past few years.

Scandal Sheet
Selected Chinese companies' problems

Company	Date	Problem
Skyworth	2004	TV-maker's top management arrested for theft of funds
D'Long	2004	Conglomerate blew up after exposure of fictious growth through acquisitions and misappropriations of $725 million
Shanghai Land	2004	Property developer collapsed after chairman jailed for fraud
Euro-Asia Agricultural Holdings	2002	Orchid grower collapsed after inflating revenues. Chairman jailed for fraud and bribery
Gitic	1999	Guangdong's investment vehicle went bust, owing over $5 billion

Table 15: Scandal Sheet, Anonymous, "Fools Rush In," The Economist, 9. December 2004: 68-69.

Hence, it seems that China still has some way to go in regard to corporate governance. Furthermore, the contradictions between dirigisme and free markets of the Chinese government, as demonstrated above with the example of Huangwei and Lenovo, remain visible. The contradictions are the result of the power of the government to control and lever enormous resources, but at the same time undercutting the government's efforts towards free markets by the paranoid desire to remain in charge of the country and the international expansion of Mainland Chinese enterprises (Anonymous, "The Struggle of the Champions" 58) . Nonetheless, Chinese companies are expanding worldwide and are facing a number of challenges and problems as well as opportunities. The next chapter analyzes these challenges and opportunities of internationalization.

5.3 The Internationalization of Mainland Chinese Business

According to Bob Broadfoot, “[is] the story now […] not the flow of foreign investment into China, but the flow of Chinese investment overseas, and its impact on other countries.” (Kurtenbach) The quote illustrates the development of China from a FDI recipient to an outward investor with expanding Mainland Chinese businesses. China has become increasingly assertive because Chinese companies are flush with cash and Chinese companies are looking abroad for expansion. Adjacently, the Chinese Government needs to maintain the high GDP growths of the past years and encourages Mainland Chinese businesses to expand internationally (Anonymous, "The Dragon Tucks In" 67). Consequently, the internationalization of Mainland Chinese business has accelerated in the last years. In 2005, Mainland enterprises established 1067 companies abroad and invested $6.92 billion overseas which is more than 12 percent of the total Mainland Chinese ODI to date. The total overseas investment by Mainland Chinese business reached $51,7 billion at the end of the year 2005. 29 percent of the overseas investment in 2005 was put in manufacturing, 28.7 percent in mining and 26.3 in information transmission, computer service and software. 60 percent of the investment went to Asia. In Europe, favorite investment locations were Russia, Germany, Britain and Kazakhstan. 56.5 percent of equity investment was used for M&A, 43.5 percent went into the establishment of production facilities. (Anonymous, China Makes More Overseas Investment in 2005, Mainly in Asia).

Figure 29 illustrates the acceleration of outward direct investment by China. As one can see, while the stock of outward direct investment (ODI) was just $2.5 billion in 1990, ten years it had reached $25.8 billion and increased to $37 billion in 2003 and 51,7 billion in 2005, respectively (UNCTAD, " Country Profile: China"; Hess). It is expected that Mainland Chinese companies will invest another $60 billion abroad by 2010 (Hess 1). Thus, the tremendous acceleration of Mainland Chinese’s investment abroad becomes evident.

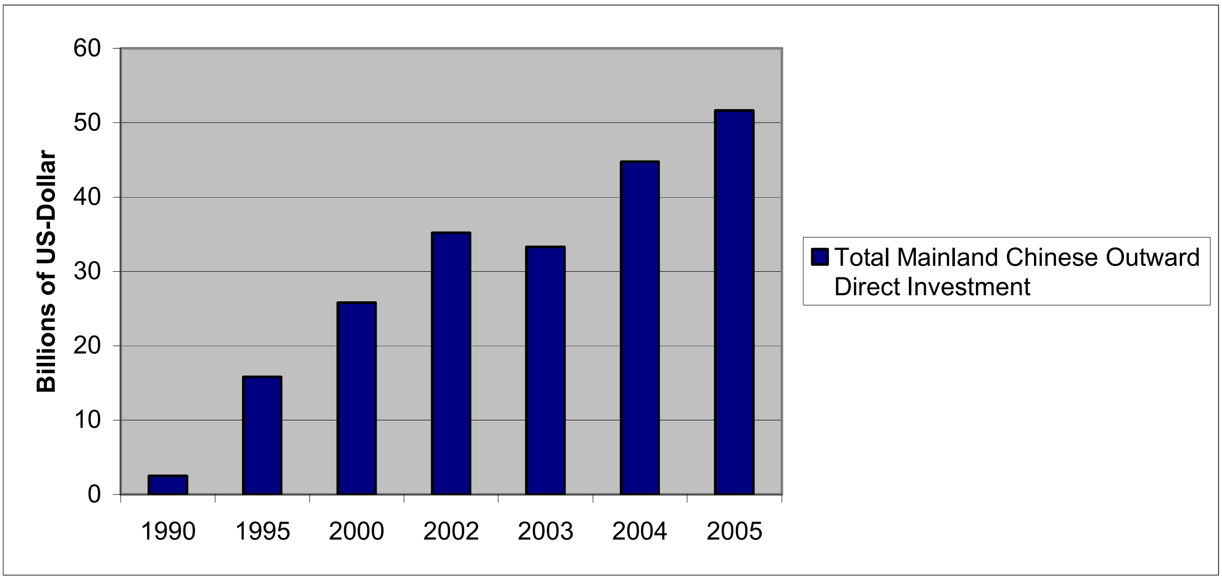

Figure 29: Total Mainland Chinese Outward Direct Investment, UNCTAD, United Nations Conference on Trade and Development, "World Investment Development - Country Profile: China," New York and Geneva: UNCTAD, 2004, and Hess, William, <u>Going Outside, Round-Tripping and Dollar Diplomacy: An Introduction to Chinese Outward Direct Investment</u>, Beijing, China: Global Insight, Available: http://www.globalinsight.com/Highlight/HighlightDetail2717.htm, 2006.

Due to the acceleration of investment of Mainland Chinese businesses, for example, in Southeast Asia, researchers believe that the numbers for total outward investments have been significantly underestimated. As discussed in the previous chapter, ethnic Chinese businesses employ networks to enter markets and channel funds to other ethnic Chinese businesses. The same holds true for Mainland Chinese businesses which utilize the ethnic Chinese networks when expanding, for example, in Southeast Asia. Frost states (Hua et al. 20):

> There's really a black hole of Chinese FDI. The data are missing lots of small and medium-sized enterprises and one-man bands, as well as money that goes through ethnic Chinese or other countries. It's impossible to know how much investment isn't being picked up, but I reckon it's a lot.

According to Wong and Chan, Chinese ODI underwent 4 stages. Because the ODI was initially directed by the government, certain industries or sectors were favored and encouraged to invest overseas to gain access to raw materials and technology as well as increase foreign exchange earnings and promote China's exports. During the first stage from 1979-1985, only state-owned trading companies as well as municipal international and technological cooperation enterprises were allowed to invest abroad. The total number of projects was 189 while the total investment was $197 million with an average of $900,000 per project (Wong and Chan 279).

The second stage from 1986 to 1991 was characterized by a liberalization of restrictive policies and the permission for more enterprises, even private firms, to invest abroad. Firms were allowed to set up subsidiaries abroad provided that sufficient capital, technical and operational know-how and a suitable JV partner were available. 891 projects were granted with a total volume of $1.2 billion having an average project value of $1.4 million. An increasing number of local and provincial enterprises invested abroad during the third stage from 1992-1998. Corruption and nepotism as well as heavy losses by many firms led to a restriction of rules, policies and procedures. Therefore, the average value of a project decreased to $1 million while a total of $1.2 billion were invested overseas. The fourth and continuing stage which started in 1999 is marked by the introduction and consolidation of the “going-out” strategy of the government. (Wong and Chan 280-281).

According to the Ministry of Commerce of the People’s Republic of China (MOFCOM), the “Going Out” – Strategy was designed to enhance the strengths of Chinese enterprises in the exploiting of resources, processing and labor. But in recent years, the focus shifted to technology, production capacity and brands. Chinese enterprises increasingly cooperate or purchase foreign enterprises to gain access to technology and brands. By cooperating with small and medium foreign enterprises, Chinese businesses gain access to sophisticated technology and improve the competitiveness of the Chinese enterprise (MOFCOM It is a New Trend for Scientific and Technological Enterprises to Go Out).

China’s businesses are emerging as powerful rivals, not only in China but on the global market. But so far only few companies have become known globally. There are three reasons why Chinese businesses are not yet globally as big and powerful as multinationals from other countries. First, China is a vast country with a weak transportation, distribution and retail infrastructure. The coastal regions are also significantly richer in terms of income per head than the western regions of China (Zeng and Williamson 93). The differences in household incomes between regions as well as the inadequate infrastructure of China means that there is not one single market, but several markets with strong disparities in income, living style and available products. The rivalry between provinces and the local/regional grooming of enterprises into champions leads to the establishment of many regional brands, but few national brands. Because of the cumbersome process of taking over rival companies, Chinese companies in generally seldom grow large enough to compete on the national stage let alone the global stage (Zeng and Williamson 93). In conclusion, the weak infrastructure, the income disparities between regions and the rivalry between provincial governments hinder the development and implementation of national champions.

Second, only large organizations can compete on the global stage. However, in China these large organizations are mostly state-owned. The SOEs are, as has been discussed previously in this chapter, mostly unprofitable, riddled with debt and are not truly globally competitive. Third, in the past the government did not support Mainland Chinese SMEs and continues to prop up SOEs with cheap credit and favorite investment regulations. The measures introduced by the government in recent years ensure that Mainland Chinese SMEs are now being assisted by the government and regional institutions as well, but the lack of support in the past means that the Mainland Chinese SMEs have yet to catch up. The development of Chinese businesses has been hard to track since the evolution has so far not taken place in a predictable form such as in Japan or South Korea. Instead, 4 different groups of Chinese enterprises are emerging as challenger on the global stage (Zeng and Williamson 94-95).

The first group consists of national champions. Examples for national champions are Haier, Huawei Technologies and Lenovo [Legend][19]. These national champions have successfully coped with the multinational's entrance onto the Chinese market. When these Mainland Chinese businesses expand abroad, the companies look for small, segmented markets, define niches and use their competitive advantages of low labor and material cost in China to successfully serve segments and markets vacated by multinationals due to low profitability. National champions find it difficult to leverage the companies' advantages in highly segmented markets as the companies often lack understanding of local tastes and customer behavior. Furthermore, investment in R&D continues to be low (Zeng and Williamson 95).

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[19] Legend changed its English name to „Lenovo" on 1st April of 2004 (Lenovo)

The second group of emerging Chinese businesses is the group of dedicated exporters. The dedicated exporters move into mass market where Mainland Chinese businesses can apply the competitive advantage of low production cost in China. The dedicated exporters try to reap global economies of scale by targeting the global market for manufactured products. After gaining in the production of goods at a global scale and increasing technological skills and capabilities, the dedicated exporters move up the value chain and into higher segmented markets. Examples for dedicated exporters are BYD Battery, China International Marine Containers and Galanz. Although strong in mass markets, dedicated exporters face difficulties when the business requires customized products or service (Zeng and Williamson 96-97).

Competitive networks are the third group of emerging global businesses from Mainland China. A competitive network consists of several hundred small entrepreneurial companies in one location, each producing or servicing a certain part of the production chain of a product. All entrepreneurial enterprises which specialize in just one part of the value chain form a cohesive and interdependent entity. A good example for a competitive network can be found in Wenzhou where cigarette lighters are produced. Today, more than 700 private companies operate as a single unofficial entity and produce cigarette lighters in the Wenzhou network. The network now enjoys a world market share of approximately 70 percent. Further examples for competitive networks can be found in Chenghai and Shenzen for toys, as well as in Shenzhou for neckties. Competitive networks from China now dominate the world markets in watches, socks, shoes, toys, pens among others. So far, the competitive networks have been unable to make the investments necessary to turn a competitive network into a strong brand (Zeng and Williamson 97-98).

The last group of emerging businesses from Mainland China encompasses technology upstarts. These upstarts have sprung from the large infrastructure of basic science research and military-related technology research. The technology upstarts have used state-of-the-art technologies created in government laboratories and applied them to the production of goods for the world market. The upstarts are normally able to acquire the technology relatively inexpensively since the Chinese government underwrites most of the costs. One impressive example of the technology upstarts is consumer electronics producer Lenovo which was founded by scientists working at the Institute of Computing Technology (Zeng and Williamson 98-99).

Under orders of the Chinese government, more and more Chinese businesses have dared to expand abroad. Companies such as Lenovo, Baosteel, TCL, Huawei and Haier are aggressively pushing into foreign markets. The drive abroad not only results from the desire of the Chinese government to build national champions, but is also due to structural overcapacity and cut-throat competition on the Mainland China market. The fierce competitors are often domestic firms which are not allowed to go bankrupt by officialdom and, thus, force Chinese businesses to expand abroad in order to survive (UNCTAD, “Country Profile: China"). Table 16 gives an overview of the motives of Chinese companies expanding abroad.

Area	Motives
Resources	- Acquire technology to deploy in China - Secure access to raw materials - Advance product development - Acquisition of locational assets that enhance the competitiveness of a Chinese business - Acquire brands and distribution/sales networks
Growth	- Growing and fierce competition in home market - Sustain growth rate having become dominant in one or more domestic markets through • Exports • Building global footprint - Support exports and service local markets - Expand market presence - Diversification strategy in the generation of revenues - Acquire advantages related to “transnationality”, i.e. confidence and of knowledge of operating in foreign environment - M&A used to enhance the competitiveness of a mainland Chinese business - Avoiding tariff barriers and trade quotas
Image/Branding/ Marketing	- Prestige of having international operations - Acquire brands and marketing skills - Aspiration to become global players

Table 16: Motives for Chinese Business to Expand Internationally, compiled from: McKinsey, "China's Businesses Go Global," Launch Event Presentation Asia House Opening, Frankfurt: McKinsey, 2004, 3; and UNCTAD, United Nations Conference on Trade and Development, China - an Emerging FDI Outward Investor, 4. December 2003, UNCTAD, 5-8.

The most aggressive push abroad seen so far by a Chinese business has probably been the acquisition of the PC division of IBM by Lenovo for $1.75 billion in December 2004. The acquisition makes Lenovo the third largest PC manufacturer worldwide, behind Dell and Hewlett-Packard. However, it is questionable whether Lenovo can obtain significant synergies or bring anything significant to the target in terms of management skill or strategy. Lately, Lenovo dithered strategically, changing its name from Legend to Lenovo, selling non-core businesses and focusing on rural customers. And the production of the PC division of IBM already took place in China so that cost savings are limited to synergies in purchasing (Anonymous, "Champ or Chump?" 54-55). So, why did Lenovo buy IBM and what does the step mean for the expansion of Chinese businesses in general?

Ostensibly, Lenovo wanted to gain access and control over distribution, customer and service networks as well as research facilities of IBM. The deal also provides Lenovo with the access to the global network of IBM, a global player (Anonymous, Chinas Lenovo Wird Drittgrösster PC-Hersteller Der Welt). Furthermore, Lenovo obtains the sole rights to the valuable IBM brands for the next 5 years. It seems that "[China's] leaders – both political and corporate – clearly want to develop their own brand names and technology, for both the prestige and the fatter profits they bring." (AP) "They are very ambitious but also quite pragmatic in the sense that they want to buy brands," says Duncan Clarke, the managing director of a consulting firm (AP). Clarke elaborates his point of view by stating that "the government is encouraging this 'go forth' program to encourage Chinese enterprises not only to export, but to acquire companies or set up bases for manufacturing overseas and buy brands, whatever it takes." (AP)

The acquisition of IBM's PC division by Lenovo has been heralded as "the dawn of a new era in China's merger and acquisitions market." (Guerrera and McGregor) According to Guerrera and McGregor, Lenovo "has become the first state-controlled Chinese company to acquire an iconic global brand, together with the high profile and psychological leap of faith such a deal entails." (Lenovo Deal May Herald Dawn of Chinese M&A) Thus, the acquisition provided Lenovo with a reputable brand, respect by other multinationals and a morale boost. Lenovo took the step in order to enter the global stage, soften the effects of tough competition at home and raise the company's reputation and image. The incremental M&A activities among Mainland Chinese businesses are a sign of the growing maturity of the Chinese companies and the commitment of the companies to global activity (Guerrera and McGregor). Table 17 gives an overview about a selected number of M&A deals and other FDI by Chinese businesses abroad while Figure 30 illustrates the growing value of M&A transactions by Chinese companies over the last few years.

Company	Country	Investment time	Investment amount (USD millions)	Projects/assets/investments
Petro China	Kazakhstan	2003	426	Purchased Oil field
	Algeria	2003	245	Invested in Adrar oil field project
	Liberia	2002	175	Purchased oil and gas field
	Indonesia	2002	430	Purchased oil and gas field
	Indonesia	2002	216	Purchased oil field assets
	Sudan	90's to now	2730	Invested in various oil field development projects
TCL	France	2003	66	Mobile phone business JV with Alcatel
		2004	278	Combined TV business with Thomson
	Germany	2002	8	Acquired Schneider Electronics
	India	2000	>20	Established color-TV manufacturing JV with Baron
CNOOC	Indonesia	2003	585	Bought oil and gas field from Repsol-YPE
			275	Acquired 12.5 % share of Tangguh Gas Field from BP
	Australia	2002-03	248	Invested in 2 LNG gas development projects
China Aviation Oil	Singapore	2004	27.4	Invested in 20.6 % share of Singapore Petroleum
Haier	U.S.A.	1999	30	Set up production facility in South Carolina
	Pakistan	2001	9	Set up Haier Industrial Park
	Italy	2001	7	Acquired refrigerator manufacturer Menghetti

Table 17: Overview of M&A-Deals and other FDI by Mainland Chinese Businesses in the Past Years, McKinsey. "China's Businesses Go Global," Launch Event Presentation Asia House Opening, Frankfurt: McKinsey, 2004, 9-10.

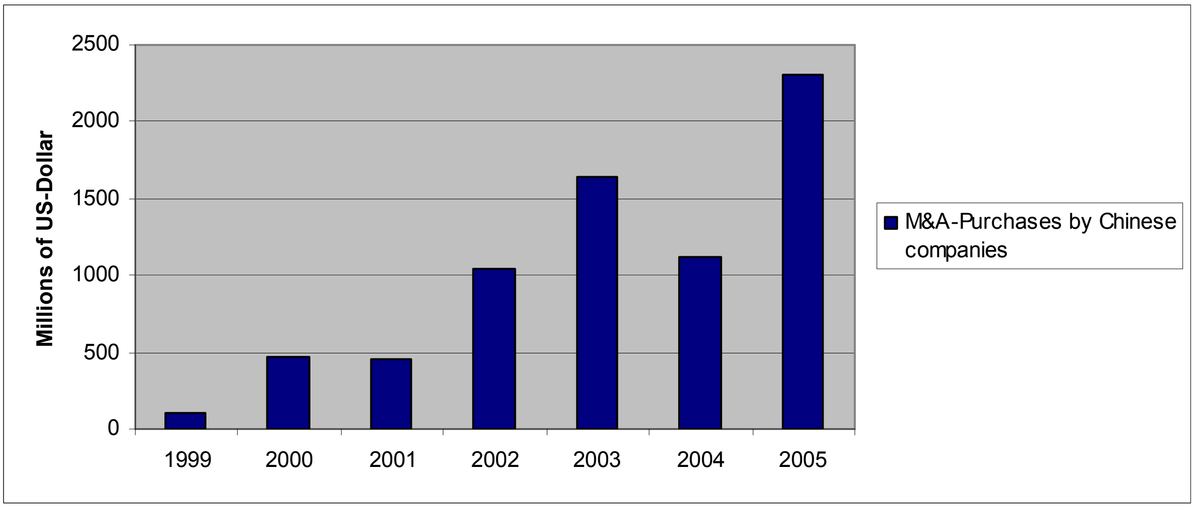

Figure 30: Overview About the Yearly M&A-Purchases by Chinese Companies for the Period 1999-2005, UNCTAD, United Nations Conference on Trade and Development, "World Investment Development - Country Profile: China," New York and Geneva: UNCTAD, 2004; and UNCTAD, Foreign Direct Investment Statistical Database, 2006, UNCTAD, Available: http://www.unctad.org/Templates/Page.asp?intItemID=3159&lang=1, 19. January 2005; and Anonymous, China Makes More Overseas Investment in 2005, Mainly in Asia, 10. February 2006, People's Daily Online, Available: http://english.people.com.cn/200602/10/eng20060210_241644.html, 31. March 2006.

The growing value of M&A-purchases by Chinese companies and the increasing number of big M&A-deals and FDI by Chinese companies illustrates that Mainland Chinese companies are using part of the capital inflow from China-bound FDI (see Figures 26 & 27) to invest in foreign ventures themselves. The acceleration in the number and value of deals also signals a new trend: Mainland Chinese businesses are willingly to spend heavily on foreign resources and speed up the internationalization process of Mainland Chinese businesses. Probable targets are Western industrial firms that are little-known and private since, as Meyer believes, “internationalization will be a small-firm phenomenon.” (Knowledge@Wharton) Buying up these Western companies „can provide competitive advantages to Chinese firms struggling to survive in hypercompetitive domestic markets.” (Knowledge@Wharton)

It seems that Mainland Chinese businesses indeed do not have another choice. According to Marshall Meyers, “Chinese companies are now facing serious foreign competition at home. So they have to do something. They’ve got to grow to global scale.” (Barboza) Adds DiPaola of Bain&Company, “the Chinese understand that global scale gives them lower-cost components, and that R&D and branding are now done globally. […] Chinese companies in industries where the economics are global will have no choice but to make these [M&A] deals." (Roberts, et al.) Subsequently, "China Inc." (Kurtenbach) is aspiring to global scale and raising its international profile by spending billions of dollars on assets and resources. But as Table 17 shows, so far most deals focus on the acquisition of access to natural resources. Nonetheless, three quarters of all Mainland manufacturing firms have plans to expand abroad (Kurtenbach). Chinese exporters especially have bold ambitions, wanting to sell products with their own brand names and capture foreign markets. "The Chinese are fast learners. When they realize what it takes to build a brand, they will really get into it," says marketing expert Shirley Young (Dolan and Hardy 72). "The perception is that the Chinese are never going to get anywhere because they don't have their own brands. That was true ten years ago, but it's changed dramatically," adds Nicholas Lardy, a scholar at the Brookings institution (Dolan and Hardy 72). Therefore, endangered Western companies with strong brands but a weak capital base could be the perfect target for Mainland Chinese companies to acquire. A banker from Shanghai observes, that "it's a perfect match. The Western companies have the technology, and the Chinese have the money and the low-cost manufacturing base." (O'Connell)

The observation by the banker is accurate since Chinese businesses' main advantage is cost. Factory input costs, such as labor and utilities, are low in China. The Chinese government supports local companies in the drive abroad with cheap capital for the expansion and special programs. Furthermore, R&D costs are low and response time to market changes is fast. A comparison of China, other emerging countries and the U.S. reveals that skilled labor costs average \$242 a month in China, compared to \$707 in Brazil and \$5,451 in the U.S. Unskilled labor costs are around \$0.59 in China compared to \$21.33 in the U.S. Manufacturing land costs \$33 in China compared to \$43.04 per square meter in the U.S. and \$94.53 in Korea. Energy costs are 3.76 US-Cents/Kwh. in China compared to 4.98 US-Cents/Kwh. in the U.S. and 9.28 US-Cents/Kwh. in India. Additionally, a comparison of Huawei and Cisco, both producer of network routers, reveals that Huawei's engineers earn about 1/8 the salary of Cisco's employees and Huawei's engineers work an average of 55-60 hours a week compared to Cisco's 40 hours a week (McKinsey 4-6). Although wages and production costs are rising, steep differences in operating and labor costs between China and Western countries remain. Thus, Mainland Chinese businesses enjoy a unique competitive advantage with the low costs of manufacturing in China.

The importance of the development of powerful branding has finally been recognized by Mainland Chinese businesses which want to be multinational. "With well-known brand names and strong marketing strategies, not only can companies dominate [in China], but also succeed in going global," observes Stremme (Local Famous Brands in China). In the past, Chinese businesses have limited themselves to the role of OEM. OEMs supply multinationals and retailer's private labels with products ranging from toys to televisions. Since business with own products and brands is significantly more lucrative than producing for other companies, Mainland Chinese businesses are now striving to position their company and their products abroad by developing and positioning their brands (Deckstein, Kerbusk and Wagner 73). Companies that try to establish a branded presence in foreign markets are Haier, Lenovo, Kejian and SVA. However, "sustaining brands in developed markets is complex, expensive, and uncertain. The biggest obstacle is the Chinese manufacturer's lack of vital marketing skills." (Gao, Woetzel and Wu)

Thus, the lack of marketing and branding skills hinders the expansion of Chinese businesses in developing and developed markets. According to Stremme, "most Chinese companies lack marketing experience and fail to understand the importance of brand positioning." (Local Famous Brands in China) But, "pristine production, however, won't be enough to win over rank-and-file consumers," warn Dolan and Hardy ("The Challenge from China"). Thus, "the Chinese need a Sony: a company that will stand for high quality, that will produce incredible amounts of innovation," concludes Martyn Straw (Dolan and Hardy). The development of a company such as Sony in consumer electronics requires substantial investments in R&D to identify market niches as well as develop and produce new products. Furthermore, considerable investments have to be made into the advertising and marketing of the products. In the past Chinese companies did not significantly invest in innovation and brand marketing as the Chinese businesses underestimated the importance of innovation and marketing. The same holds true for distribution and sales networks. That is why most Chinese products are generally regarded as cheap, low-tech and of poor quality. But now more and more Chinese businesses realize that a change of attitude towards expenses for innovation, branding, distribution and sales networks is needed (Dolan and Hardy; Roberts, Balfour and Einhorn et al. 77-80).

Chinese carmakers are a case in point because they understand the assembly of vehicles, but lack profound knowledge in vehicle research, components technology, purchasing or brand-building (Anonymous, "Rover's Return"). Consequently, for example, Mainland Chinese Shanghai Automotive Industry Corporation (SAIC) is trying to take on global car makers by spending heavily on the acquisition of technology and brands of other endangered car makers. SAIC planned to form a JV with British MG Rover that would give SAIC control of the brand and the design. So far, SAIC has JVs with German Volkswagen and American General Motors. However, even counting its commercial vehicle maker Wuling, SAIC still does not possess its own brand. The planned JV in which SAIC and Nanjing Auto would have hold approximately 70 percent and MG Rover 30 percent would have given SAIC the rights to the Rover brand name, the engine technology and the rights to make Rover models in China (O'Connell).[20] SAIC spokesman Zhu Xiang Jun explains SAIC's strategy by saying that "we have to have our own brands. And we want to acquire and develop a bridgehead for international expansion. To start our own brand from scratch would be too slow and expensive." (O'Connell) Dunne observes that "SAIC's strategy seems to be one of buying struggling companies for their expertise." (Wilson)

Consequently, SAIC has been busily buying up assets outside China. In 2002 it acquired a 10 percent stake in Daewoo Auto and in 2004 a 48.9 percent controlling stake in Korean car maker Ssangyong Motors (O'Connell). It also seems that SAIC is trying to buy a stake in Italian car maker Fiat. In December 2004 both firms signed a treaty for a long-term cooperation between both firms (Anonymous, Chinas Größter Autokonzern Will Sich Bei Fiat Einkaufen). In conclusion, SAIC is trying to position itself as an international car maker and stepping on the global stage by buying the necessary technology, know-how, design and brands.

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[20] The joint venture ultimately was not established, but Chinese Nanjing Automobile outbid SAIC and acquired the remains of MG Rover in July 2005 after Rover went bankrupt (Anonymous, Rover Sold to Nanjing Automobile). "Both Chinese companies car companies [SAIC and Nanjing Automobile] made no bones about the fact that buying MG Rover was a way for them to start fulfilling their ambitions in the global car market." (Maidment)

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Hence, Gao, Woetzel and Wu identify two different approaches for Mainland Chinese businesses to expand a company's branded goods into developed markets. The first approach involves the M&A of foreign companies with valuable assets by Mainland Chinese businesses. Valuable assets can be brands, customer bases, technology, channels and products that have become too pricey for the foreign company. To save cost and to integrate the acquired assets with the Mainland Chinese organization, the acquired company's production is moved to China. At the same time, the brand name, distribution channels and valuable employees are being retained. After some time, a co-branding strategy that would consist of both the Chinese and the foreign brand being displayed on the products can be introduced. After establishing the Chinese brand in the minds of consumers, the original (foreign) brand would be slowly phased out until the products are solely sold under the Chinese brand (Gao, Woetzel and Wu).

SAIC, as discussed above, and the Chinese electronic consumer products maker TCL are a case in point. TCL acquired the German brand Schneider in 2002 for €8 Million. In 2003 TCL founded a JV with Thomson in which the TV division of Thomson was incorporated. TCL has a controlling stake in the JV with Thomson and the rights to the brands Thomson in Europe as well as RCA in the USA. The strategy of TCL aims to use the 4 brands, i.e. TCL, Schneider, RCA, Thomson, for the different markets in Germany and Europe, the USA and China. In a twist, TCL even introduced the German brand Schneider to the mobile phone market in China for maximum utilization of the brand. TCL also acquired the mobile phone business of the French company Alcatel and plans utilize the brand in Europe and Latin America (WirtschaftsWoche). After selling in the markets under the acquired brand, a co-branding strategy could be introduced by TCL. In the end, the acquired brands could be phased out and the brand TCL would finally be established in the foreign markets. TCL, thus, could be a good example of the first strategy identified by Gao, Woetzel and Wu.

Gao, Woetzel and Wu propose a second approach for Chinese businesses to introduce their company's product into the foreign market. The step-by-step approach entails the penetration of foreign markets through independent distributors which serve independent channels. The gradual process of exporting and penetrating the market allows the Mainland Chinese business to gain an understanding of the market, the local customer profile and establish brand recognition for products and goods. After having established a brand presence in the foreign market, the Mainland Chinese business can begin to move into similar markets, develop its own distribution and sales network and try to expand the brand's reach by spending significant amounts on marketing (Gao, Woetzel and Wu).

The Shanghai-based electronics company SVA sells high-end plasma TVs, TFT-LCD displays (flat-panel monitors) and DLP projection TVs. SVA exemplifies the second approach identified by Gao, Woetzel and Wu to establish a branded presence in a foreign market. First, SVA chose to work together with the distributors Ingram Micro and D&H Distributing which offer promotion and service assistant to manufacturers when entering the US market. The collaboration allowed SVA to learn about the US market and build its own marketing capabilities in regard to foreign markets. In the next step, SVA attended industry and trade conferences in order to promote the company's products rather than spend money on advertising efforts. Subsequently, SVA decided to target the high-end plasma TV and TFT-LCD market instead of low-tech color TV market where the company would have had to compete with numerous OEM from China and other low-cost countries. Instead, SVA focused on offering high quality products to customers who were technology savvy, but not too brand-conscious. One of the most important steps was putting a local team in charge in the USA to understand local markets and consumer behavior and to develop appropriate company strategies (Gao, Woetzel and Wu). As proposed by Gao, Woetzel and Wu, a business expands step-by-step and increases the commitment of its resources in accordance with its increasing knowledge about and matching capabilities in doing business in foreign markets.

Not everyone agrees that Mainland Chinese businesses, whether they utilize the M&A strategy or the step-by-step approach, are ready to conduct business globally and become true global multinationals with strong brands. Tom Doctoreff, CEO for Greater China at the US ad agency J.Walter Thompson asserts, that "Chinese companies are light years away from [exporting their brands successfully]." (Roberts, Balfour and Einhorn 78) Brand awareness of Chinese brands among Americans and Europeans is low. Most Mainland Chinese businesses do not even know what positioning a brand means. Furthermore, China has a mediocre record in innovation as Chinese companies tend to save on innovation costs. Management is another problem. Most Mainland Chinese businesses are established by entrepreneurs who lead the company the same way as in the founding days of the business, regardless of the complex management challenges that come about when a business generates billions of dollars revenues and expands internationally (Roberts, Balfour and Einhorn 80).

When comparing the management of Mainland Chinese businesses to the management of Overseas Chinese businesses it becomes obvious that both, as has been predicted in the conclusion of Chapter 4, rely on autocratic leadership of the family business, tend to focus on keeping operating costs low and save on technology and brands. Additionally, Mainland Chinese management lacks the experience of capitalism, especially the problems posed by taking over a company. Most Mainland Chinese businesses invest in run-down companies which pose serious and sometimes insurmountable challenges when these acquired companies need to be restructured. Mainland Chinese businesses lack the experience to turn around such businesses. For example, the take-over of Schneider by TCL and the subsequent restructuring has not gone well. Revenue targets have been missed and the management admits that it needs more time to implement and achieve the goals of the acquisition (Deckstein, Kerbusk and Wagner 77).

In regard to outward investment, most of the investment by Mainland Chinese businesses is the purchase of access to resources by SOEs. Also, the competitiveness of the home market in China translates into low profits for Mainland Chinese businesses which are, therefore, cash-stripped. Furthermore, the turn to foreign markets with the intention of utilizing the competitive cost base at home does not pay off as the lack of brand power makes it difficult to gain a foothold in the foreign markets. Thus, Chinese M&A activities for natural resources do not "presage the emergence of super-competitive Chinese firms producing brand-name finished goods," writes Kroeber (Chinese Invasion Has yet to Happen). Deals such as the acquisition of IBM's PC division by Lenovo and the spending spree of TCL do not signify a new trend in M&A (of brands) for Chinese businesses, because as Joe Zhang, co-head of China research at UBS asks, "how many other companies are there that can do the same?" (Guerrera and McGregor)

Michaelis concludes (Knowledge@Wharton):

> Realizing the benefits of a transaction depends strongly on the experience, discipline and cultural sensitivity of the acquirer when actually negotiating the deal and merging the operations. Given the comparatively low level of

> experience Chinese companies have with large-scale cross-border M&A transactions[…] a lot still needs to be learned until Chinese outbound mergers can be executed successfully.

Still, Chinese companies have a big cost advantage by manufacturing their products in Mainland China compared to other MNEs. But the deficiencies, such as lack of marketing skills, discussed above, could mean that China might not be able to produce global brands but would be better advised to focus on the cost advantage of China's manufacturing base. The FDI inflow into China ensured the build-up of a first-class infrastructure while at the same time labor costs are low which leads Kroeber to observe that China is unique in the "combination of first world infrastructure and third world [labor] costs."(Anonymous, "The Struggle of the Champions" 58) In conclusion, the unique combination and "[China's] focus on capacity building rather than technological innovation mean that corporate successes are more likely to be component manufacturers or processors of intermediate goods than global consumer brands such as South Korea's Samsung." (Anonymous, "The Struggle of the Champions" 58)

Furthermore, a close look of the competitiveness of big Mainland Chinese companies reveals serious business faults and competitive disadvantages. For example, white goods producer[21] Haier lacks cost control, production discipline, market dominance and sales support. Lenovo who bought IBM lacks efficiency, failed to make its brand "Legend" global and suffers from laggard profits. SAIC is trying to catch up to global car companies by buying technology and design. TCL is relying on the foreign brands RCA, Thomson and Schneider to expand internationally instead of TCL's own brand. It is, thus, fitting that Vincent Yan, managing director of TCL International admits that "no Chinese company is ready to build a global brand. You need technology and products. Just spending money on ads without good products doesn't make sense." (Anonymous, "The Struggle of the Champions" 58)

Other impeding factors to the growth of Mainland Chinese businesses and the businesses' brands seem to be the lack of focus on long-term commitment and cooperation among Mainland Chinese businesses. Horizontal networks of

[21] Definition of White Goods: Large electrical home appliances (refrigerators or washing machines etc.) that are typically finished in white enamel (Webster's Online Dictionary)

cooperation between a business, suppliers, trade bodies and customers are basically non-existent. Mainland Chinese businesses tend to pursue short-term interests and favor excessive diversification instead of investing in long-term technological development (Anonymous, "The Struggle of the Champions" 59). *The Economist* observes, that (“The Dragon Tucks In" 68):

> China’s political system makes its managers particularly unsuitable for running complex, global companies that demand consistent strategies. In an environment of regulatory inconsistency, corruption and political patronage, Chinese companies have tended to pursue short-term returns and excessive diversifications rather than long-term technological development. And rather than build networks of suppliers and customers, they have preferred to curry favor with bureaucrats and party officials.

Good examples for the neglecting of technological development in favor of excessive diversification are Haier, TCL and Baosteel which all have subsidiaries in insurance or banking. For example, Baosteel has a 5 percent stake in Shanghai AJ Corp, a property and finance firm (Anonymous, Baosteel Buys Stake in Finance Company). George Gilboy, a former manager at a multinational in Beijing asks, “how can a long-term company emerge in such a short-term environment?” (Anonymous, "The Struggle of the Champions" 60)

A lack of skills in segmentation, supply chain management and after sales services add to the woes of Mainland Chinese businesses. Further problems are posed by the lack of patience to build businesses organically. Researchers blame the political and corporate landscape of China for the lack of long-term commitment to organizational and technological development. Significant reforms in political and market structures are needed to aid and boost long-term technology, product and strategy development of companies. Additionally, management and human resources have to be improved to survive in the global arena. Management skills to clinch cross-border alliances and mergers are missing which means that “even the best Chinese companies have still not developed the killer instinct to close deals.” (Mc Kinsey; Guerrera and McGregor)

Within, but not limited to, the context of M&A, one should take into account potential difficulties arising from the distinct differences in Chinese and Western culture. The problems and challenges are not limited to national cultural differences but also corporate cultures. Hemerling, Michael and Michaelis observe (17):

> Chinese companies also face major cultural barriers when it comes to integrating a non-Chinese acquisition. To be sure, any postmerger integration must navigate often subtle differences in the cultures of the merged entities. But the differences between how Western companies and Chinese companies operate are extensive. Often, they are run by a small group of owner-managers who create a strong patriarchal culture characterized by personal loyalty. They make decisions quickly with a lot of analysis. They also lack process discipline and their management processes tend to be disorganized. Integrating this kind of corporate culture with the more professionalized managerial cultures of most Western companies requires an even higher than normal degree of sensitivity, determination and flexibility.

In general, "Chinese companies face the hurdles of getting to grips with very different management styles, culture, priorities and mindsets of other companies." (Egan et al. 7) Finding solutions for intercultural problems is one of the key challenges Mainland Chinese businesses face if they want to successfully expand abroad. Consequently, Mainland Chinese businesses have to find ways to overcome or align differences in communication, language and culture (Ewert 19).

Table 18 provides a summary about the weaknesses, problems and challenges Mainland Chinese businesses face on the way to being global players as has been discussed in this chapter.

Area	Challenges, Problems and Weaknesses
Management	- Lack of negotiation skills in M&A - Most private companies are still led the same ways as in the founding days of the business despite the fact that companies have considerably grown since then - Lack of internationally experienced management, especially in people management - Foreign operations are generally characterized by low efficiency - Lack of patience to build business organically
Brands & Marketing	- Lack of basic marketing skills - Branding is a new concept to Chinese businesses - Many regional brands, but few national brands due to the size of the country and protectionism of regional and provincial authorities - Chinese brands are unknown to American and European customers - Lack of cultural references = Lack of understanding of local needs and customer profiles and behavior - Lack of Sales and Distribution networks for products - Lack of critical skills in: • Segmentation • Supply chain management • After-sales services - Products are often regarded as cheap, low-tech and of poor quality
Technology	- Lack of investment in technology, thus, most products are low-tech - Missing commitment to long-term R&D - Specialization of mainland Chinese companies in low-tech manufacturing - Missing cooperation among China's companies in R&D leads to serious competitive disadvantages as their own standards cannot be introduced but license fees to foreign MNEs for their technology have to be paid
Government and Market	- Competitive home markets in China cut into profits and removes much needed cash for the international expansion of the company - Structural and political hurdles constrain the internationalization of firms, for example, the former restriction of support funds for companies was limited to SOEs - Few private companies are large enough to go abroad, but SOEs are not yet globally competitive - Consolidation in industries is hampered by regulations - So far overseas investment by mainland Chinese business has been negligible when compared to yearly FDI flow into China

Table 18: Weaknesses, Problems and Challenges for Mainland Chinese Businesses in the Drive to Become Global Players.

Wong and Chan conclude (296):

> Chinese companies remain woefully unprepared to deal with the competitive business environment. When they venture abroad, they often have

> misconceptions about the host countries. Their business plans generally fail to address the business climate, marketing, operational efficiency, and foreign regulations of the host countries. They also frequently misgauge the additional costs, prospective competition and management complexities of the foreign marketplace. […] Faced with a myriad of problems, it is little wonder that most Chinese companies have yet to make an impact on world markets.

Thus, the above quote accurately illustrates that Mainland Chinese companies are not yet ready to dominate global markets. Mainland Chinese companies still have to learn how to adapt to foreign markets and how to deal with foreign business environments. Furthermore, Mainland Chinese companies lack vital management skills and advanced technology capabilities. Mainland Chinese businesses will need several years to acquire these skills and capabilities. Therefore, it is not really surprising that no Mainland Chinese company has so far become a globally competitive and truly global business.

5.4 Synthesis from the Expansion of Ethnic/Overseas Chinese Business

The previous section of this chapter analyzed the international expansion of Mainland Chinese business. Most of the information available and analyzed above refers to large companies which are mainly wholly or partly government-owned. However, the analysis of the expansion of Mainland Chinese business is at least partly flawed if the dissertation solely concentrates on the discussion in Chapter 5.3 as a further analysis of the international expansion of Mainland Chinese business because the above discussion focused nearly exclusively on the expansion of partly or wholly-owned SOEs or enterprises with (suspected) government ties. However, private Chinese SMEs are also preparing for going abroad. “At the moment, the majority of Chinese enterprises overseas are large SOEs. There are indications that non-state-owned firms are now nurturing global ambitions and following the SOEs in making forays into the world markets although most of them are small and medium-sized companies.” (Wong and Chan 297)

The expansion of small and medium Mainland Chinese businesses can be expected to be of similar form as the expansion of Overseas Chinese firms, due to cultural closeness as well as the status of being ethnic Chinese SMEs. As far as Mainland Chinese businesses are privately owned and, thus, family held, the conclusions drawn in Chapter 4.5 should be considered in the analysis of the expansion of Mainland Chinese business. The main conclusions drawn in Chapter 4.5 were:

- Ethnic Chinese businesses are led by the head of the family, family members hold key positions in the enterprise, professional management is missing and the businesses are part of formal and informal networks
- Ethnic Chinese businesses utilize informal and formal networks for the expansion of the firm as well as for competitive advantages
- Ethnic Chinese businesses are mainly employing JV and acquisitions in their internationalization process to pave the way for a later establishment of a WOS and integration into local networks.

Hence, it is time to review whether the analysis of the expansion of ethnic Chinese business in the previous chapter indeed does hold some insights applicable to Mainland Chinese SMEs. To describe, analyze and predict the characteristics and expansion of small, private Mainland Chinese companies the application of the results from the analysis of ethnic Chinese business is proposed. Here, based on of the expansion behavior and characteristics of ethnic Overseas Chinese business, a comparison to Mainland Chinese is appropriate as long as the deducing is based on shared features of ethnic Chinese business such as common cultural roots. Since ethnic Chinese and Mainland Chinese share the same cultural determinants and variables , for example *guanxi*, collectivism and Confucian teachings, it is reasonable to expect Mainland Chinese to think and act similar as Overseas or ethnic Chinese. The similarity is also recognizable in the analogous structure and behavior of Mainland and ethnic Chinese businesses.

M.-J. Chen states that these private, family-owned Mainland Chinese businesses “are similar to the typical Overseas Chinese business: They make decisions quickly, are sensitive to cost, have low debt-to-equity ratios, and are linked to similar organizations across the country through interpersonal networks.” (164) The strong focus on the family in the business is a distinctive feature of ethnic Chinese business and can be expected to be found in Mainland Chinese business as well. The same holds true for the personalism and autocratic management style of most Mainland Chinese businesses. Opportunistic diversification into unrelated business sectors is likely, too. Least but not last, the diversification allows a Chinese firm to integrate other ethnic Chinese businesses into the firm's network and create a relationship of mutual indebtness and reciprocity.

However, the one child policy in the PRC has drastically reduced the number of average family members and, therefore, possible members of the family business. Hence, family businesses have to reach out to friends of the family and extended relatives for the management and survival of the family enterprise. That is why, although it seems that Chinese family tradition is still strong, M.-J. Chen asserts that "PRC businesses will diverge from Overseas Chinese business family model and will map out their own development and transformation paths." (42)

Ethnic Chinese business networks have close ties to the mainland and, thus, the integration of Mainland Chinese business into the networks can be anticipated. Mainland Chinese SMEs are able to utilize the same advantages of business networks as overseas/ethnic Chinese, e.g. access to organizational resources, capabilities, provision of capital and information, lower transaction because of mutual trust and reciprocity, closeness of the network and protection of network members. The integration into ethnic Chinese networks based upon, for example, ethnicity, *guanxi* or friend- or kinship facilitates and enhances the expansion drive of Mainland Chinese business. Thus, the setting up of wholly-owned subsidiaries with the help of *guanxi* and networks can be anticipated.

Private Mainland Chinese business lack marketing skills and technology just like Overseas Chinese business when they first started their businesses. Therefore, the M&A of technology, know-how and management can be expected by private Mainland Chinese businesses as well. JV and alliances are probably the preferential way to access technology from MNEs and gaining a first foothold in foreign markets as well as learning to work abroad. The assumptions are affirmed by Wong and Chan who found that "Chinese firms engage in JVs with foreign counterparts due to limited financial resources, lack of knowledge about local conditions, to minimize various risks, or utilize the wide distribution networks of local partners." (294) In regard to M&A, Chinese private firms (Wong and Chan 294):

- Merge or acquire foreign firms to access advanced technologies and promote the Chinese products
- Utilize M&A as a channel to raise funds
- Use M&A in developed countries with mature systems of law and regulations

In conclusion, it seems that Mainland Chinese SMEs are likely to emulate the expansion of ethnic and Overseas Chinese business. Thus, Mainland Chinese SMEs are family-led businesses in which key posts are staffed by family members. The firm is likely to diversify into unrelated business sectors. The firm is embedded in and utilizes interpersonal formal and informal ethnic (Mainland and Overseas) Chinese business networks in the process of international expansion, i.e. the networks are utilized for the establishment of wholly-owned subsidiaries. Additionally, Mainland Chinese SMEs use JVs and M&A as preferential method to access markets, technology, know-how and management skills in their globalization drive. Consequently, Mainland Chinese businesses are similar to Overseas Chinese businesses, follow similar strategies and take similar steps when expanding abroad.

5.5 Approaches to a Theoretical Framework for the International Expansion of Mainland Chinese Business

This part of the chapter discusses possible theoretical frameworks that apply to, and could explain, the expansion and internationalization of Mainland Chinese business. So far, the literature lacks a significant number of contributions of frameworks for the internationalization of Mainland Chinese businesses at the firm-level. Within this section, a number of different explanatory approaches to the expansion of Mainland Chinese businesses are tried and analyzed.

5.5.1 The Investment Development Path (IDP)

Chapter 1.1.3 analyzed the eclectic paradigm of Dunning. The investment development path (IDP) discussed here is closely related to the eclectic paradigm. While the eclectic paradigm refers to the theoretical framework for and analysis of the internationalization of businesses at the firm-level (micro-economic analysis), the IDP is concerned with the analysis of the internationalization of firms at a macro-economic level and analyzes the development of countries as the countries' firms internationalize. A short summary of the IDP- theory is given and a possible application to the expansion of Mainland Chinese business is analyzed.

According to Dunning and Narula (1):

> The IDP suggests that countries tend to go through five main stages of development and that these stages can be usefully classified according to the propensity of those countries to be outward and/or inward direct investors. In turn, this propensity will rest on the extent and pattern of the competitive or ownership specific (O) advantages of the indigenous firms of the countries concerned, relative to those of firms of other countries; the competitiveness of the location-bound resources and capabilities of that country, relative to those of other countries (the L specific advantages of that country); and the extent to which indigenous and foreign firms choose to utilize their O specific advantages jointly with the location-bound endowments of home or foreign countries through internalizing the cross-border market for these advantages, rather than by some other organizational route (i.e. perceived I advantages).

The IDP is divided into 5 stages. In stage 1, the L specific advantages of a country are not sufficient enough to attract direct investment. The exceptions are natural resources. Economic systems, government policies and communication and transportation infrastructure are inadequate. The market is characterized by low per-capita income and non-qualified labor force. Therefore, "foreign firms will prefer to export to and import from this market, or conclude cooperative non-equity arrangements with indigenous firms." (Dunning and Narula 2-3) The lack of O specific advantages of domestic firms, few assets and low-technology mean that the focus is on labor-intensive manufacturing. The government will try to improve the situation with policies aimed at the import and export of products as well as providing infrastructure and training to the labor force (Dunning and Narula 3).

In the stage 2, inward direct investment rises while outward direct investment (ODI) is still low or negligible. Local markets have grown insofar that some local production by foreign firms is viable. The inward investment is likely to still take place in natural resources and labor-intensive manufacturing. The manufacturing in stage 2 substitutes for importing (as in stage 1) and is related to the possession of intangible assets, for example, trademarks or technology. The inward investment hinges on the question whether the host country can supply transportation and communication infrastructure as well as a pool of unskilled and skilled labor. Thus, “a country must possess some desirable L characteristics to attract inward direct investment.” (Dunning and Narula 3) The stage 2 country begins with ODI but restricts the investment to market-seeking or trade related investment in neighboring countries as well as to asset-seeking investments in developed countries. The extent of the ODI depends on the support of the government, for example, cheap loans and export programs, as well as the development or acquisition of technology by domestic firms. Still, the rate of ODI is significantly lower than the inflow of inward investment (Dunning and Narula 4).

Stage 3 of the IDP is characterized by the gradual decrease of inward investment and an increasing ODI which results in a positive net outward investment (NOI). Comparative advantages in labor-intensive areas, for example, manufacturing, are decreasing while the standardization of products takes place and a higher level of expectation in regard to product and services quality can be observed. ODI is directed at companies at a lower IDP stage while O specific advantages of foreign firms are undermined as domestic firms draw level with the multinationals and compete head on in the local market. O specific advantages of foreign firms are now more focused on intangible knowledge of, for example, production processes which manifests itself in more technology-intensive manufacturing and higher value added in the local production. One of the motives for local production by foreign firms is the trend to efficiency-seeking production as opposed to import-substituting production as in stage 2. O specific advantages by domestic firms are not government-related anymore but rather to the learning effects from the first two stages and their own proprietary assets. The government will focus on reducing structural barriers and attract FDI into sectors in which domestic firms’ O specific advantages are the weakest, but comparative advantages of location-bound assets are the strongest. For example, luring companies with vital marketing skills to the local market which has plenty of consumers. Outward investment takes the opposite direction, investing in sectors in which the O specific advantages of domestic firms are the strongest and the locational advantages of the host country the weakest. For example, offering labor-intensive products or services in high labor-cost markets (Dunning and Narula 5-6).

The outward investment stock has reached or exceeded the inward investment stock in stage 4 of the IDP. Additionally, the ODI is still rising faster than the inward FDI. Domestic companies compete effectively in foreign markets and rely upon capital-intensive production as the cost of capital is lower than the cost of labor. Subsequently, created assets will have the highest share in L specific advantages (Dunning and Narula 6). Inward investment is mostly from other stage 4 countries and O specific advantages are more transaction- than asset-related. ODI is increasing as domestic firms are trying to keep the firm's competitive advantage by moving operations abroad to countries at a lower stage. The focus now lies on internalizing advantages by FDI, for example, into subsidiaries, as opposed to export. There is a clear trend towards the conducting of business between units within MNEs as opposed to the transacting of business between MNEs from different countries. The role of government will be directed towards the structural adjustment of location-bound assets and technological capabilities. Subsequently, the government is phasing out declining industries and promoting promising industries. Thus, "the role of government is now moving towards reducing transaction costs of economic activity and facilitating markets to operate efficiently." (Dunning and Narula 7)

In stage 5 the NOI fluctuates around zero. Stage 5 is further characterized by two key features. First, cross-border transactions are not transacted through the market but within MNEs. Second, countries and their location-bound assets converge and so does the international direct investment positions. The result is the trade of goods and services within hierarchies or cooperative ventures between MNEs of different countries which produce similar products. Thus, "MNEs will be less dependent on their country's natural resources but more on their ability to acquire assets and on the ability of firms to organize their advantages efficiently and to exploit the gains of cross-border common governance." (Dunning and Narula 8) By internalizing transactions, MNEs increasingly act like mini-markets. Countries that had low international activities in the past internationalize at faster rates than those countries with more geographically dispersed activities which results in the reduction of the NOI. The reduction of the NOI and the continuing fluctuating around the zero level can be explained by the fact that the catch-up processes of countries as well as the growth-seeking of MNEs lead to an equilibrium of fluctuation around zero of the NOI as companies are seeking to imitate competitors and "develop similar O specific advantages in the same industry, but not necessarily in the same country." (Dunning and Narula 8)

Inward investment will come from countries of lower IDP seeking markets and knowledge while investments from stage 4 and 5 countries are directed at seeking efficiency, i.e. "plant and product specialization is encouraged in sectors where economies of scale and scope are important." (Dunning and Narula 9) The quest for efficiency gains results in an increase in cross-border alliances, mergers and acquisitions and the governance and equity positions of MNEs becomes increasingly transnational. The commercial success of MNEs depends on the ability of firms to coordinate the firm's resources and capabilities at a regional and global level. In regard to the role of government, Dunning and Narula assert that "in stage 5, governments will increasingly assume the role of strategic oligopolists, taking into account the behavior of other governments in the formation and execution of their own macro-organizational strategies." (Dunning and Narula 11)

To summarize, Dunning and Narula assert that countries undergo 5 stages in the IDP and that in the end all countries converge toward an equilibrium in which stage 5 countries produce nearly the same products, offer the same services and undertake investments solely for the purpose of efficiency gains. ODI is non-existent at the beginning and rises to overtake the inward FDI in stage 4 which results in a NOI. The NOI fluctuates for countries in stage 5 around zero, depending on whether domestic efficiency gains are perceived to be feasible by foreign MNEs or countries from lower IDP stages undertake strategic asset seeking; resulting in the NOI becoming negative. Or efficiency gains can be achieved abroad in which case the NOI increases. Additionally, the more a country moves towards stage 5, the more transactions are conducted internally within and by the MNEs leading to the premise that the firm switches from O specific advantages which are location-bound over knowledge-based advantages to transactional advantages which result from internalization specific advantages.

During the past 30 years, three variables have been identified as being critical to the development and economic restructuring of countries (Dunning and Narula 13):

- The type of FDI undertaken
- The structure of the indigenous resources and capabilities of the specific country
- And the macro-economic and organizational policies pursued by the government

Now, the concept of the 5 stage model is further elaborated by Dunning and Narula who recognize that circumstances, situations and variables in economies and in business have changed in the past years. While in the past MNEs were engaged in FDI in order to better exploit or organize the existing competitive advantages, nowadays MNEs are increasingly motivated by the drive to acquire new competitive advantages or to protect existing ones. M&A is undertaken due to (Dunning and Narula 15):

- The rising costs of innovation and of entry into unfamiliar markets
- The competitive pressure to be more cost competitive
- The growing need for complementary technology and economies of scale and scope
- The protection or advance of global markets
- The need to encapsulate the time of the innovating or market entry process

Therefore, "such strategic asset acquiring FDI implies that firms may engage in outward FDI from a position of weakness, and that countries may attract inbound FDI because their resources and capabilities offer competitive advantages to foreign MNEs." (Dunning and Narula 15) The effect of the strategic asset seeking investment is the increase in ODI, especially for rapidly growing industrializing nations. The ODI is aimed at the establishment of a market presence. Firms from developing countries often lack the full range of resources and capabilities to expand on their own and, thus, choose to engage in FDI, minority JVs and other forms of cooperative alliances. To conclude, the presence of strategic asset seeking investments leads to a rise in inward FDI in industrialized nations and a rise in ODI from industrializing developing countries as MNEs from the developing countries seek to advance their entrance into global markets (Dunning and Narula 15).

How can or does the IDP model and recent modifications by Dunning and Narula apply to China? Analyzing the differences between the different stages of the IDP paradigm, one would conclude that China is probably in the transition from stage 2 to 3. As has been discussed in this chapter, the inward investment hit a new high of $72.4 billion in 2005 while the outward direct investment was 6.92 billion. L specific advantages could be the vast pool of unskilled and skilled labor as well as the low manufacturing costs in general. Additionally, the government is pushing the Chinese enterprises to venture abroad. Chinese enterprises are also increasingly pursuing asset seeking investments as the illustration in Table 17 has shown. China is starting to push abroad from a position of weakness, as the Chinese lack vital resources, for example, brands, technology and know-how. The strategic asset seeking investment through M&A by Chinese companies is supposed to ensure the entrance into global markets.

It is reasonable to expect China to conclude the move from stage 2 to stage 3 in the next few years. Some of the characteristics that define stage 3 and differentiate stage 3 from stage 2 can already be observed in China even though the country has not yet reached stage 3. For example, China has, and will probably not reach a NOI in near future, but the drive to technology-driven manufacturing can already be observed as demonstrated by the firms TCL and Lenovo. Furthermore, an investment by China in other developing nations (stage 1 and 2 countries), for example, Indonesia, can also be observed as well as the stage 3 attributed fierce competition in the local market between foreign and domestic firms possessing specific O advantages. For example, Lenovo, and TCL compete directly in consumer electronics with global players such as Siemens and Sony on the Chinese domestic market.

In conclusion, the IDP model by Dunning and Narula might offer a possible explanation and framework for the expansion of Chinese businesses as the model points to the relationship between O, L and I specific advantages and the importance and interaction of these advantages as well as of inward FDI for the development of ODI and the accompanying internationalization of Chinese businesses. Furthermore, the IDP model offers an explanation of the drive of Chinese companies to actively engage in M&A as Table 17 has shown.

5.5.2 Networks and China's Outward FDI

According to Yang, if the IDP is to be applicable to China, then China would already be in the early phase of stage 3. Yang argues that "contrary to the IDP pattern, the emergence and development of outward direct investment flows coincide with each other." (5) Yang further refers to the substantial total FDI outflows of $29.5 billion by the end of 2001 ($51.7 billion at the end of 2005) and concludes that "these features suggest that China's outward FDI has skipped the first and part of the second stage of the investment-development path, and has now entered the early period of the third stage. Therefore the process of the development of China's outward FDI is difficult to be explained by the IDP paradigm." (5) Hence, the IDP would be inadequate to fully explain the development of China's ODI and expansion drive of Chinese business.

Yang further elaborates his criticism at the IDP model of Dunning and Narula. Yang explains that the IDP model rests on the possession of sufficient ownership advantages as has been also illustrated in the previous section of this chapter. Yang asserts that (36-41):

- Chinese companies are small
- Chinese companies are weak in R&D
- Chinese firms badly need technological transformation
- The product quality of Chinese products is unsatisfactory
- Chinese companies as a whole are inferior in management
- Lack management efficiency, productivity and corporate performance

The described weaknesses of the Mainland Chinese companies are mostly congruent with the weaknesses of ethnic Chinese companies previously identified in Chapter 4.2.1 and Table 9. It is, thus, all the more astonishing that contrary to the IDP and despite the lack of ownership advantages, the ODI from China has been substantial. Also, the main investment by China has been in the U.S.A., Canada and Australia which is the antithesis to the common FDI theory which states that the investments of a country is directed at geographically and culturally close countries during the first step of international expansion. To conclude, China seems to have skipped the first two stages described by Dunning and Narula. (Yang 42-45) Yang concludes that (47):

> China's outward FDI exhibits two conspicuous characteristics, rapid expansion in a relatively short time, and high geographic concentration in the United States, Canada and Australia. A further examination of China's outward FDI reveals that Chinese firms do not possess clear competitive advantage, especially when considering the fact that China's overseas direct investment takes developed countries as its major destinations. Therefore, China's outward FDI is not readily explained by the insights gained from existing theories of FDI from developing countries. The difficulties in providing a convincing explanation of the pattern of China's outward FDI by using a mainstream theory call for a different approach.

Yang offers the application of the network theory, developed by Johanson and Mattsson, to China's FDI to offer a framework for the Chinese outward investment. The network approach to the internationalization of firms has been discussed at length in previous chapters and can be summarized as follows.

Economic activity can involve two methods of organization (price and hierarchy) and three possible institutions (the market, network and firm). Parent firms and subsidiaries, whether they are wholly-owned or JVs, for example, can constitute a network. A network is a model of nodes which are connected with each other. Each node represents a business entity, for example, a firm. Each firm is engaged in a network of relationships among customers, suppliers, distributors, etc., and through indirect relations with the supplier's customers, suppliers, distributors, etc.. A firm can access the resources of other members of the network through exchange processes in the formal and informal networks the firm is embedded in. The members of the network have differential knowledge about activities, resources and other actors in the network. Resources can be physical assets, for example, production facilities, as well as immaterial assets, such, for example, country-specific knowledge and information. Networks can reduce governance costs and save transaction costs by decreasing boundaries between firms. Communicating information, assuring quality and reducing in information costs lead directly to a saving in transaction costs and are attributable to firms actively participating in networks. Additionally, economies of scale and scope, for example, joint research and production, are possible. Business networks are characterized by a division of work, the complementarity of resources of firms in the network and a relative stability of the network itself. In the process of internationalization, the firm can utilize the network's resources to access and enter foreign markets and accelerate the internationalization of the firm.

The internationalization of the firm can be modeled as a three-fold sequential process of establishing and strengthening international relationships (Yang 55):

(1) Relationships with firms in new countries are formed (international extension)
(2) Commitment to existing foreign networks are increased (penetration)
(3) Integration of positions in networks in different countries (international integration)

The engaging in networking can lead to a reduction of costs in two ways. First, networking saves transaction costs and, second, networking reduces governance cost. The cost savings stem from the overlapping of economic and governance boundaries in networks. The bonds sustained in a network reduce the cost of communicating information and assuring quality. Furthermore, networks can lead to economies of scale and/or scope in, e.g. joint research, marketing or production (Yang 70-71). Now, how is FDI utilized in networks and what are the motives for engaging in FDI from a network perspective?

According to Johanson and Mattsson, within the concept of networks (Yang 191):

> FDI can be defined as a process in which resources are committed to create, build or acquire assets in foreign countries so as to establish and develop positions for the investing firm in relation to its counterparts in foreign networks. An FDI project is a node (in the case of an initial investment) or an improvement at an existing node (in the case of subsequent incremental investment) in the network of the investing firm's global business and this node not only ties different business activities of the firm but also ties the firm's business network to the market network of the host country.

The FDI is, thus, aimed at creating (subsidiary), building (extending or taking-over of JV) or acquisition of assets (M&A) in a foreign country and ties the node into the firm's local and global network. According to Yang, three motives for FDI in regard to business networks are predominant (77):

(1) Taking advantage of networks in resource exchange and sharing
(2) Enforcing transactions via markets
(3) Improve the firm's position in the network

The above sequential process illustrates that FDI is utilized to stretch, expand or integrate networks. By investing FDI in a foreign country, the firm is basically investing in the development of the firm's network. Expanding networks with FDI aims to expand already existing nodes/projects, undertake new FDI projects, for example, in different locations, alter ownership structure or establish a new venture on the base of an existing node. Network integrating FDI is targeted at forming and improving a firm's global business network (Yang 81-86). However, the network model relies on the existence of markets and autonomous firms as a prerequisite for the application of networks. Therefore, Chinese companies could only engage in networking since the introduction of market reforms, the opening of local and foreign markets and the retreat of the state from the management of companies because before the opening a market economy did not exist and firms were state-owned and -managed (Yang 193-196).

The establishment of foreign subsidiaries through FDI establishes networks between the subsidiary and the parent company. Yang states that "through these networks, information, technology and natural resources can flow more smoothly within the relevant firms. […] Direct benefits from such investments are transaction costs saving and efficiency improving. Indirect benefits include the improvement of the market power of the investing firm." (158-159)

As Yang observes above, Chinese companies are weak in R&D and badly need technological transformation. One of the motives of Chinese companies to expand internationally is, therefore, the acquisition of technology seeking investment. In terms of network theory, "it is natural for Chinese investors to have such motives." (Yang 153) New overseas ventures are similar to a node. The node provides the company with an internal flow of information and enables the company to collect and process local information in a short period of time. Yang states that "FDI is the unavoidable choice, as it is a type of knowledge not codifiable in nature and information needs close contact to be obtained." (Yang 154) The inferiority of Chinese companies as a whole in management and management efficiency is supposedly overcome by using the overseas ventures for training and experimenting with Western management styles and principles. The same holds true for production techniques. Furthermore, the establishment of the node and the ensuing activity in the foreign environment also leads to the improvement of the network position of the company and, thus, the transactions performed by the firm (Yang 155-157).

Chinese companies also venture out to gain access to natural resources and exploit them accordingly. (Yang 149) In regard to the network theory, if a subsidiary exploits natural resources in a country and faces production disruptions, the network established by the parent firm with subsidiaries in various locations is able to minimize the total effect on the firm. Furthermore, natural resource exploitation often results in the vertical integration within the investing firm and, therefore, leads to cost reduction through co-ordination of activities amongst the different subsidiaries in the network of the parent firm (Yang 158). Thus, information, technology and natural resources are accessed and exchanged efficiently within the networks of the firm.

So far, China's outward investment in terms of resource access and exchange has been directed at countries with abundant natural resources and at countries with technological leadership. The investment in countries with abundant resources and the resulting establishment of network nodes is aimed at bringing the relevant natural resources under control. The establishment of JV with foreign companies as well as of subsidiaries in developed countries with technological leadership serves the collection of information, technology acquisition and transfer as well as the recruitment and improvement of human resources. The overseas investment in technologically leading countries ensures the establishment of nodes which facilitate the internal flow of critical information and resources. In regard to the improvement of transaction enforcing and improving FDI, the investment is targeted at reducing the distance between the transaction partners and thereby improving transaction conditions. The FDI by Chinese companies is market-seeking oriented and facilitates other types of transactions, for example, imports, information collection, technology acquisition and transfer, and leads to internationalizing manufacturing. The establishment of manufacturing ventures enables the immersion of the company in the local setting and leads to the improvement and strengthening of the node's bonds in the local networks as well as the reduction of transaction costs (Yang 169-176).

The existing network of ethnic Overseas Chinese business can be utilized by Mainland Chinese business for the internationalization of Mainland Chinese companies by using them used as a platform for Mainland Chinese companies to access local markets and business communities. The networks of ethnic Chinese, thus, helps the Mainland Chinese lower transaction costs and efficiently accelerate the internationalization of the Mainland Chinese companies (Yang 178-180). This holds especially true for the investment in countries which inhibit ethnic Chinese minorities and extensive and powerful business networks, for example, in Southeast

Asia. In Southeast Asian countries, “the common cultural heritage among the Mainland Chinese and Overseas Chinese enable China’s investors to settle down to business quickly. [..] These factors contribute greatly to the growth of China’s outward FDI in these countries.” (Yang 181)

Mainland Chinese ODI has been mainly directed at the U.S.A., Canada and Australia which have the largest ethnic Chinese communities outside Asia (Yang 201). The concentration of Mainland Chinese investment in these three countries can be explained in three ways. First, the developed countries possess advanced technology and management skills which Chinese companies desperately lack and, thus, seek with the investment. Second, the large Chinese ethnic community makes these countries very useful as a platform for Mainland Chinese firms who access the ethnic Overseas Chinese networks to accelerate the expansion of Mainland Chinese firms. Third, Australia and Canada possess large amounts of natural resources which are of great interest to resource-hungry China. The drive of Mainland Chinese businesses for natural resources has previously been illustrated in Table 17.

In conclusion, it is argued that the IDP model has proven unsuitable for the expansion of Mainland Chinese businesses. The development of Mainland China’s ODI has been dependent to a great extent on the introduction of reforms aimed at introducing the concepts of markets and autonomous firms to China. Autonomous firms and markets are a pre-requisite for the network model. After reforms had been introduced in China, inward FDI as well as ODI started to rise and the conditions for networks were set (Yang 193-196). The development shows that the network model is more adequate to explain the development of ODI from China.

The reforms enabled Mainland Chinese companies to invest on a global scale and accelerate the internationalization of the Mainland Chinese companies. Thus, Mainland Chinese companies are now able to access business networks established wholly or partly by Overseas Chinese all over the world and use these networks for the international expansion of Mainland Chinese businesses. According to the network model, the ODI in nodes is undertaken in order to establish subsidiaries, support existing operations or take-over JVs and acquire businesses. The goal of these activities is to overcome gaps/deficiencies in technology, management and marketing skills as well as gain access to markets and (natural) resources.

5.6 Conclusion

This Chapter has shown that the internationalization of Mainland Chinese companies has rapidly increased in the past years. But, so far no Mainland Chinese enterprise has become a real global power in its industry nor does one wield significant power on the global market. The same holds true for Chinese brands. Both Mainland Chinese SMEs and SOEs lack vital skills for the success in the global economy, e.g. brands, technology, know-how, management skills. However, Mainland Chinese companies are busily engaging in JVs and M&A abroad in order to close the gaps in know-how and capabilities. Chinese companies are still impeded by the lack of past corporate governance; Chinese SOEs and Mainland Chinese SMEs with complicated ownership structures and the legacy of the command economy, i.e. obstructive regulations and procedures that hamper all Mainland Chinese companies. As has been discussed in Chapter 5.2, the ownership of most large companies still lies at least partly with the state which means that expansion plans have to approved by local or national government, complicating business transactions. Most, if not all, of the large companies expanding abroad and trying to make an impression on the global stage are state-owned. Most SOEs are still struggling to improve the competitiveness of their operations in the local Chinese market. These SOEs have so far mainly focused on acquiring natural resources. SOEs from consumer electronic industries which are significantly large enough to conduct business globally have not yet succeeded in conquering foreign markets.

The analysis of the nature of ethnic Chinese businesses, their expansion behavior and internationalization within business networks in Chapter 4 offered enlightening insights for the internationalization of private, family-led Mainland Chinese SMEs. Because of shared cultural determinants such as filial piety and collectivism, it can be concluded that Mainland Chinese businesses are similarly structured and behave akin to ethnic Chinese businesses. Similar to Overseas Chinese family businesses, Mainland Chinese family-led SMEs use JVs and M&A to gain access to technology, know-how, brands and other resources. Additionally, Mainland Chinese SMEs employ networks to establish nodes, i.e. wholly-owned subsidiaries which give them full control over the venture. The Mainland Chinese family businesses is be led by a dominant company head with an autocratic management style and key posts in the enterprise and in subsidiaries are be staffed by family members. Diversification of the enterprise into unrelated industries is pursued. Also, Mainland Chinese SMEs are able to utilize the same advantages of business networks founded upon, for example, ethnicity, *guanxi*, friend-or kinship as overseas/ethnic Chinese, for example, access to organizational resources, capabilities, provision of capital and information, lower transaction because of mutual trust and reciprocity, closeness of the network and protection of network members. The large informal and formal networks of ethnic Chinese (overseas and mainland) accelerate the international expansion of Mainland Chinese SMEs.

Again, as in the expansion of Overseas Chinese businesses, the network theory has proven to be a suitable tool for providing a theoretical framework for the expansion of ethnic Chinese SMEs. The IDP as postulated by Dunning and Narula could not offer sufficient explanation for the development of China's ODI in recent years. However, the network model of China's ODI was able to explain China's ODI more adequately. In the context of the network model, FDI is undertaken to support existing or establish new nodes in the network of the firm and enhance the competitive advantages Chinese firms gain from networks. The implementation of nodes takes place through either the establishing of a subsidiary, the support of an existing node through the take-over of a JV or the acquisition of a company. Mainland Chinese business, just like their overseas counterparts, engage in informal and formal networks to facilitate the exchange of immaterial and material goods and increase the competitiveness of the network's member as well as the network itself. In recent years Chinese SMEs engaged in FDI to accelerate the internationalization of their firms and pursue new opportunities abroad.

The formidable challenges let one doubt whether Mainland Chinese enterprises can soon play an imminent role on global markets. Nonetheless, Wong and Chan forecast that "as Chinese indigenous enterprises emerge more competitive and stronger as a result of further domestic restructuring, they are likely to spearhead Chinese investment overseas and achieve considerable success in the global marketplace." (297) Therefore, it seems reasonable to expect an accelerating internationalization of Mainland Chinese businesses in the next years, but it is yet unclear if they will succeed in (developed) Western countries, for example, in Germany.

6 Market Entrance in Germany

This chapter analyzes the economic situation in Germany and the conditions of doing business in Germany. Consequently, the chapter shows why foreign businesses could possibly be interested in the German market. Furthermore, the role and importance of the German *Mittelstand* for the German economy is demonstrated. Subsequently, frameworks for the internationalization of the firm and the chosen *modus operandi* for entering the Germany market are analyzed. Finally, the market entrance of Mainland Chinese businesses in the German market is described and hypotheses for the author's study are deduced.

6.1 The German Economy and Market

According to the Federal Statistical Office of Germany, Germany is the biggest economy in Europe and was also the world's leading exporter in 2005. Germany exported products and services worth about \$786.2 billion while imports amounted to about \$625.6 billion which resulted in a total account surplus of about \$160.6 billion. Germany's most important trading partners are France, the United States and Great Britain. With over 82 million citizens, it is also the largest country in Europe measured by population (Statistisches Bundesamt). However, in recent years its economic performance has been disappointing when compared to the Euro Area as a whole and to the United States. Despite being the world leading export nation, Germany has failed to translate the growth generated by its export into strong domestic demand by its consumers. The constant underperformance of the German economy can be observed in Figure 31 which compares actual and projected GDP - growth rates for the World, the Euro Area and Germany from 2000 to 2007.

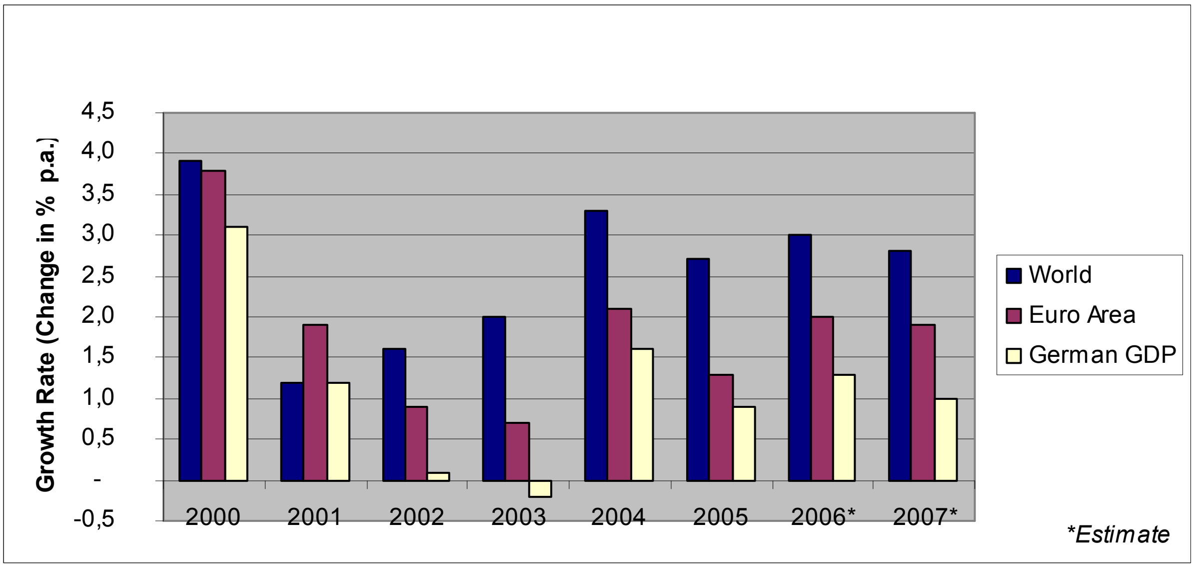

Figure 31: Comparison of GDP – Growth Rate of the World, the Euro Area and Germany, compiled from: OECD, Organization for Economic Co-operation and Development, OECD Economic Outlook No. 79, Paris: OECD, 2006.

The weak performance of the German economy as a whole compared to the World and the Euro Area is even the more surprising if one compares the growth rates in net exports of products and services of Germany and the Euro Area. Figure 32 shows that Germany, except in 2003, exports more than it imports leading to a net-inflow of capital which in turn should bolster the German economy. Still, the German economy lags behind the Euro Area and the World.

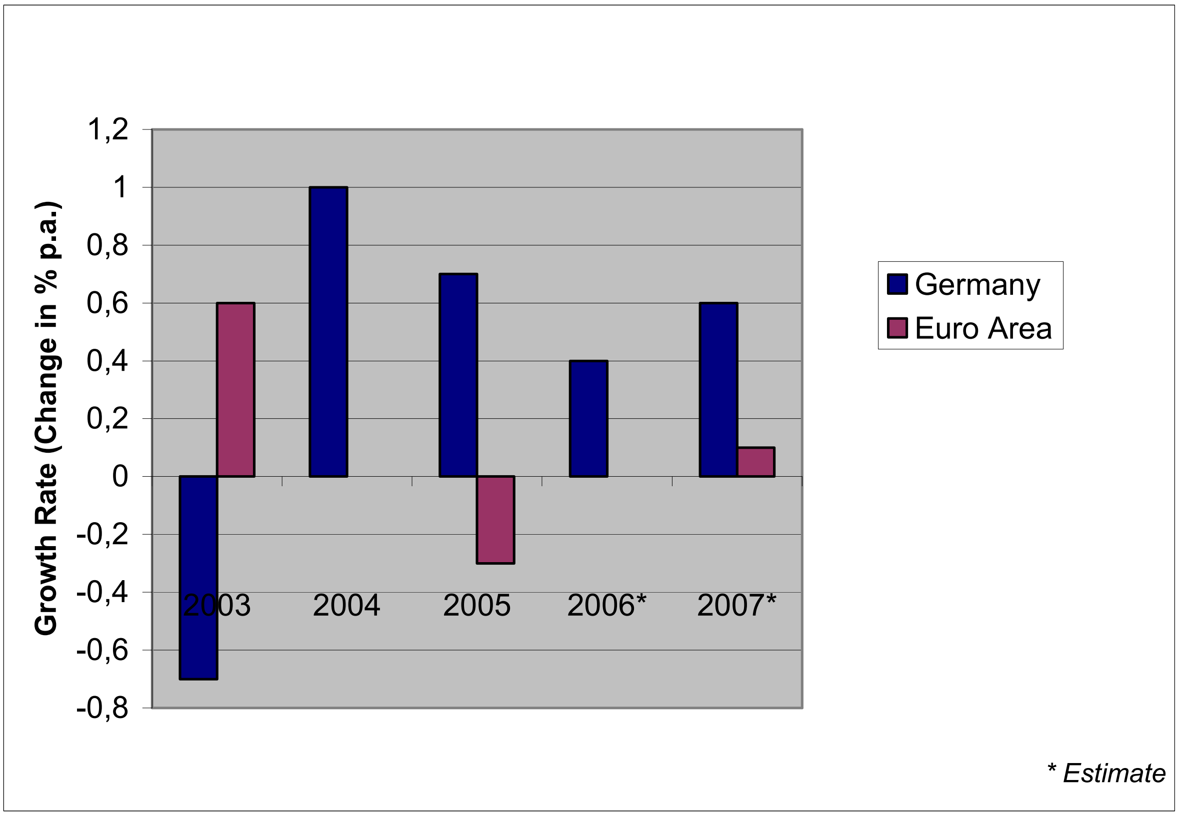

Figure 32: Net Export Growth Rates of Germany and the Euro Area, compiled from: OECD, Organization for Economic Co-operation and Development, <u>OECD Economic Outlook No. 79</u>, Paris: OECD, 2006.

The strong performance in Germany's net-exports can be traced back to a constant and sound growth in exports in the past years. An accelerating growth in exports is expected for the foreseeable future. Figure 33 shows the expected growth for exports in products and services from Germany for the period of 2003-2007.

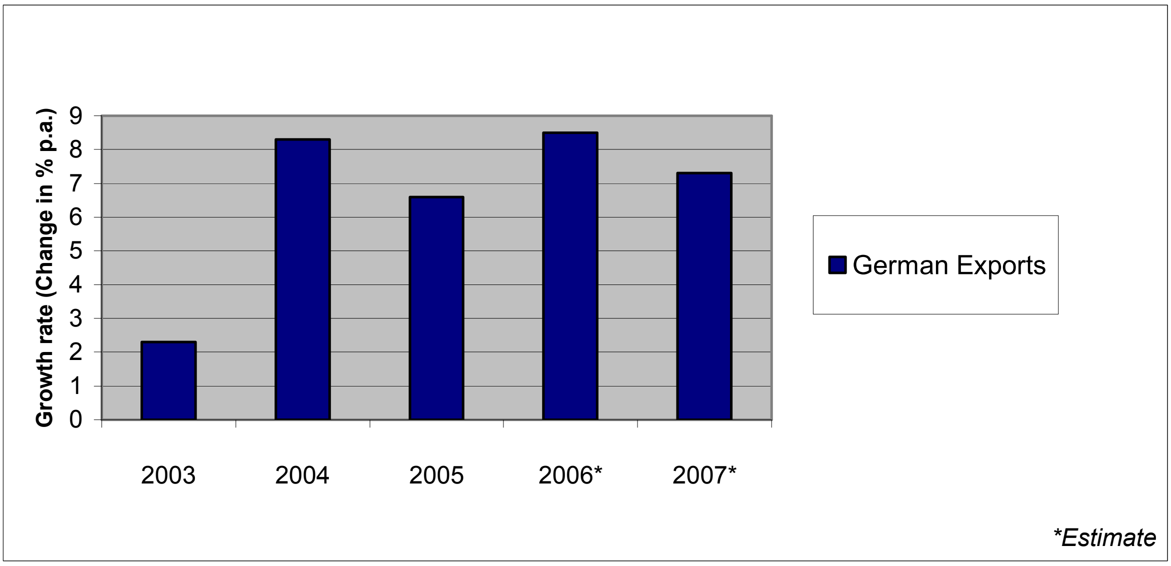

Figure 33: Growth Rate of German Exports for the period of 2003-2007, compiled from: OECD, Organization for Economic Co-operation and Development, OECD Economic Outlook No. 79, Paris: OECD, 2006.

In 2005 the average income per person in Germany was € 27,253 while the disposable income per household stood at € 17,842 (Statistisches Bundesamt). The amount of € 17,842 available to discrete spending shows that consumers in Germany have considerable purchasing power. Despite the purchasing power of the German consumers and the strength of growth in exports, consumption by German customers has been negative in the past. It is expected that consumption will continue to rise less than German GDP and German exports. The same holds true for the overall pattern in domestic demand. The trend rates of private consumption and total domestic demand are compared in Figure 34 for the period of 2002-2006.

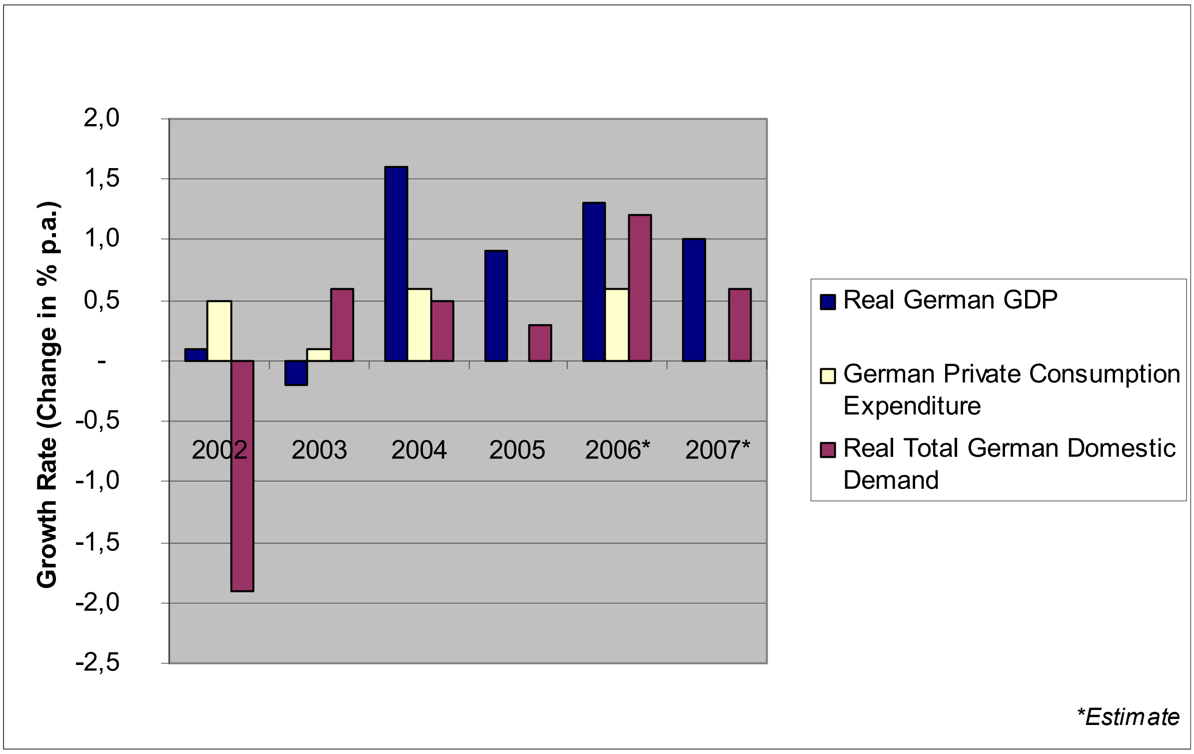

Figure 34: Growth Rate of Real GDP, German Private Consumption Expenditure and Real Total Domestic Demand for the Period of 2002-2007, compiled from: IMF, World Economic Outlook: Globalization & Inflation, Washington: International Monetary Fund (IMF), 2006.

The growth rate of the German private consumption constantly lags behind the real GDP growth rate as well as the real total German domestic demand and significantly underperforms when compared to the growth of German exports. Thus, the German economy is characterized by a weak private consumption and domestic demand while at the same time there is a strong growth in exports of products and services. Therefore, the strong growth in exports has in the past offset the sluggish, and sometimes even negative, private consumption growth and enabled Germany's GDP to even rise at all. In conclusion, the German economy has depended largely on the exports of products and services to sustain economic growth and reach positive growth rates.

6.2 The German Mittelstand

The following section of this chapter is concerned with the German *Mittelstand*. A qualitative and quantitative definition of SMEs, i.e. the German *Mittelstand*, is given. The definition of German the German *Mittelstand* is compared to the definition of SMEs in the EU. Furthermore, the economic relevance of enterprises of the *Mittelstand* and permanent challenges facing the German *Mittelstand* are analyzed. First of all, a definition of the German *Mittelstand* is needed.

6.2.1 Definition of the Mittelstand

Each economy is compromised of large, medium and small enterprises. The differentiation between “Large Size Enterprises” (LSEs) and “Small- and medium-sized enterprises” (SMEs) is usually based on two variables: the number of employees and the annual turnover of the enterprise. In most countries the small and medium enterprises are called SMEs, the Germans use the term *Mittelstand* to refer to those small and medium sized businesses. Although from the statistical point of view, the definitions of SMEs from other countries and German enterprises from the *Mittelstand* are the same, there are characteristics unique to these German enterprises which can not be deduced from official statistics. The German term *Mittelstand* includes economic, social and psychological as well as qualitative and quantitative features. Without taking into account these unique features which are further elaborated in this section, one will not be able to apprehend the behavior, motives, conditions, peculiarities and impacts of this group of economically and legally independent entrepreneurs and businesses (IfM, SMEs 2004 1).

According to the Institut für Mittelstandsforschung Bonn (IfM), the enterprises of the *Mittelstand* are characterized by “private ownership, freedom in decision making and contracting, individual responsibility of entrepreneurs for the success or failure of their own enterprise.” (IfM, SMEs 2004 1) The institute emphasizes two main aspects of the definition of German *Mittelstand*-enterprises, the qualitative and the quantitative aspects. The qualitative aspects of German *Mittelstand* which is the most visible in the coherence between the owner and the enterprise and which in turn influences the market behavior, performance and social and political role of the *Mittelstand* (IfM). In the report "SMEs in Germany – Facts and Figures 2004", the IfM lists qualitative factors such as (1-2):

- Identity between *ownership* and *personal responsibility* for the enterprise's activities
- Identity of *ownership* and *personal liability* for the entrepreneur's and the enterprise's financial situation
- *Personal responsibility* for the enterprise's success or failure and
- *Personal relationship* between employer and employees

These characteristics are responsible for the fact that the *Mittelstand* is defined not only by economic variables but also through the social factor, i.e. the close connection between owner and enterprise (IfM, SMEs 2004 1-2). The qualitative part of the definition, thus, illustrates the unique connection between a SME-owner and the enterprise and its employees.

Quantitative aspects of the definition of the *Mittelstand* are measured by indicators, such as profit, fixed assets, balance sheet total, value added, number of employees or annual turnover as decisive instruments to separate enterprises from the *Mittelstand* from LSEs. Due to statistical restrictions alleged by the IfM, the sector in which the enterprise conducts business, the annual turnover and the number of employees as criterions are available to estimate and describe enterprises by size-classes or generate and compare empirical findings. However, one should note that each sector of economic activity has its own micro- and macro-economic conditions, for example, relationship to suppliers or labor intensity, which forecloses a precise comparison of companies from different economic sectors (IfM, SMEs 2004 2-3).

To generate and analyze data, the IfM has developed a pragmatic definition of SMEs for research purposes. Table 6 displays the different classifications of enterprises by turnover and the number of employees.

Size of Enterprise	Number of Employees	Turnover (€/Year)
Small	Up to 9	Up to 1 million
Medium-sized	10 to 499	1 to 50 million
Large	500 and more	50 million and more

Table 19: Classification Scheme for SMEs used by IfM Bonn, IfM, Institut für Mittelstandsforschung, SMEs in Germany - Facts and Figures 2004, Bonn: IfM, 2004, 3.

Table 19 illustrates the fact that companies below the threshold of €50 Million and with up to 499 employees are considered small to medium-sized companies. The classification of the IfM is more inclusive when compared to the new classification by the EU which is given in Table 20. On the one hand, the IfM considers enterprises with as many as 9 employees and up to €1 Million annual turnover to be small enterprises. The EU classifies enterprises with up to 9 employees and up to €2 Million in annual turnover and on the balance sheet as micro. Small enterprises have 10-49 employees and €2-10 Million in annual turnover and on the balance sheet. The EU considers companies with an annual turnover of €9-50 Million and up to 249 employees to be medium-sized while the IfM classifies enterprises with an annual turnover of €1-50 Million and up to 499 employees as being medium-sized. In conclusion, the German *Mittelstand*, i.e. micro, SMEs, can be defined as 1. being enterprises with up to 500 employees and up to €50 Million annual turnover and 2. are in quantitative terms not that much different from SMEs as defined by the EU. Ultimately, the qualitative characteristics of the German SMEs constitute the definition and uniqueness of German SMEs as being the *Mittelstand*.

Size of Enterprise	Number of Employees	Turnover (€/Year)	Balance Sheet total (€/Year)
Micro	Up to 9	Up to 2 million	Up to 2 million
Small	Up to 49	2 to 10 million	2 to 10 million
Medium-sized	50 to 249	10 to 50 million	10 to 43 million
Large	250 and more	More than 50 million	More than 43 million

Table 20: Classification Scheme for SMEs according to the EU, IfM, Institut für Mittelstandsforschung, SMEs in Germany - Facts and Figures 2004, Bonn: IfM, 2004, 4.

6.2.2 Economic Relevance and Structure of the Mittelstand

To truly assess the uniqueness and importance of the *Mittelstand* for Germany one has to look at the economic activities of these small and medium-sized companies. Companies from the *Mittelstand* are defined by the ownership and management by an entrepreneur. Not all large family-led enterprises belong to the *Mittelstand*, but generally, companies which are led by an entrepreneur or by a family are attributed to the *Mittelstand*. And these family-led companies are a major economic force in Germany. 38 of the top 100 German companies are led by entrepreneurs or entrepreneurial families. No other country in the EU comes close to the ratio displayed in Germany. Of the 50 biggest private companies in Europe, 26 reside in Germany (Tiemann). Though not the major contributor to the German GDP with just 41.2 percent of all turnover subject to Value Added Tax (VAT), the German *Mittelstand* nonetheless employs 70.2 percent of all employees in private businesses and represents 99.7 percent of all businesses in Germany. The enterprises provide vocational training for 81.9 percent of all apprentices. Currently, there are over 3.384 million small and medium-sized companies registered (IfM, SMEs 2004 5). Thus, the German *Mittelstand* is probably the most powerful sector of the German economic and is commonly referred to as the *Rückgrat*[22] of the German economy and business landscape (Friedrich).

[22] Translation: „Backbone“ (LEO)

Small and medium-sized can choose from different kinds of forms of business organization when conducting business. The sole proprietorship (*Einzelhandelskaufmann/Einzelunternehmen*) is the most common form. The sole proprietorship commits a person to be liable for all obligations and authorizations in regard to the sole proprietor's business activities, including the private means. The chosen type of enterprise, sole proprietorship, requires no formal or legal requirements. If the annual turnover exceeds a certain limit, the sole proprietorship is required to be registered with the trade register (IHK). Nearly 70 percent of all SMEs are sole proprietorship as it is the most convenient legal form of an enterprise without too many formal and legal requirements (IfM, SMEs 2004 12).

The limited liability company (*GmbH*) is the second most popular type of enterprise. The liability of the enterprise and its partners is limited to the capital of the enterprise. Several partners can invest in the limited liability company, but each has to contribute at least 100 Euro. Furthermore, the minimum nominal capital required is €25.000. The limited liability company has to register in the trade register and is preferred by many entrepreneurs due to the easy set-up, the flexibility and the limited liability of the shareholders (IHK).

Partnerships, such as the unlimited company (*OHG*) or limited partnerships (*KG*) are other means to conduct business. The *OHG* (*Offene Handelsgesellschaft*) requires at least two partners, both who are fully personally and unlimited liable for the financial accounts and legal matters of the enterprise. The *OHG* is most appropriate when the partners are fully involved in the daily business of the enterprise since all partners of the *OHG* can act as managing director and legally represent the enterprise. The *KG* (*Kommanditgesellschaft*) requires at least two partners of whom at least one is fully liable and another is liable to the extent of his/her deposits in the *KG*. The partner in a *KG* cannot act as a managing director or a proxy of the *KG*. However, authorization can be transferred to the partner to also act as managing director. The partner has limited access to the yearly financial statement and the daily business operations (IHK).

Other types of enterprises include the *Gesellschaft bürgerlichen Rechts* (*GbR*), the *GmbH & Co. Kg*, the *Aktiengesellschaft*, *Partnerschaftsgesellschaft* and the *Stille Gesellschaft* (IHK). These types of enterprise are not widely used by the *Mittelstand* and are, therefore, for the purpose of this dissertation neglected. Figure 35 shows the dispersion of types of enterprises among the German *Mittelstand*.

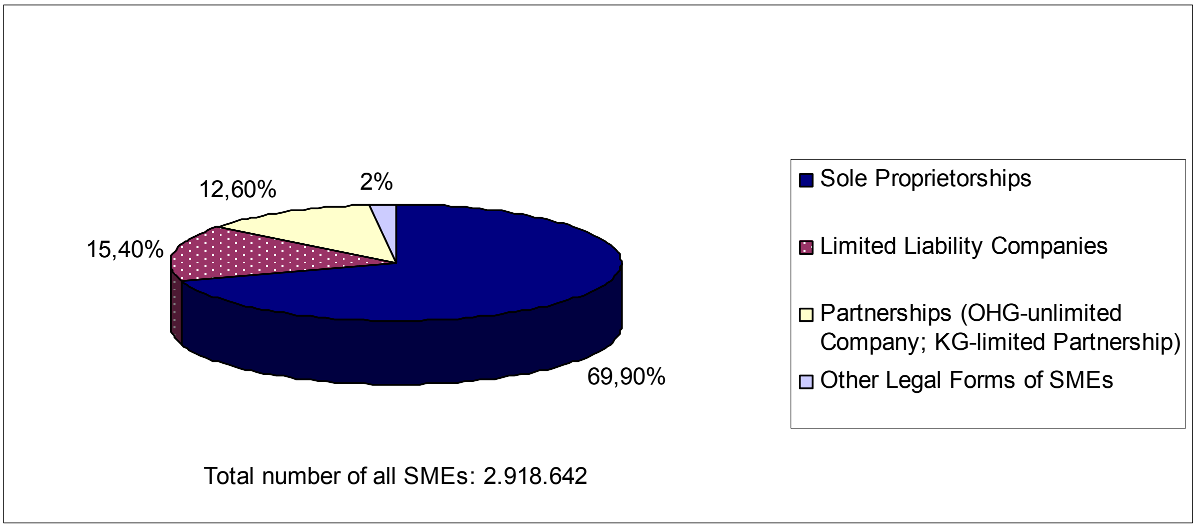

Figure 35: SMEs by Legal Forms - Forms of Enterprises, Germany, 2002, IfM, Institut für Mittelstandsforschung, SMEs in Germany - Facts and Figures 2004, Bonn: IfM, 2004, 12.

Nearly 70 percent of all SMEs are sole proprietorships which offer the benefit of easy set up and minimal legal and formal requirements. The second most chosen mode of operation with 15.40 percent is the limited liability company (*GmbH*) which offers the entrepreneur flexibility in doing business while at the same time limiting the legal and financial exposure and liability. Partnerships, unlimited and limited, account for 12.60 percent off all legal enterprise forms and are the third most popular chosen mode of operation. Other legal forms account for only 2 percent of all enterprises and, thus, do not have a significant impact on the composition of the German *Mittelstand*. Figure 36 shows the ranking of the different forms of enterprises in regard to the enterprise's generation of annual turnover which is an indication for the financial volume related to each kind of chosen mode of operation.

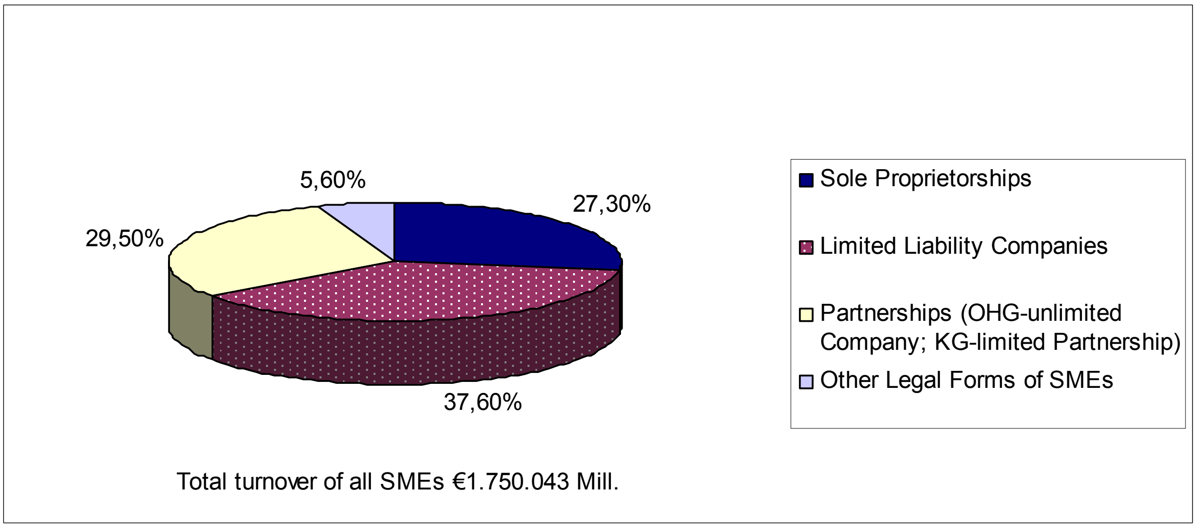

Figure 36: SMEs by Legal Forms - Turnover of Enterprise Forms, Germany, 2002, IfM, Institut für Mittelstandsforschung, SMEs in Germany - Facts and Figures 2004, Bonn: IfM, 2004, 12.

Figure 36 illustrates that limited liability companies generate the highest part of the annual turnover of all SMEs. Partnerships and sole proprietorships generate roughly about the same share of the annual turnover of SMEs. Again, other legal forms of other enterprises generate only a small percentage, i.e. 5.6 percent, of the whole turnover of all SMEs. The shares of each enterprise form in regard to the total number of enterprises in conjunction with the shares of each enterprise form in regard to the share of the total turnover of all SMEs leads to several conclusions. Although nearly 70 percent of all enterprises are sole proprietorships, they generate only 27.3 percent of all turnovers. Thus, it can be assumed that the sole proprietorships are small businesses with relatively low annual turnover. Most of the annual turnover is generated by limited liability companies; the appropriate share in annual turnover is nearly 2.5 times larger than the share in the total number of enterprises. The same holds also true for partnerships whose share in turnover is twice the size of their share in the total number of enterprises. Thus, both partnerships and limited liability companies are forms of enterprises which are used to deal in business with high annual turnover. The relative prominence of the limited liability companies also indicates that entrepreneurs appreciate the flexibility given by its legal and formal requirement as well as the protection of personal wealth through limited liability vs. the sole proprietorship with the full personal liability.

6.2.3 Challenges facing the Mittelstand

The German *Mittelstand* faces a number of challenges which threaten to lead more than even the 39,320 registered insolvencies among SMEs in 2003 into insolvency (IfM, SMEs 2004 18). According to the *Kreditanstalt für Wiederaufbau (KfW)*[23] the lagging domestic demand and private consumption, as described previously in Chapter 6.1, is especially worrisome for the SMEs since, in contrast to the LSEs, they rely mostly on domestic demand. The actual share of SMEs in export-based activities is 98.1 percent, but SMEs only account for 20.9 percent of all export-based turnover. Furthermore, the turnover generated by exports is only 8.8 percent of the entire annual turnover of SMEs (Reize, IfM, SMEs 2004 29). Thus, a weak domestic demand and sluggish private consumption hurt SMEs disproportionately.

The weak domestic growth requires SMEs to ensure that their business is run financially sound and that liquidity is available in an adequate amount. Therefore, further pressure on the financial situation of SMEs is added by the requisites of Basel II[24] which require banks and, ultimately, SMEs to bolster their capital base and comply with rules laid down by the Basel directives in order to be eligible for loans. Of 1.9 million SMEs (about two third of the total number of SMEs) who negotiated with banks, 59 percent failed to secure a loan agreement. Interviews revealed that in 57 percent of the cases, the negotiations were terminated by the banks. The banks refrained from granting loans in 60 percent of the cases due to lack of securities and in 45 percent of the cases due to a change in business policies.[25] Enterprises broke off negotiations due to the lack of available and requested securities in 41 percent of the cases and regarded the interest rates asked in 34 percent of the cases as being too high. 24 percent of the enterprises also blamed poor advisory services for the failure of the negotiation. In the end, of those enterprises which did not secure a

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[23] The *Kreditanstalt für Wiederaufbau (KfW)* is the *KfW Bankengruppe* (the KfW banking group) and consists of the KfW promotional bank, the KfW SME bank, the KfW IPEX-Bank and KfW development bank. The KfW Bankengruppe is owned by the federal government (80 percent) and the Länder (20 percent) and is active in the promotion of SMEs, in home finance or housing modernization, in the protection of the environment and the climate, in export and project finance or in the promotion of the developing and transition countries (KfW). For further information please visit http://www.kfw.de.

[24] Further information on Basel II and the effect on the financial situation of German SMEs can be found at http://www.mittelstand.info/.

[25] Please note that multiple answers could be chosen in the questionnaire.

loan agreement, only 14 percent actually went ahead with the planned investments (Reize).

Another dangerous development is the rising number of insolvencies among the SMEs. In 2003 39,320 insolvencies were reported. The number is expected to rise even further in the next years, due to the weak growth in the domestic market (IfM, SMEs 2004 20). Further pressure comes from the restriction of capital lending by banks due to Basel II as discussed above. More and more enterprises are probably not able to continue business operations due to an insufficient capital base. Although the enterprises generate revenues, outstanding payments might put pressure on the liquidity of the enterprise, resulting in a cash-drain and ultimately in the need for capital lending. Thus, the restriction of capital lending by Basel II might lead to a further increase in the number of insolvencies. As more enterprises slip into insolvency, domestic demand will further decrease. The dependence of SMEs on the domestic market as illustrated in this chapter means that a further increase in insolvencies of SMEs hurts the domestic demand and, thus, in turn poses a serious threat to the existence of the surviving SMEs.

A permanent challenge for the SMEs is the question of the leadership of the enterprise. As has been seen in Figure 35 above, most enterprises are sole proprietorships which have to find a suitable successor once the entrepreneur and founder of the enterprise dies or goes into retirement. Every year about 71,000 enterprises are affected by the (voluntarily) retirement of its leader. The number of employees to be affected in 2005 is estimated at about 680,000. Consequently, about 21.2 percent of the affected enterprises will have to be sold to external buyers. Still, each year about 5,900 enterprises have to be closed due to a lack of successors or adequate outside buyers (IfM, *Jahrbuch*). Thus, the question of a suitable solution for enterprises facing an alternation of generation, for example, choosing a suitable successor or buyer is a pressing issue for SMEs.

Small and medium-sized companies also have to confront the fact that in a globalized world they have to compete globally on quality and price with their products. But the relative high labor costs in Germany make it hard for SMEs to compete on price. The average working hour cost for a German employee was \$25.08 in 2002, while the comparable figure for an American employee is \$21.11 and for a Chinese employee even only \$0.64 (Coy, Economist.com Economic Data). The low labor costs in China puts German production at home at a distinct disadvantage and, coupled with a promising market of 1.3 billion customers, led to an investment in China of nearly all major German businesses. German companies that invested in China include, BMW, Volkswagen, Bayer, BASF, Metro and TUI (Ludwig 6). However, this option is mainly available to LSEs. As has been discussed above, SMEs generally cannot meet the requirements in terms of capital and human resources needed for international production. The higher labor costs in Germany compared to the USA are another source of worry, since the SMEs that export products and services, deal in US-Dollars. Due to the continuous rise of the Euro against the Dollar to around $1.30 (wallstreet:online) over the past years, German labor becomes even more expensive.[26] Figure 37 illustrates the development of the exchange rate of Euro/US for the period 2001-2006.

Figure 37: Development of Euro/USD Exchange Rate from 2001-2006, Wallstreet:online, EUR/USD Spot, 27. June 2006, wallstreet:online AG, Available: http://www.wallstreet-online.de/informer/common/charttool.php?tr=5y&inst_id=100742&market_id=19&spid=ws, 27. June 2006.

[26] The exchange rate is from 27. June 2006 (Wallstreet:online). A continually high exchange rate of the Euro against the Dollar is expected due to the trade deficit of the USA and the still mounting budget deficit. For further information see: "The Disappearing Dollar." and "The Future of the Dollar - The Passing of the Buck", *The Economist* 2. December 2004.

The growing competition from low-cost countries like China and the lack of competitiveness in regard to labor costs compared to developed countries, such as the USA, are another challenge German SMEs have to cope with. Friedrich summarizes the challenges German SMEs face as follows (9):

- Growing stress of competition
- Structural transformation
- Globalization
- locational / national competitiveness
- Euro
- Succession transition problems
- Business policy congestion
- Change in the way enterprises are financed
- Basel II
- Increment in Insolvencies

The previous section of the chapter has defined the German *Mittelstand* using qualitative and quantitative factors. German SMEs are the backbone of the German economy and distinguish themselves from counterparts in other countries mainly due to the qualitative definition of the *Mittelstand*, i.e. the close connection between the owner and its company. The German *Mittelstand* is the main economic force in Germany. Despite the fact that Germany is a leading export nation, most SMEs depend on the home market. The SMEs face a number of persistent challenges, namely the succession problem for those enterprise-founders retiring, a weak capital base of the enterprises, the new and strict financial requirements laid down by Basel II and high labor costs when compared to other developing and developed countries.

6.3 Investment in Germany

The United Nations Council on Trade and Development (UNCTAD) regularly reviews the institutional settings and conditions in a country to assess the attractiveness of a country as an investment location. The last available UNCTAD-report certifies Germany to possess an open and welcoming FDI environment and to actively seek and permit FDI in Germany. Germany offers an investor-friendly environment by encouraging foreign investment by guaranteeing (intellectual) property rights by law, with tax incentives, investment grants and loan programs ("World Investment Development - Country Profile: Germany" 62). In 2005, € 26,264 billions were invested in Germany (Bundesbank,Ausländische Direktinvestitionen in Deutschland). Figure 38 shows the development of FDI in Germany for the period of 1999 – 2005 while Figure 39 illustrates the accumulation of total FDI in Germany for the period of 1990-2005.

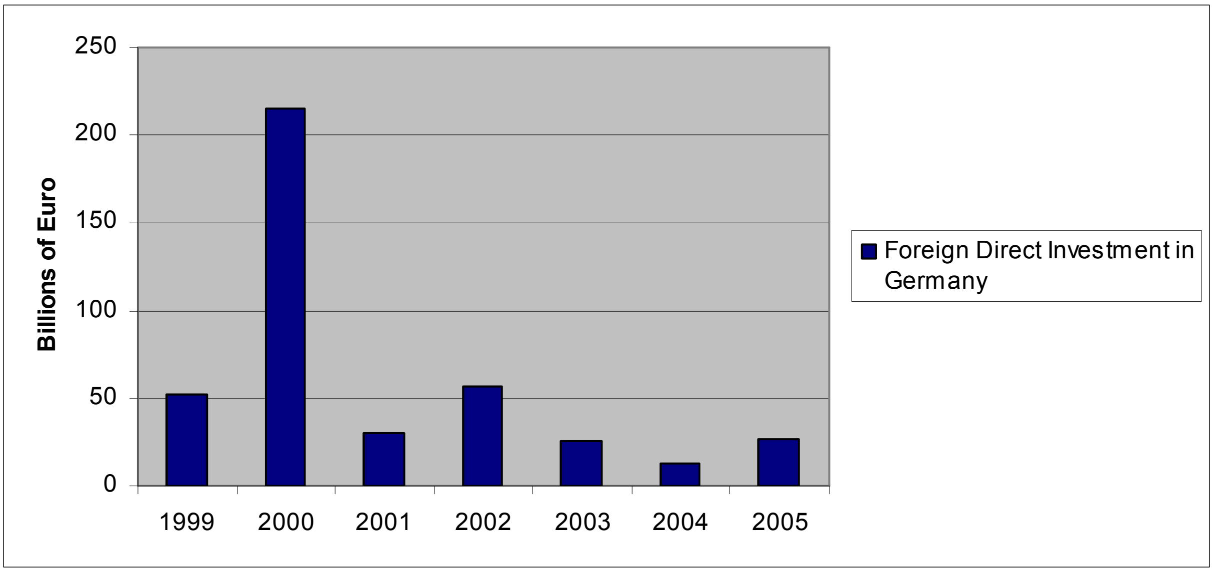

Figure 38: Development of FDI in Germany (in Billions of Euro) for the Period of 1999 – 2005, compiled from: Deutsche Bundesbank, Zahlungsbilanzstatistik: Ausländische Direktinvestitionen in Deutschland, 12. June 2006, Available: http://www.bundesbank.de/stat/download/aussenwirtschaft/S201ATB34849.PDF, 12. June 2006.

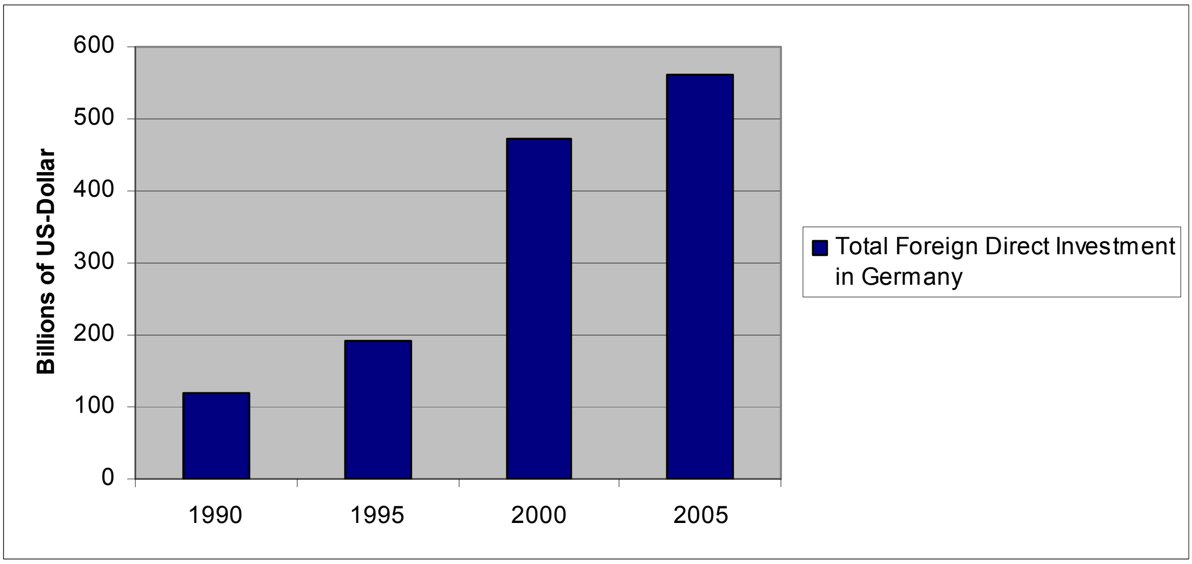

Figure 39: Total FDI in Germany for the period of 1990 - 2005, compiled from: United Nations Conference on Trade and Development, World Investment Report 2004, New York and Geneva: UNCTAD, 2004, 376; and Deutsche Bundesbank, Zahlungsbilanzstatistik: Ausländische Direktinvestitionen in Deutschland, 12. June 2006, Available: http://www.bundesbank.de/stat/download/aussenwirtschaft/S201ATB34849.PDF, 12. June 2006.[27]

The different types of operation manners available for the market entrance in Germany were discussed at length in Chapter 1.4. According to the International Enterprise Singapore (IE) organization, investing and setting up a business in Germany can take the following forms (IE):

- Sole proprietorship
- Limited liability company (GmbH)
- Joint stock company[28]
- Partnership
- Branch
- JV

[27] An exchange rate of 1 Euro = 1.25441 US Dollar was used in the compilation of the statistics.
[28] A joint stock company is known as Aktiengesellschaft (AG) in Germany is commonly used by larger corporations and listed companies. The AG allows the transfer of shares. The liability of the AG is limited to €50,000 and is raised by the issuance of shares. A minimum of 5 incorporators is needed. Furthermore, a supervisory board has to be nominated which appoints the management board. The management board has to be independent from the supervisory board and the shareholders (IE).

Of course, M&A of a German company is also an option. M&As are generally responsible for a major part of the FDI-investment in a country since M&As allow a company to gain complete control of a business which most firms desire when the firm enters a foreign market. The biggest M&A in Germany took place in 2000 when Mannesmann was taken over by Vodafone. The deal was valued at $183 billion (CBC) at the time and is the reason for the distortion of the M&A sales statistics of Germany in 2000. German companies are attractive take-over targets for companies favoring market entry in Germany by M&A because of the good reputation of German companies, the domestic German market, the low price for German companies and the competitiveness of German companies (Anonymous, "Langsam Aber Stetig Aus Dem Tal"). Figure 40 illustrates the development of M&A sales of German companies to foreign transnational companies[29] as well as sales of affiliates of foreign businesses to companies from Germany.

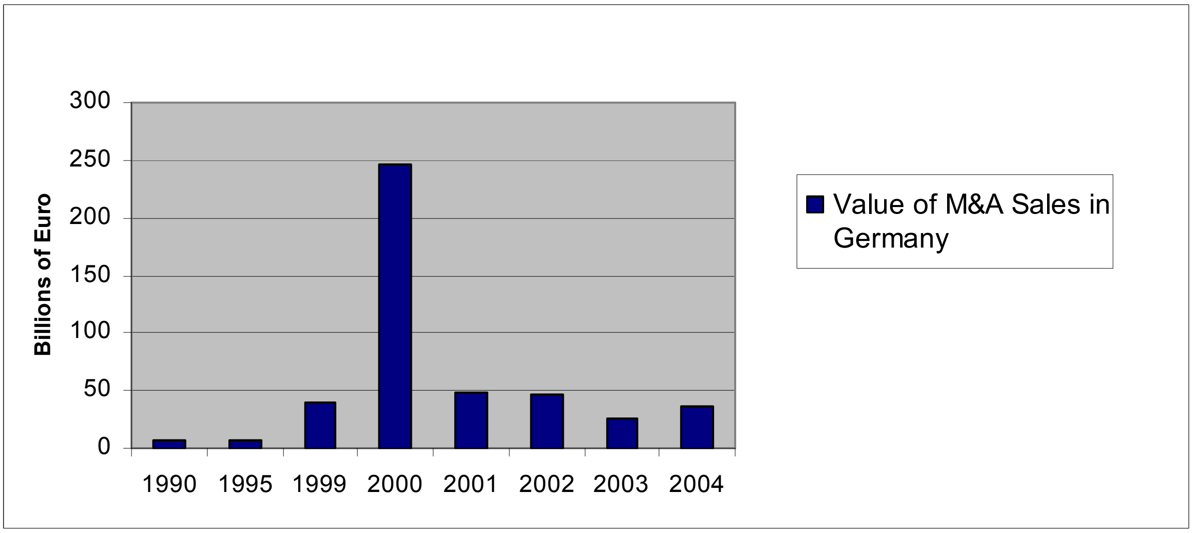

Figure 40: Development of the Value of M&A Sales in Germany for the Period of 1990 – 2004, United Nations Conference on Trade and Development, World Investment Report 2004, New York and Geneva: UNCTAD, 2004, 411; and Foreign Direct Investment Statistical Database, 2006, UNCTAD, Available: http://www.unctad.org/Templates/Page.asp?intItemID=3159&lang=1, 25. June 2005.

[29] A transnational corporation (TNC) is generally regarded as an enterprise comprising entities in more than one country which operate under a system of decision-making that permits coherent policies and a common strategy. The entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the others and, in particular, to share knowledge, resources and responsibilities with the others (UNCTAD, Transnational Corporations Statistics).

M&A sales in Germany grew from $6.22 billion in 1990 to $35.69 bill. in 2004 (UNCTAD, Foreign Direct Investment Statistical Database). SMEs are good target candidates for the M&A market entry mode since they have succession problems, a weak capital base and growing stress of global competition (Friedrich; IfM). Most German SMEs are purchased because the acquirer (Behringer 19)

- Aims to increase market share or access new markets
- Acquire know-how or immaterial assets, such as licenses or brands
- Acquire a qualified labor force
- Improve their own market position by buying up a competitor

Although one regularly hears only about the acquisition of or merger amongst large companies, actually most activities in the M&A-sector take place in the German *Mittelstand*. Of the problems plaguing German SMEs mentioned above, the succession problem is probably the most pressing one to German SMEs and the major reason for the sale of German SMEs to domestic and foreign investors (Behringer 7).

Consequently, German companies are attractive take-over candidates. The arguments used to justify the SMEs' appeal to acquirers can also be applied to companies seeking a partner for a JV. Furthermore, the large domestic market and an annual disposable income of € 17,842 per household (Statistisches Bundesamt) make Germany a appealing market for other entry modes, such as for example, exporting or licensing, as well.

Although Germany's economic performance has been disappointing when compared to the economic growth to worldwide or Euro Area growth (as has been seen in Chapter 6.1), it still has managed to attract foreign investors who consistently seem to achieve a higher growth in the German market than the German economy. For example, U.S. companies continue to invest in Sales, Marketing and R&D in Germany and make Germany the core location for marketing and competence centers precisely because these U.S. companies continue to generate excellent revenues in the German market (Anonymous, US-Unternehmen Verlagern Produktion Nach Osteuropa).

According to the business initiative "Invest in Germany" and Gösche, Germany offers several distinct advantages which make it a favorable investment location (Invest-in-Germany; Gösche 14):

- Highest GDP and population of all EU-members
- Central location in Europe and a bridge between central and eastern Europe
- Excellent labor training and resulting high labor productivity
- Highly developed infrastructure
- Quality seal "Made in Germany"
- Superior technology standard of German companies and innovation
- Innovation and dynamism through successful cooperation between research and industry
- Political Stability and flexibility.

The ascertainments made by Invest-in-Germany and Gösche are confirmed by a study conducted by the consultancy Ernst & Young. The study interviewed more than 1000 enterprises worldwide and concluded that 18.5 percent of all enterprises rate Germany as one of the three top investment locations worldwide, behind China and the USA. At the same time, Germany is the most attractive investment location in the European Union. The interviewees argued that Germany has one of the best transport and telecommunication infrastructures in Europe. Praise is also given to the training and qualification of German employees as well as the attractiveness of the German market. Last but not least, Germany is rated the best spot worldwide in terms of quality in research and development and logistic centers. Furthermore, in terms of political stability and stability of law as well as social climate, Germany is ranked second-best in Europe. Criticism was voiced in regard to bureaucracy in Germany and the flexibility of labor legislation. 57 percent of the respondents rated the German investment policy as good. Therefore, it comes as no surprise that 55 percent of those interviewed expect Germany’s attractiveness as an investment location to continuously rise in the coming years. Further investments in Germany would most likely take place through the acquisition of shares and the formation of subsidiaries (Ernst&Young 1-31).

Adjacently, Germany has impressively improved its productivity and competitiveness in recent years. According to *The Economist* ("Germany's Economy: A View from Another Planet"),

- Germany has enjoyed productivity growth nearly as fast as America since 1995 while wages have risen more slowly, resulting in falling labor costs
- German exports growth in exports growth was more than three times the growth of America’s exports

- Germany is the only G7 country to increase the share of exports in world markets in the face of rising Chinese competition
- German corporate profits increased stronger than at America’s companies
- Germany has a 3 percent surplus account in savings while America has a current-account deficit of 6 percent.

The praise for German communication and transport infrastructure, labor qualification and the revival of German competitiveness compared to fellow EU members and the U.S. shows that Germany can offer substantial competitive advantages as an investment location to foreign companies. The intended expansion by some 40 percents of the interviewees of the survey by Ernst&Young, the third place in the ranking of favorite investment locations worldwide in the same survey and the favorable rating of the German investment policy by UNCTAD indicate that further investment in Germany is probable. Consequently, the distinctive advantages enjoyed by Germany as an investment location suggest that FDI will continue to flow into Germany.

6.4 The Market Entrance of Mainland Chinese Business in Germany

6.4.1 Current Situation

Chinese businesses view Germany as a strategic key market because (Anonymous, "Chinesen Kaufen *Mittelstand*" 1):

- Germany is the biggest European market
- German Technology is state-of-the-art
- Germany is the gate to West and East Europe

Figure 41 shows the FDI of Mainland Chinese Business (excluding retained profits and credit transfers of foreign investors). As one can see, yearly Mainland Chinese FDI in Germany has been low.

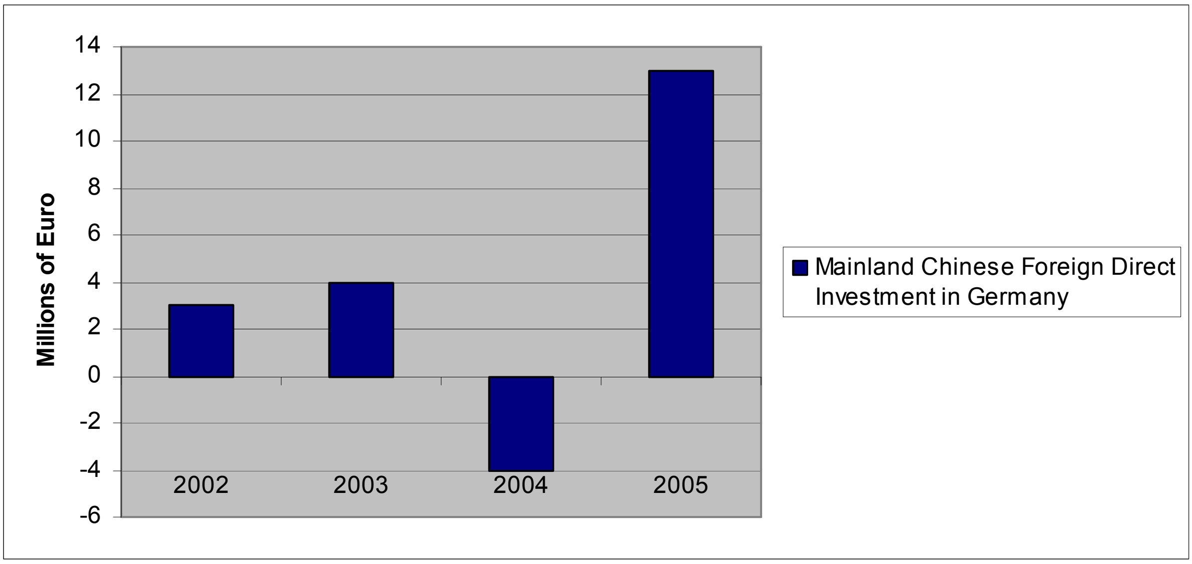

Figure 41: Yearly Mainland Chinese FDI in Germany, compiled from: Deutsche Bundesbank, <u>Direktinvestitionen Laut Zahlungsbilanzstatistik: Ausländische Direktinvestitionen in Deutschland</u>, 12. June 2006, Available: http://www.bundesbank.de/download/statistik/stat_direktinvestitionen.pdf, 12. June 2006.

Figure 42 illustrates the total Mainland Chinese investment in Germany for the period of 1994 – 2005. The stock of Mainland Chinese investment in Germany has been rising drastically since 1994. Still, by comparing the Mainland Chinese investment with investment from, for example, the Netherlands, which invested € 7,895 million in 2005 alone, one can see that Mainland Chinese investment in Germany has been marginal so far (Bundesbank <u>Ausländische Direktinvestitionen in Deutschland</u>).

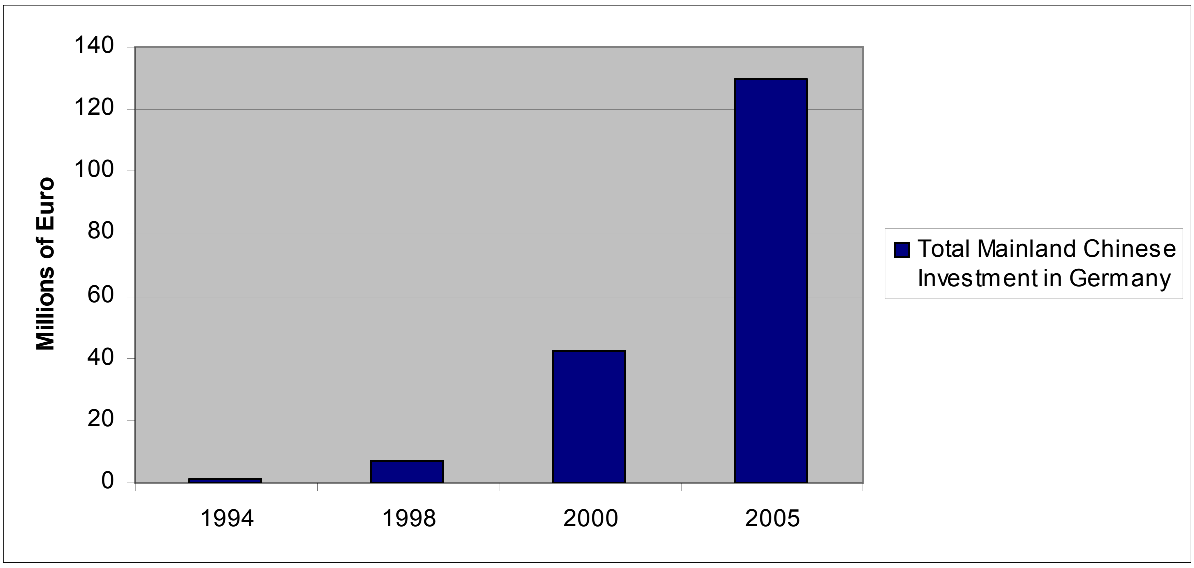

Figure 42: Total Mainland Chinese Investment in Germany, compiled from: Deutsche Bundesbank, Zeitreihe:Ausländische Kapitalanlagen Im Inland/China/Direktinvestitionen/Insgesamt/Saldo, 12. June 2006, Available: www.bundesbank.de/statistik/statistik_zeitreihen.php, 12. June 2006.

A survey by the Chinese Academy of International Trade and Economic Cooperation conducted in 2005 among 102 international active Chinese businesses showed that Germany was the second-most important investment location for Chinese investors (Anonymous, Schleichender „Kauf Deutschlands"). About 600 Mainland Chinese companies are nowadays active in the German market (Oldekop 42). While in the past Mainland Chinese businesses chose to establish a subsidiary in Germany, nowadays the M&A of a German business is the preferred course of action (Anonymous, Schleichender „Kauf Deutschlands").

German SMEs are especially interesting take-over targets for Mainland Chinese SMEs since the organizational structure with a strong family and business head is similar to the Chinese organizational form of SMEs. Consequently, it comes as no surprise that Mainland Chinese Business acquired an estimated 278 German companies in 2004 alone. Nearly all acquired businesses are SMEs with an annual turnover between € 1 - 10 million. Mainland Chinese businesses prefer not to buy the whole company, but to concentrate on acquiring the brand, the technology and the distribution networks. The acquisitions are seen as a fast way to the establishment of a brand and appending distribution networks as well as attractive patents and modern technology (Anonymous Schleichender „Kauf Deutschlands").

Table 21 gives a supplementary overview about the acquisitions of German SMEs by Mainland Chinese businesses in the last years.

Name of Chinese Company	**Name of Acquired German Company**	**Date of Acquisition**	**Mode of Acquisition**	**Acquisition Price**
Ningbo Zhongqiang Company	LUTZ Company	January. 2004	Acquisition of Brand and parts of the production equipment	Not publicly known, but allegedly around € 3 million
Dalian Machine Tool Group Corp.	Zimmermann Corp.	October 2004	70% Shares	Approx. € 10 million
SGSB Group Co., Ltd.	Deutsche DA Company	July 2005	94,98% Shares	No more than € 35 million
Shenyang Machine Tool (Group) Co., Ltd.	Deutsche Schiess AG	Nov. 2004	Complete Net-Assets	Approx. €. 2 million
Harbin Measuring & Cutting tool Group Co., Ltd.	Deutsche Kelch Corporation	March 2005	Acquisition of Production Equipment, Technology and Distribution Networks	€ 9,5 million
Shangdong Yan Kuang Group	Kaiserstuhl Koksfabrik	2005	Acquisition of Technology	Unknown
Jiangsu Shanggang Group	Dortmunder Stahlfabrik	2004	Production Equipment transported separately to China	Unknown

Table 21: Overview about Mainland Chinese Acquisitions of German Companies, Anonymous. Schleichender „Kauf Deutschlands“, 2005, Investinchina.de, Available: http://www.investinchina.de/onearticle.aspx?id=396# http://www.investinchina.de/onearticle.aspx?id=398# http://www.investinchina.de/onearticle.aspx?id=400#, 8. December 2005.

Mainland Chinese investors often contemplate purchasing financially stricken German SMEs, but frequently lack the necessary German market knowledge, for example, official regulations, and underestimate the difficulties of restructuring a German company which leads to disappointments after the purchase goes through (Anonymous, Die Chinesen Kommen). Most Mainland Chinese investors tend to acquire a German SME that missed out on the internationalization of the companies’ business as well as companies that are well positioned on the market but failed to find a successor for the current company leader. These Mainland Chinese companies aim to take over long-term assets as well as tangible and tangible assets, patents, production technologies and trademark rights (Weber). States Matz, “The establishing of a new company by Chinese investors is the exception; the trend is that they buy companies.” (Anonymous, Chinesische Investoren Drängen Auch Nach Deutschland)

Although Mainland Chinese investment into has been negligible so far, this chapter has shown that Mainland Chinese businesses are expanding onto the German market and that the market entrance through M&A seems to be one of the preferred market entry modes. Is the choice of a certain market entry mode solely motivated by business considerations or is it possible that culture as a significant variable influences the choice of market entry mode? How might ethnic Chinese networks, which have been used for the international expansion of Overseas Chinese businesses, possibly play a role in the choice of market entry mode by Mainland Chinese businesses? Based on observations and conclusions drawn in this dissertation so far, hypotheses for the international expansion and the market entrance of Mainland Chinese businesses onto the German market are developed and, subsequently, tested.

6.5 International Expansion & Culture – Hypotheses for the Market Entrance of Mainland Chinese Business in Germany

6.5.1 Hypothesis 1

The analysis of internationalization processes of Mainland Chinese Businesses in Chapter 5 revealed that Mainland Chinese Businesses essentially draw on 3 different market entry choices when expanding abroad: Market entrance by a WOS, through a JV with a local business and the acquisition of or merging with a local business. Therefore, these three choices are analyzed in regard to the selection of the right market entrance mode in Germany.

Table 18 showed the weaknesses, problems and challenges Mainland Chinese businesses face. The deficiencies in brand-reputation, technology, distribution infrastructure and management skills are being resolved by Mainland Chinese businesses through strategies involving M&A and alliances. Another way is the establishment of subsidiaries in order to gain local knowledge and experience (UNCTAD, World Investment Report 2004 25-26).

In Chapter 2 it was found that China has a high ranking on the power distance index developed by Hofstede. A high power distance culture emphasizes the status of the superior and supports the obedience of subordinates towards authority which is not to be challenged. A survey of different studies published on the effect of power distance on the choice of market entry mode reveals that “the cultural dimension of power distance can be considered a determinant in the choice of market entry-mode choice.” (Mayrhofer 85) In effect, “a high power distance increases the likelihood of choice of majority or full control rather than shared control of international operations.” (Mayrhofer 85).

Thus, an internationally expanding business from a high power distance culture probably chooses market entrance modes with a high degree of control, i.e. M&A, WOS and majority JV. Since China has a high power distance culture the choice of market entrance by M&A and WOS is anticipated. The choice of a majority JV is neglected because, first, JVs in Germany between a German and Chinese company do not bear any obvious benefits since, second, JVs which enhanced the strengths and benefits of Germans (technology, brands, management skills) and Chinese (low cost labor and production assets) usually take place in China. Therefore, Hypothesis 1 (H1) proposes that Mainland Chinese business employ M&A and WOS for the market entrance in Germany because of the empirically proven correlation between a high power distance culture (China) and the choice of a high degree of control market entry mode.

6.5.2 Hypothesis 2

Chapter 6 argued that the focus of this dissertation is on Mainland SMEs as opposed to SOEs. At the end of 2003 only 10 percent of all Mainland Chinese enterprises going abroad were private enterprises. The number is expected to rise to 50 percent by 2010 (Vidaillet). It is of significant interest how these growing numbers of private SMEs expand abroad. As has been shown in Chapter 6, Mainland Chinese SMEs utilize *guanxi* networks to expand abroad. While the significance of *guanxi* and *guanxi* networks has decreased for SOEs, *guanxi* is still of significance for Mainland Chinese businesses (Hutchings and Murray 189-190). Hence, so is the use of networks for Mainland Chinese SMEs.

Guanxi networks are a unique part of Chinese culture. As shown in Chapter 2 and 3 as well as in Figure 19, Chinese individuals and the Chinese self cannot exist without their embedment in networks. "*Guanxi* is part of the fabric of Chinese society. Personal relationships are central to every aspect of Chinese society, including business." (Vanhonacker, "*Guanxi* Networks," 49) Therefore, Mainland Chinese businesses employ networks in the market entrance in Germany because of the cultural programming of Chinese individuals.

Networks protect their members against outsiders, provide their members with organizational capabilities, lower transaction costs through mutual reciprocity and trust and offer exclusive access to capital and business opportunities. In other words, networks generate sustainable competitive advantages for their members (Yeung, Transnational Corporations and Business Networks 214-218).

Luo observes that (135):

> it is important for firms that lack marketing experience, distinctive competencies, or distribution channels, to cultivate *guanxi* in order to compensate for their deficiencies. Eventually, they can build a *guanxi* network of their own, which helps them gain access to and expand their local market. In other words, a firm can enhance its performance by benefiting from the *guanxi* network it has established. In essence this network constitutes a firm's core competency and distinctive competitive advantage that can lead to high performance for the firm.

According to Luo, Mainland Chinese SMEs engage in *guanxi* networks in order to create a competitive advantage and increase the firm's performance. As has been shown in Chapter 6, Mainland Chinese SMEs lack, for example, marketing experience or distribution channels. Thus, by establishing *guanxi* networks and utilizing them for the international expansion, Mainland Chinese SMEs can create a competitive advantage.

The engagement of Mainland Chinese SMEs in *guanxi* networks is a competitive advantage since the utilization of networks leads, for example, to the reduction of transaction costs. Because resources are complimentary and information is shared freely, the Mainland Chinese business is able to access local knowledge when entering the German market. Additionally, the ethnic Chinese network provides with all necessary information, introduces it to the local market network, lets it participate in established customer and distribution networks and might even finance part of the local operation of the Mainland Chinese SMEs. Also, ethnic Chinese could protect Mainland Chinese SMEs against competitors, for example, by solely purchasing products from the Mainland Chinese business in order to financially secure the first months of the venture in Germany. To conclude, Hypothesis 2 (H2) proposes that Mainland Chinese SMEs employ ethnic Chinese networks when entering the German market because these networks are part of the cultural fabric of Chinese society and at the same time provide a competitive advantage to Mainland Chinese SMEs entering the German market.

6.5.3 Hypothesis 3

As has been discussed in Chapter 3 and Chapter 4, there is a considerable cultural distance between Chinese and Germans. For example, whereas Chinese emphasize the role of hierarchy and obedience, Germans have a bias for individualism and independence. Distinctive Chinese cultural variables such as *guanxi*, collectivism and face have been analyzed and found to greatly influence Chinese communication behavior. Therefore, it is reasonable to assume that the distinctive characteristics of Chinese and Germans can prove troublesome when Mainland Chinese businesses begin to expand to Germany.

Only in recent years have Mainland Chinese businesses have begun to expand abroad. As described in Table 18, Mainland Chinese businesses lack management skills since most Chinese businesses and managers have little or limited knowledge of foreign markets. M&A is a chosen tool of Mainland Chinese businesses to overcome these deficiencies. However, Mainland Chinese businesses should be careful with their choice of target and the resulting consequences because “cultural barriers, social misunderstandings and policy puzzles can also lead to business failures. Chinese companies may have grown under a very different business environment with the ones that they are about to merge or acquire.” (Renfeng) Larsson and Risberg caution that “an acquired foreign subsidiary may be more difficult to manage if there are great cultural distances between the two countries, since it is difficult to affect or change an existing corporate culture, and the national culture and macro-variables differ (43). Therefore, Mainland Chinese businesses are expected to have trouble not only with the corporate, but also with the national culture when acquiring a German business. Are the Mainland Chinese businesses yet prepared to deal with problems arising from different cultures?

The seclusiveness of the Chinese system in the past has led to a lack of international experienced managers as underlined by the shortage of international experienced managers. Therefore, it cannot be expected that Mainland Chinese businesses know how to deal with local cultures and situations. Subsequently, it is reasonable to expect Mainland Chinese businesses to face serious challenges and problems in terms of cultural and social adaptation when entering a foreign market. For example, Mainland Chinese businesses employ Chinese who do not speak one word German to manage their German investment (Anonymous, Die Chinesen Kommen). One example is Li Tiehuan, managing director of Kelch & Links, who has a has a Chinese professor as translator at his side at all times since Li Tiehuan speaks neither English nor German (Oldekop 41). Adds Arras, president of Chinese-French JV TCL-Thomson Electronics, “the communication challenge is one of the unique items we face.” (Roberts et al.) Boos warns that Mainland Chinese businesses also have to give their businesses operating a European face, otherwise the business would face a loss of acceptance (Anonymous, Chinesische Investoren Drängen Auch Nach Deutschland).

In conclusion, so far Mainland Chinese businesses have ignored the pitfalls of cultural and social differences when internationalizing abroad. Hypothesis 3 (H3) proposes that due to the lack of experience in international business activity, Mainland Chinese business still lack the understanding and ability to deal with cultural differences in the market entrance and subsequent business activity in Germany, and, therefore, run into difficulties when doing business in Germany.

7 Discussion of Survey Results

Chapter 7.1 describes the methodology of the survey. A comprehensive and compounding analysis of the most significant results revealed by the survey is offered in Chapter 7.2 in regard to possible inductive explanations for the choice of the market entrance mode of Mainland Chinese businesses in Germany. Chapter 7.3 describes the key findings of similar survey and studies. Chapter 7.4 subsequently creates a synthesis of the results of Chapter 7.2 and 7.3 and draws final conclusions for the general internationalization and choice of market entry modes of Mainland Chinese in Germany.

7.1 Methodology

In order to establish possible links between the choice of market entry of Mainland Chinese businesses and Chinese cultural variables, a detailed questionnaire[30] was developed. The questionnaire is held in English and can be classified into several categories. First of all, participants are asked about the their company, including the size and structure of the business as well as its business activities. The second part of the questionnaire deals with the motivations of going abroad and why a company would choose the German market and the according market entrance mode. The third part is concerned with the success of the company's activities in the German market and the success of the chosen market entrance mode. The fourth part of the questionnaire deals with cultural factors in the market entrance and marketing activities of the business. Finally, the questionnaire tries to shed a light on the connection between market entrance and Mainland Chinese business relationships with ethnic Chinese individuals or organizations. By

[30] The questionnaire can be found in the Appendix.

analyzing the answers given by the participants and establishing statistical correlations between results of the survey, one should be able to ascertain whether cultural variables of Chinese culture influence the choice of market entry modes of Mainland Chinese businesses. The survey was conducted in the period from November 2005 to February 2006 among Mainland Chinese Businesses which entered the German market. The questionnaire, in cooperation with the German Delegation of Industry and Commerce Shanghai, was sent by e-mail and fax to prospective participants and regional German business development agencies who were asked to forward the questionnaire to local Chinese businesses. The questionnaire was then sent back by post, fax or e-mail. Due to the limitations imposed upon the survey by German data protection law it is not known how many prospective participants the questionnaire received. The total number of recipients can only be estimated and, subsequently, is believed to be above 500.

However, only 8 companies sent the questionnaire back by fax, postal service or e-mail. Of those 8 companies, 6 are Mainland Chinese SMEs, the target audience of the survey, while the other two are a state-owned enterprise and an overseas Chinese business. It should be noted that the participating companies of the case studies requested to be kept anonymous due to the perceived sensitivity of the companies' provided answers and data.

Participants in the survey had the choice between the market entry modes wholly-owned subsidiary, JV, M&A and trading company. In the course of the research, it was found that companies chose to describe their market entry as being through a trading company. Subsequently, the term trading company was added in the questionnaire in order to provide the Mainland Chinese companies with the most accurate available choices of market entry modes and enrich the quality of this survey.

Since an empirical, and, thus, purely quantitative analysis, due to the low and, thus, empirically non-utilizable response rate, cannot be pursued, a qualitative analysis approach is being applied.

7.2 Analysis Case Studies

7.2.1 Hypothesis 1

One can argue that in the context of Mainland Chinese businesses entering the German market, a trading company is actually a WOS[31], too. Out of a total of 6 companies, 4 chose the entry mode trading company alias WOS for the market entrance with one company actually choosing the form of a JV for the trading company. Even if one subtracts this JV/trading company, there are still 3 companies choosing the market entry mode trading company alias WOS, and one company that entered the German market through M&A. Taking into account that another one of the companies also gained previous experience with M&A in Germany, one can, thus, make a case for the preference of Mainland Chinese businesses for those entrances modes (trading company alias WOS, M&A) associated with a high level of control. Subsequently, deducing from the available case studies, it is proposed that Mainland Chinese businesses do indeed select the market entry modes M&A and WOS for the German market due to a culture-based preference for a high degree of control market entry mode as proposed by H1.

7.2.2 Hypothesis 2

Hypothesis 2 (H2) proposes that Mainland Chinese SMEs employ ethnic Chinese networks when entering the German market because these networks provide a competitive advantage to Mainland Chinese SMEs entering the German market. Analyzing the answers given by the participating Mainland Chinese SMEs, it can be observed that the majority of participants thinks that networks are useful for the internationalization of their business; half of the participants state that ethnic Chinese networks are useful for the market entrance in Germany, but only two companies actually employed ethnic Chinese networks when entering the German market. Half

[31] Please see 7.2.5 for further explanation

the questioned companies admitted to having asked Chinese companies for advice or information in Germany. One company said that it actually used non-Chinese (local) networks for the market entrance. Consequently, one can ascertain that there is indeed a willingness to acknowledge the importance of ethnic Chinese networks for the international expansion of a Chinese business.

In conclusion, H2 can neither be confirmed nor dismissed. Certainly, there is enough evidence to suggest that ethnic Chinese networks exist and are used for the international expansion of Mainland Chinese businesses. Concerning the question of the importance of these networks for the market entrance in Germany, though, one cannot precisely judge their relevance due to ambiguous responses and the rest is mere speculation, at best.

7.2.3 Hypothesis 3

H 3 proposes that Mainland Chinese businesses so far lack the understanding and ability to deal with cultural differences when entering a foreign market. By closely examining the answers of the participants of this survey, one has to disagree. Nearly all companies offer intercultural training courses for their employees and adapt their products and marketing strategy to the German market. The Chinese management of half the German operations of the Mainland Chinese participants speaks German. Additionally, the majority of companies have a German website and all participants regard culture as a very relevant variable when doing business with foreigners. Thus, it seems that Mainland Chinese businesses recognize the pitfalls of social and cultural differences and address these issues when entering the German market. In conclusion, a case can be made that Mainland Chinese businesses indeed understand and have the ability to deal with cultural differences within the context of a market entrance in Germany and, therefore, H 3, concerning the available case studies, cannot be confirmed.

7.2.4 Response Rate and Guanxi

The low response rate of the survey can be explained by taking a look at the characteristics of Chinese individuals and enterprises as described and discussed in the current literature. As has been discussed in Chapter 4.3, Chinese utilize different communicative and behavioral approaches towards people they know and people who are unknown to them, i.e. insiders vs. outsiders (G. Gao and Ting-Toomey 50). The author of this survey did not have *guanxi* with prospective participants, thus, limiting the success probability of the study from the start. Additionally hindering research efforts is the preference of Chinese individuals for authority (China being a high power distance culture) and the fact that the author of the study lacked authority (because of simply being a young researcher with no formal title). Thus, it is not really surprising that most Chinese companies declined to participate in this survey.

Participating companies were acquired through personal contacts of the German Delegation of Industry and Commerce Shanghai and the various local business development agencies. These institutions had already established relationships with the participating Chinese companies, i.e. these institutions were able to draw on *guanxi* (as discussed in Chapter 3.4.2 and 5.2.3 et sqq.). Therefore, these institutions were not seen as outsiders and, consequently, were offered cooperation by the Chinese. In conclusion, *guanxi* networks established by ethnic Chinese individuals or organizations are of imminent importance and employed, utilized, cultivated and served for the benefit of their members. Approaches on a personal or professional basis by outsiders, however, are ignored and disregarded unless/until one is being introduced into the *guanxi* network. Thus, the survey was essentially predestined to fail; but in failing confirmed typical Chinese behavior.

7.2.5 Trading company alias WOS

It can be argued that participants chose to select the market entry mode trading company when in fact, from a scientific point of view, the appropriate description would have been wholly-owned subsidiary. The enterprises established by the companies of the case studies where registered as GmbHs which require an initial investment of at least € 25,000. Furthermore, following the description of the WOS - market entry mode given by Newbury and Zeira (89), B. E. D. Economist.com (Wholly-Owned Subsidiary) and Hollensen (295,305), it can be argued that these trading companies are, indeed, affiliates or subsidiaries of the Mainland Chinese companies and act as a sales subsidiary for these Mainland Chinese companies.

The trading companies chosen by the Mainland Chinese businesses are similarly structured and managed as a WOS and also offer the same organizational benefits of control as a WOS. Therefore, the choice of a trading company, i.e. WOS, underlines the cultural preference of Mainland Chinese businesses for market entry modes with a high degree of control. Thus, it is reasonable to label these trading companies, from a scientific point of view, to be actually WOS. Additionally, the legal and organizational model of a trading company presents a risk-averse as well as low capital means for Mainland Chinese businesses to establish a presence in the German market which can, at a later point of time, be expanded.

7.2.6 Distribution Networks

Nearly all participants agreed that the establishment of distribution networks was one or the main reason for expanding internationally, beating even the diversification of the business or becoming a global player. This result suggests that Mainland Chinese businesses see the distribution of products and the establishment of networks through which the products or services can be delivered the main problem in their international expansion. One could also argue that the establishment of distribution networks is the first step toward establishing formal and informal networks in the relevant industry, region or country which can later be turned into a competitive advantage. Thus, seen from that point of view, the overwhelming desire to establish distribution networks can also be at least partly explained by the culture-based desire to establish, cultivate and extend networks, i.e. to create *guanxi*.

7.2.7 Management Style

Mainland Chinese businesses prefer decision making to be something that is done by the company head. Half the participants state that operational and strategic decisions are made by the company head. Further questions in regard to the role of managers and employees in the company show strong agreement on the concept that each person should know their place in the company and their obligations towards others as well as that each manager is responsible for his/her team and employees. Half the participants also say that a manager is a person every employee looks to for guidance. Participants are split on whether the company head knows best how to lead the company and that one should not disagree with him. Surprisingly, a majority of the participants thinks that it is not, or only to a minor degree, inappropriate for employees to question the authority and integrity of their managers. The results of the survey, thus, only partly support the notion that Mainland Chinese businesses are managed and led in accordance to the high power distance culture which China supposedly is (as has been discussed in Chapter 2). The results could also imply that Mainland Chinese businesses are partly adapting to global or local management practices in regard to employee empowerment. Without further empirical evidence, these conclusions are, again, mere speculation at best.

7.3 Additional Surveys

To be able to understand and put the results of the conducted survey in a broader context as well as to analyze and verify whether conclusions drawn from the survey are empirically and scientifically relevant, a further comparison with existing literature and surveys is proposed. First, the survey conducted by the Foreign Investment Advisory Services (FIAS), a body of the World Bank Group, is described. Subsequently, the results of a survey jointly conducted by the Asia Pacific Foundation of Canada (APFC) and the China Council for the Promotion of International Trade (CCPIT) are reported. Last but not least, findings of a study conducted by the IBM Institute for Business Value and the School of Management at Fudan University are presented. The results of the author's study and key findings of the three external studies mentioned above are compared and analyzed in the synthesis in Chapter 7.4 and final conclusions are drawn.

7.3.1 FIAS Survey

The survey conducted by FIAS included 150 Mainland Chinese businesses firms. Of the total sample of Mainland Chinese businesses, 33 percent are SOEs and 48.7 percent are private businesses. Missing percents are spread among other types of enterprises. 85 percent of the participants identified "market seeking" as their top motivation for expanding abroad. Additionally, 51 percent of Mainland Chinese businesses use FDI to acquire strategic assets. 50 percent of Mainland Chinese businesses undertake FDI abroad in the context of a global competitive strategy. The most important factors influencing the FDI by private Mainland Chinese businesses are, beside market seeking (81 percent), the acquisition of strategic assets (53 percent) and the implementation of a global competitive strategy (51 percent). About 59 percent of the Mainland Chinese businesses are planning to make new investments abroad with another 13 percent intending to. A majority of 51 percent identified cultural conflicts as one of the main challenges of operating internationally. Further problems and challenges listed are the slow reaction of Mainland Chinese companies to changes in local markets, capital shortage, labor costs, the building of brand images and distribution channels. The biggest impediment to overseas investment identified in this study is the limitations on foreign exchange use (Battat). Since Chinese officials have lifted major restrictions of foreign exchange use in March, 2006, this impediment does not really apply anymore (Lifei).

7.3.2 APFC/CCPIT Survey

In cooperation with CCPIT, APFC conducted a web-based survey in which ultimately 296 valid responses were registered. The survey was, of course, conducted with the focus on Canada as investment location. Therefore, results of the survey pertaining solely to the investment location Canada are disregarded. Nearly 90 percent of Mainland Chinese ODI projects are wholly-owned or majority-owned by Chinese investors (larger than 50.1 percent stake). However, 60.7 percent of all undertaken ODI was in the form of JV, rather than IGI (16.1 percent) or M&A (23.2 percent). Of the participating Mainland Chinese companies, about 14.5 percent are SOEs and 56.5 percent are private SMEs. Most of Mainland Chinese ODI so far has taken the organizational form of representative offices and sales offices. Including the use of agents, these forms account for 75 percent of all forms of businesses of Chinese ODI: On a scale from 1-5 (not important - very important), Mainland Chinese businesses ranked the following driving factors for their existing ODI (Anonymous, China Goes Global 16):

- Business potential/expansion - 4.47
- Access to advanced technology and R&D - 3.74
- Access to international standard management practices - 3.70
- Overall importance of target country as a market - 3.52
- Acquisition of established brands - 3.28

The results clearly show that Mainland Chinese expand internationally to overcome deficiencies by accessing technology, R&D, management skills and brands as well as to extend business potentials and seek new markets.

7.3.3 IBM/Fudan University

The survey conducted by IBM/Fudan University, similar to the one conducted by APFC/CCPIT, also used a ranking from 1-5 to determine the importance of characteristics with 1 meaning “not important” to 5 which means “very important.” The three most important motivations for Mainland Chinese companies to expand abroad are (Beebe et al. 5):

- Seeking new markets for growth - 4.5
- Acquire advanced technology and management skills - 3.8
- Intense competition in the domestic market - 3.4

Additionally, “Chinese companies consider brand ownership critical to their success overseas, but they may not fully appreciate the sustained investment required for brand building and management.” (Beebe et al.7) The study asserts that there is no “right” market entry strategy for Mainland Chinese companies expanding internationally. The study suggests that OEM should gradually build up their internationalization by keeping and enhancing their relationships with Western companies. Mainland Chinese businesses that already have limited global experience should expand to developing countries first and then move on to more advanced markets in the U.S. and Europe. In regard to M&A, Beebe et al. state that “we believe manufacturers pursuing M&A strategies will likely focus on Europe and the U.S., where acquisitions can provide access to brands, management talent, R&D capabilities, distribution and sales channels that would likely take decades to develop organically.” (11)

7.4 Synthesis of Surveys and Studies

Putting together the different findings from each survey with the key results from the author's survey complements the author's findings and creates a coherent picture of the internationalization of Mainland Chinese businesses. First, as confirmed by the studies of APFC/CCIPT, IBM, FIAS and the author, Mainland Chinese businesses expand internationally to seek new markets for growth and extend the potentials of their businesses. One could expect this result since, first, the competition on the domestic market has become intense, and expanding internationally gives the Mainland Chinese businesses new revenue and profit potentials. Eventually, international experience gained makes Mainland Chinese businesses more competitive which they ultimately need to become in order to survive in the global economy.

Second, Mainland Chinese businesses expand abroad to access and acquire strategic assets, i.e. brands, technology, R&D, management skills and distribution channels, to fill resource gaps. Hence, the M&A of a local company offers a fast and convenient way to achieve this goal. Consequently, the quest for skills and assets to overcome competitive disadvantages can be seen within the context of implementing a global competitive strategy as identified in the FIAS-survey.

Third, according to the survey by APFC/CCIPT, overseas Mainland Chinese ventures are over 90 percent predominantly owned by Mainland Chinese, i.e. even when Chinese expand abroad and cooperate in JVs or other modes of collaboration, they strive to own the majority of the enterprise. As has been discussed, trade companies, sales and representative offices are, in fact, WOS in the context of controlling a venture. Consequently, the result of the APFC/CCIPT survey underlines the findings of H1 that Mainland Chinese businesses expand through market entry modes which give them control of the enterprise/venture. Mainland Chinese businesses choose these modes due to a cultural preference for market entry modes with a high degree of control.

Fourth, Mainland Chinese businesses probably employ trade companies, sales and representative offices (which require only a small investment to be set up) as a first step toward the Mainland Chinese companies' integration into the local community and (ethnic Chinese) networks as has been illustrated by the results for

Hypothesis 2. The external studies described and analyzed above were successfully conducted because the respective institutions were able to draw on their own *guanxi* as opposed to the author's study which lacked significant *guanxi* to conduct a scientifically creditable study. Thus, it is important to appreciate the importance of *guanxi* when dealing with Chinese as well as *guanxi* as a lubricant for Mainland Chinese businesses expanding abroad.

Fifth, Mainland Chinese businesses are aware of the challenges posed by differing cultures when expanding internationally. The author's study found that Mainland Chinese businesses in Germany are aware of the problems and challenges posed by differing cultures and address these difficulties by, e.g. tailoring their marketing for the German market. The Mainland Chinese companies' awareness of problems, challenges and difficulties of sometimes conflicting cultural differences is confirmed by the result of the FIAS study which points out that Mainland Chinese companies identify culture as one of the most pressing challenges in their internationalization drive.

7.5 Comparison and Integration with Literature

The results of this dissertation are compared to existing literature, i.e. to research conducted and published by Child and Rodrigues in order to verify the validity of the dissertation's results. Child and Rodrigues analyzed the internationalization patterns of Mainland Chinese businesses by drawing on existing literature and using case studies, an approach similar to the one chosen by the author. Similar to the author, Child and Rodrigues found that existing literature is inadequate to fully appreciate and explain the internationalization of Mainland Chinese businesses. According to Child and Rodrigues, "the question arises whether the internationalization of Chinese firms can be explained in terms of mainstream theory derived largely from western multinational corporations," or rather "raises the possibility that an examination of Chinese internationalization may indicate the need for some extension of existing theorizing."(382)

Child and Rodrigues especially criticize that “the predominant assumption in mainstream theory has been that internationalization is motivated by a firm’s wish to exploit its existing ownership advantages. The conventional view therefore focuses on the overseas possibilities for asset exploitation.” (384) Child and Rodrigues offer the theoretical framework of the latecomer perspective which focuses on the internationalization of companies in order to address competitive disadvantages. According to literature, latecomers, whether nations or companies, have to ‘catch up’ with developed/superior peers in terms of technology and know-how. These latecomers start from a position of relative weakness, and outward FDI is targeted at “closing the gap that separates them from leading companies through acquiring appropriate assets and resources.” (Child and Rodrigues 384)

Child and Rodrigues state that “while such firms [latecomers] had some initial competitive advantages, such as low labor costs, these became less crucial as the firms moved into more sophisticated markets with higher value products.” (384) Companies need certain skills and assets to be able to compete in sophisticated markets, e.g. to differentiate their own product from those of competitors. Arguably, technological leadership, strong brands and superior management skills construe competitive advantages that help companies to differentiate themselves and their products in sophisticated markets. As has been discussed in Chapter 5.3 and 7.3, Mainland Chinese businesses are looking to acquire exactly these skills in their internationalization drive. As Child and Rodrigues observe (389):

> The strengthening of differentiation and/or brand advantage features an important driver for the outward FDI being made by leading Chinese firms. Often they are going abroad to acquire advanced technology, R&D capabilities, which provide the means to develop a differentiation advantage. Some are acquiring or developing global brands as the basis for securing a brand advantage.

In conclusion, the internationalization of Mainland Chinese businesses conforms more to the concept of the latecomer perspective “than to analyses derived from the exploitation of firm-specific advantages by already strong companies.” (403) As discussed in Chapter 5.3 and 7.2, and confirmed by Child and Rodrigues, a number of factors lead to the quest for international markets by Mainland Chinese businesses, chiefly among them the tough competition on the domestic market, the exporting of cost advantages and the complementation of cost advantages with differentiation through internationalization as a means to create and tap into business potentials (399).

This dissertation found that Mainland Chinese businesses prefer to enter a new market through modes that give them as much control as possible on the venture, i.e. through M&A and WOS. Child and Rodrigues confirm this finding by stating that “the apparent preference of Chinese firms when investing abroad to pursue this through acquisitions and organic growth rather than through JVs with non-Chinese MNCs suggests that they may prefer to retain their distinctive administrative heritage.” (407) One can, thus, expect Mainland Chinese business expansion to persist in relying heavily on WOS and M&A as a means for their internationalization drive towards global presence and business operations.

One of the key aspects of the author’s study was the role of networks or *guanxi* in the internationalization of Mainland Chinese businesses. One cannot extract a clear confirmation of the use and importance of *guanxi* for the market entrance of Mainland Chinese businesses, but based on circumstantial evidence, it was concluded that Mainland Chinese businesses use *guanxi* for the internationalization of their businesses. The work by Child and Rodrigues is able to complement and partly confirm the findings of the author.

First, a much larger focus of Mainland Chinese *guanxi* is directed at firm-government/state relations. The institutional support includes regulatory and financial backing as well as access to governmental research. While government support is common in most countries, its prominence in China is probably unique (Child and Rodrigues 399, 406). Second, “the extent to which they [Mainland Chinese businesses] tap overseas Chinese communities in developed countries such as the USA needs to be clarified. While not denying the potential strategic value of ethnic networks, some of the foreign investment projects being undertaken […] relied on advice and expert backing from non-Chinese sources.” (406) Similar to the author, Child and Rodrigues are also not able to give a definite answer to importance of (overseas) Chinese networks, but point to the importance of non-Chinese networks for the Mainland Chinese businesses internationalization as illustrated in the analysis of the case studies discussed in Chapter 7.2. Thus, the question whether Mainland Chinese businesses use (ethnic Chinese) networks for their internationalization calls for further research.

Since the work by Child and Rodrigues does not focus on the significance of culture for the internationalization of Mainland Chinese businesses, only a passing reference to the problems posed by differing cultures can be found in that work. The question of the liability of foreignness (=cultural differences) is raised but is focused more on the significance of overseas Chinese networks for the international expansion of Mainland Chinese businesses. However, Child and Rodrigues raise two cultural issues. First, operating globally poses a major challenge in regard to the differences in managerial culture and style between Chinese and locals; especially for the management of overseas affiliates. Second, the liability of foreignness may jeopardize the effectiveness of purchased tangible assets, e.g. brands, technology (Child and Rodrigues 385, 393). Finally, Child and Rodrigues raise the question whether Mainland Chinese businesses “adapt successfully to different modes of managing and transacting that are suited to the environments in which they expand?” (406). This question cannot be completely answered by this dissertation; nonetheless, the author’s study has shown that there are signs that Mainland Chinese businesses are beginning to understand and attempt to tackle the challenges and problems posed by operating in a foreign environment.

Although the number of samples in the author’s study was restricted, conclusions drawn from the case studies were confirmed and complemented by current literature. The international expansion of Mainland Chinese businesses is driven by the twofold quest for assets and resources and control over the ventures; WOS and M&A are seen as appropriate means to achieve these goals. Alongside, further research in regard to, first, the utilization and importance of Chinese networks and, second, to the latecomer perspective and consequences for business management theory is needed. Internationalization patterns of Mainland Chinese businesses are just beginning to emerge, but are yet not significantly pronounced since the rise of Mainland Chinese businesses on the global stage is just starting. Mainland Chinese businesses are not yet as competitive as to be able to dominate global markets in any industry. However, since the international expansion of Mainland Chinese businesses is still in its infancy, future development and internationalization of Mainland Chinese businesses should be watched closely.

8 Outlook

Although the internationalization of Mainland Chinese businesses has been widely ignored by researchers so far, there are encouraging signs that more and more researchers are paying attention to the changes taking place. Indeed, the growing presence and significance of Mainland Chinese businesses on the global stage calls for an integrated and comprehensive analysis of their actions and possible contributions to internationalization theory.

Of special interest in this regard is the organizational model of Mainland Chinese business. While ethnic Chinese businesses employ networks in their internationalization drive, this cannot be confirmed (beyond doubt) for Mainland Chinese businesses. The unique economic, social and cultural development of Mainland China in the past 50 years seems to have led to a partially different organization model in Mainland Chinese companies compared to the one by Overseas Chinese. Research directed at determining to which effect networks do influence Mainland Chinese business internationalization and management practices should give insights to possible organizational structures and transaction methods that might prove invaluable to companies doing business in the interwoven global economy of the 21st century. The same also holds true for further examination and contribution to research of the latecomer perspective in international business theory. As more and more developing countries strive to emerge on the global business stage and catch-up with (Western) developed countries/companies, new insights for internationalization theory and MNEs (from developing countries) can be expected.

The importance of culture as a variable in international business has been widely accepted only recently. While studies of cultural differences and challenges have become really prominent for the first time through Hofstede’s publications, accepting the validity of Hofstede’s results, predictions and consequences of culture in international business has taken more time. These days, culture as a variable in the international expansion of businesses, negotiations and dealings is recognized; and appropriate steps are taken by companies themselves to prepare for possible cultural conflicts. While this is mostly true for Western MNEs, little evidence has so far been found for the willingness of Eastern companies, especially Chinese ones, to tackle cultural issues. The author's study in this dissertation has shown that Mainland Chinese companies are aware of cultural challenges when entering the German market. Therefore, on the one hand, one can expect that future expansion of Mainland Chinese businesses might take into account cultural challenges. On the other hand, the inexperience of Mainland Chinese managers and the relatively strong focus on costs by Chinese businesses is probably going to lead to the negligence of culture in many instances of international business. Thus, Mainland Chinese businesses can be expected to make the same mistakes of cultural adaptation in international business as Western companies did in the past.

More and more Mainland Chinese companies step on the global stage and enter foreign markets. Still, so far none of these companies has come to dominate its industry. Mainland Chinese companies lack significant skills, capabilities and operating knowledge which impedes their success in international business. While Mainland Chinese businesses might neither be globally competitive or dominant in the near future, it is more than probable that these companies will achieve their goals in due time.

The accelerating internationalization of Mainland Chinese businesses has significance and impact going further than business theory since the repercussions of internationally active Chinese businesses in the global economy can already be felt beyond mere international trade today. Chinese SOEs are on a buying spree around the world, especially in Southeast Asia and Africa to purchase natural resources desperately needed to secure energy output and, thus, future growth of the Chinese economy. While today most countries see the USA as the sole and predominant superpower on the global stage, the rise of China may change this perception in the coming years. The rise of the Chinese economy and, thus, of a vast country with over 1.3 billion potential customers, with a tradition of innovation and hard work, could lead to a significant power shift in politics and economics worldwide. A country with a potential consumer base of over 1 billion people, with a people, is probably going to play a dominant role in global business. But the impact of a rising China will not only be felt in countries abroad, but also in Germany.

This dissertation has described the various challenges Germany and German companies, especially the *Mittelstand* face. Already, Mainland Chinese businesses have purchased several German SMEs in the quest for brands, technology and skills. Yet, the acquisition of German SMEs by Mainland Chinese businesses is far from over. While in the past Mainland Chinese businesses competed mostly by producing and supplying cheap products to Western companies and are now entering markets by selling similar products at comparatively low prices, these Mainland Chinese businesses have realized the need to move their business and products upwards on the value chain. Since most Mainland Chinese companies, first, lack the necessary know-how and skills to be able to do so organically and, second, face a serious shortage of educated Chinese managers who could, for example, develop and implement brands, processes, management technique, most Mainland Chinese companies will have to grow through M&A to, third, expand quickly.

All over the world German companies from a wide range of industries are respected for their expertise, skills and high-quality products. The same German companies have problems finding successors for their enterprise, have a low equity capital base and are at risk from weak domestic demand and high labor costs. Mainland Chinese businesses may in some cases be the only chance these German SMEs have to survive.

The ramifications of German SMEs being bought by Mainland Chinese businesses are manifold. If Mainland Chinese businesses buy German companies and shift production to China, what happens to the manufacturing jobs in Germany? If Germany loses its technological edge and leadership because it “sold out” to China, how will Germany compensate this loss? How will Germany deal with China becoming the biggest exporter (by some estimates in 2010), and later, largest economy on earth? Since Germany has only few natural resources and the German economy mostly thrives on the export of products and adjacent services for sophisticated products, how will Germany secure economic growth and, thus, jobs and social stability in the future? That is why Wolfgang Nowak, a former advisor to erstwhile chancellor Gerhard Schröder, remarked that “the biggest challenge for us [Germans] is not Hartz IV, Hartz V oder Hartz XVIII, but that millions of people in

China are successful and that millions will join them. What happens in China is part of German domestic politics."[32] (Seibel and Blome 4)

The analysis of the international expansion of Mainland Chinese businesses has shown that, first, Mainland Chinese businesses have not yet emerged as dominant player on the global stage, but that they are probably on their way. Second, it can be deduced that developed countries which possess high-technology industries, rely on intellectual property-intensive industries and are export-dependent, should pay heed to future Mainland Chinese expansion and take a close look at possible consequences for their own economies and enterprises. Nonetheless, this advice actually applies to nearly all economies and enterprises since nowadays everything and everybody seems to be intertwined in the global economy in some way. While the rise of Mainland China on the global stage is widely perceived as a threat, the Chinese symbol for crisis is also the same as for chance. This is probably why paying attention to the internationalization of Mainland Chinese businesses becomes indispensable to any business wanting to successfully prevail in the 21st century.

[32] „Die große Herausforderung für uns ist nicht Hartz IV, Hartz V oder Hartz XVIII, sondern das Millionen Menschen in China erfolgreich sind und Millionen neue noch kommen werden. Was in China geschieht ist Teil der deutschen Innenpolitik." (Own Translation)

Appendix

Questionnaire

1) *What is the name of your Company?*

____

2) *Where is your German business operation located?*

____

3) *Where is your Chinese parent business (headquarters) located?*

____

4) *Which of these choices best describes your Chinese company?*

☐ state-owned ☐ a private business ☐ a collective enterprise

☐ has mixed ownership ☐ is a joint stock enterprise – majority-held by Overseas Chinese

If your business is a private one, please continue with question 5.If your business is <u>*not*</u> *a private one, please continue with question 8.*

5) *If your business is a private one, is it family-owned?*

☐ yes ☐ no

6) *If your business is family-owned, is the family head also the head of the business?*

☐ yes ☐ no

7) *If your business is family-owned, are family members managing the business in key positions?*

☐ yes ☐ no

8) *Who makes operational decisions in the business?*

☐ company head ☐ the top management

☐ each group head ☐ each individual employee ☐ N/A

9) *Who makes strategic decisions in the enterprise?*

☐ company head ☐ the top management

☐ each group head ☐ each individual employee ☐ N/A

10) *How long have you been active on the German market (in years)?* _________

11) *How many workers does your German operation employ?*

☐ <below 5 ☐ 5-10 ☐ 10-20 ☐ 20-50 ☐ 50-100

☐ 100-250 ☐ 250-500 ☐ over 500 ☐ N/A

12) *How many employees does your parent operation in China have?*

☐ <below 5 ☐ 5-10 ☐ 10-20 ☐ 20-50 ☐ 50-100

☐ 100-250 ☐ 250-500 ☐ over 500 ☐ N/A

13) *What is the approximate yearly sales revenue of your German operation (in Euro):*

☐ < 100,000 . ☐ 100-500,000. ☐ 500,000-5 Mio. ☐ 5-10 Mio.

☐ > 10 Mio. ☐ N/A

14) *What is the relative proportion the revenue generated in Germany contributed to the revenue your Mainland Chinese business achieved (in percent)?*

approx. _________ percent ☐ N/A

15) Your German operation is resident in the product sector/branch:

☐ mechanical engineering/ plant construction

☐ electronics/ electrical engineering

☐ energy

☐ construction

☐ automobile/ -supplier

☐ chemicals/ pharmaceutics

☐ Culture & Arts

☐ tourism/wellness

☐ natural resources

☐ industrial goods

☐ food

☐ real estate

☐ consumer electronics

☐ consumer goods

☐ information technology

☐ wholesale/retail

☐ advertising/media

☐ transportation

☐ medicine/healthcare

☐ biotechnology

☐ telecommunication services

☐ shipping products & services

☐ finance/banking/investment

☐ Other ____________________

16) What are generally your motives for going abroad and internationalize your business? Please rate the following factors according to their relevance:

	not at all	to a minor extent	to a moderate extent	to a great extent	to a very great extent
• Increase revenue potentials	☐	☐	☐	☐	☐
• Acquire brands to extent reach to potential customers	☐	☐	☐	☐	☐
• Access to up-to-date technology	☐	☐	☐	☐	☐
• Open up new markets	☐	☐	☐	☐	☐
• Establish distribution networks	☐	☐	☐	☐	☐
• Learn from competitors	☐	☐	☐	☐	☐
• Acquire and enhance management and marketing skills necessary for competing with multinational enterprises on the global market	☐	☐	☐	☐	☐
• Become a global player	☐	☐	☐	☐	☐
• Diversify the business	☐	☐	☐	☐	☐

17) To which extent did/do the following factors influence your decision to choose the German market as a target market?

	not at all	to a minor extent	to a moderate extent	to a great extent	to a very great extent
• Technology expertise of German businesses	☐	☐	☐	☐	☐
• German brands and reputations (“Made in Germany”)	☐	☐	☐	☐	☐
• Geographic location	☐	☐	☐	☐	☐
• Education/Qualification of German personnel	☐	☐	☐	☐	☐
• Establishing a market presence in Germany	☐	☐	☐	☐	☐
• Infrastructure in Germany	☐	☐	☐	☐	☐
• Germany’s private consumer market	☐	☐	☐	☐	☐
• Germany’s industrial market	☐	☐	☐	☐	☐

18) Please rate the following factors of Germany:

	Very unsatisfactory	unsatisfactory	satisfactory	good	Very good
• Legal issues, for example, setting up an enterprise	☐	☐	☐	☐	☐
• Education/Qualification of employees	☐	☐	☐	☐	☐
• Technological leadership	☐	☐	☐	☐	☐
• Telecommunication infrastructure	☐	☐	☐	☐	☐
• Transportation Infrastructure	☐	☐	☐	☐	☐
• Geographical location	☐	☐	☐	☐	☐
• Quality of products	☐	☐	☐	☐	☐
• Work ethos	☐	☐	☐	☐	☐
• Wage rates	☐	☐	☐	☐	☐
• Unions	☐	☐	☐	☐	☐

19) How do you gain knowledge about the German market?

☐ Previous M&A of a German business

☐ Market studies/reports

☐ Ethnic Chinese friends/colleagues/associates who live in Germany

☐ German Chamber or trade associations

☐ Agents

☐ Trade fairs

☐ Personal visit

☐ Previous activities (for example export)

☐ Internet

☐ Länder representative office

☐ Trade fairs

☐ Consultants

☐ Other___________________

20) Which one of the given market entry mode did/do you choose for the German market?

☐ Wholly-owned Subsidiary ☐ Joint Venture

☐ Trading Company ☐ Mergers & Acquisitions (M&A)

☐ Other________________________________

Please continue the questionnaire according to the chosen market entry mode and disregard the questions pertaining <u>not</u> to your chosen mode:

21. → M&A
22. → Joint Venture
23. → Wholly-owned Subsidiary
24. → Trading Company

21) Which factors are important regarding your market entrance strategy through the merger with or acquisition of a German small- and medium-sized enterprise (SME)?

	not at all	To a minor extent	to a moderate extent	to a great extent	to a very great extent
• The structural and managerial similarity of the German M&A target with a Chinese company	☐	☐	☐	☐	☐
• The German M&A targets are available at comparably low prices	☐	☐	☐	☐	☐
• The M&A brings access to the resources (distribution channel, brands, human resources, etc.) of a German business	☐	☐	☐	☐	☐
• The M&A assures a fast and easy market entrance	☐	☐	☐	☐	☐
• The M&A gave us local market knowledge, connections and business relationships	☐	☐	☐	☐	☐
• The M&A allows us to exert control over technological and managerial issues	☐	☐	☐	☐	☐

22) Which factors are/were important regarding your market entrance strategy by JV?

	not at all	to a minor extent	to a moderate extent	to a great extent	to a very great extent
• To select suitable German partner(s) with extensive ties in the business environment	☐	☐	☐	☐	☐
• To gain access to the resources (distribution channel, brands, human resources, etc.) of a German business	☐	☐	☐	☐	☐
• JV-partner has technological leadership in his business field	☐	☐	☐	☐	☐
• To learn and adapt to the German way of doing business	☐	☐	☐	☐	☐
• To learn from German partner about the German market	☐	☐	☐	☐	☐
• To gain access to German market	☐	☐	☐	☐	☐

23) Please evaluate the importance of the following factors contributing to the choice of wholly-owned subsidiary for the German market:

	not at all	To a minor extent	to a moderate extent	to a great extent	to a very great extent
• The choice of a suitable legal enterprise form	☐	☐	☐	☐	☐
• The fast and easy access to the German market	☐	☐	☐	☐	☐
• The level of managerial control over local subsidiary/branch	☐	☐	☐	☐	☐
• The level of technological control	☐	☐	☐	☐	☐
• The use of local ethnic Chinese contacts	☐	☐	☐	☐	☐

24) Please evaluate the importance of the following factors contributing to the choice of a Trading Company for the German market:

	not at all	To a minor extent	to a moderate extent	to a great extent	to a very great extent
• The choice of a suitable legal enterprise form	☐	☐	☐	☐	☐
• The fast and easy access to the German market	☐	☐	☐	☐	☐
• Learn about the German market	☐	☐	☐	☐	☐
• Establish a company base in Germany	☐	☐	☐	☐	☐
• The use of local ethnic Chinese contacts	☐	☐	☐	☐	☐
• Establish a network of contacts with distributors, customers, etc.	☐	☐	☐	☐	☐

25) Please evaluate the success-probability of these market entry modes in the German market:

	Very bad	bad	moderate	Rather good	Very good
• Wholly-owned Subsidiary (branch/subsidiary)	☐	☐	☐	☐	☐
• Joint Venture	☐	☐	☐	☐	☐
• M&A	☐	☐	☐	☐	☐
• Trading Company	☐	☐	☐	☐	☐

26) How satisfied are you with your chosen market entry mode?

☐ very satisfied ☐ satisfied ☐ less satisfied

☐ not satisfied ☐ N/A

27) Please rate the overall success of your market entry mode:

☐ very successful ☐ successful ☐ less successful

☐ not successful ☐ N/A

28) *What are the most common market entry errors in your opinion? (You can select more than one statement)*

☐ Insufficient market analysis

☐ Insufficient understanding of German culture

☐ Insufficient preparation for conflicts with German employees and business partners

☐ Insufficient knowledge of German customer demands

☐ Insufficient knowledge of operating costs in Germany

☐ Other: ____

29) *Do your employees or business partners in Germany speak Chinese?*

☐ Yes ☐ No ☐ N/A

30) *Does the Chinese management, responsible for the operation in Germany, speak German?*

☐ Yes ☐ No ☐ N/A

31) *Do you offer intercultural training courses for Chinese employees working in/with Germany?*

☐ Yes ☐ No ☐ N/A

32) *Do you already have a website in German?*

☐ yes ☐ no ☐ N/A

If No, please go to question 33; otherwise please continue with question 34.

33) *Do you plan to have a website in German?*

☐ yes ☐ no ☐ N/A

34) Are you planning to introduce Chinese-branded products to the German market?

☐ Yes ☐ No ☐ N/A

35) If you would or are planning to introduce Chinese-branded products to the German market, do you think an adaptation of the product is necessary?

☐ Yes ☐ No ☐ N/A

36) For the German market, our company:

	We don't	We intend to	We do	
Adapts the entire communication package	☐	☐	☐	☐ N/A
Adapts the marketing concept	☐	☐	☐	☐ N/A
Adapts the advertising strategy	☐	☐	☐	☐ N/A
Creates a customized German ad campaign	☐	☐	☐	☐ N/A
Adapts the product to conform to the ecological standards	☐	☐	☐	☐ N/A
Adapts the product to conform to environmental regulations	☐	☐	☐	☐ N/A
Adapts the product to conform to ecological awareness	☐	☐	☐	☐ N/A
Adapts the product to conform to the legal rules and regulations	☐	☐	☐	☐ N/A
Adapts our services to German standards	☐	☐	☐	☐ N/A

37) Do you agree with the following statements?

	not at all	to a minor degree	to a moderate extent	to a great extent	to a very great extent
• Employees should not question the authority and integrity of their managers	☐	☐	☐	☐	☐
• Each manager is responsible for his/her team and employees	☐	☐	☐	☐	☐
• A manager is a person every employee looks to for guidance	☐	☐	☐	☐	☐
• The company head knows best how to lead the company and one should not disagree with him	☐	☐	☐	☐	☐
• Each person has its place in the company and has to know its obligations towards others	☐	☐	☐	☐	☐

38) To which degree:

	not at all	to a minor degree	to a moderate extent	to a great extent	to a very great extent
• Do you think are Chinese and Germans are able to work together without problems?	☐	☐	☐	☐	☐
• Do you adapt your products and services to the German market and environment?	☐	☐	☐	☐	☐
• Do you expect problems when dealing with Germans?	☐	☐	☐	☐	☐
• Do you think is one's culture relevant when doing business with people from other cultures?	☐	☐	☐	☐	☐
• Do you expect Germans to be able to deal with cultural differences between Chinese and Germans in everyday situations?	☐	☐	☐	☐	☐

39) *Do you personally know other ethnic Chinese individuals or organizations in Germany?*

☐ Yes ☐ No ☐ N/A

40) *Do you seek guidance and advice regarding business matters from other ethnic Chinese individuals or organizations in Germany?*

☐ Yes ☐ No ☐ N/A

41) *Do you think using contacts with other ethnic Chinese is useful for the internationalization of your business?*

☐ Yes ☐ No ☐ N/A

42) *In your opinion, are personal connections and relationships with other ethnic Chinese useful for entering the German market?*

☐ Yes ☐ No ☐ N/A

43) *Did/do you use personal contacts or relationships with ethnic Chinese individuals and organizations for expansion to Germany?*

☐ Yes ☐ No ☐ N/A

If you answered "Yes", please proceed to question 44, otherwise you are finished with the questionnaire.

44) *To which extent do connections or relationships to Germany-based Chinese play a role regarding the following factors?*

	not at all	to a minor degree	to a moderate extent	to a great extent	to a very great extent
• Analysis of the German market	☐	☐	☐	☐	☐
• Gathering of information about the German market	☐	☐	☐	☐	☐
• Strategic planning of the market entrance in Germany	☐	☐	☐	☐	☐
• Preparation for market entrance in Germany	☐	☐	☐	☐	☐
• Financing of German operation	☐	☐	☐	☐	☐
• Choice of market entry mode	☐	☐	☐	☐	☐
• Successful market entrance in Germany	☐	☐	☐	☐	☐

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