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Exploring the link between policy regulation and entry model selection: The case of the automotive industry in China.

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Chapter 1: Introduction

China has become one of the most popular foreign direct investment (FDI) destinations since 1980s, and its automotive industry always an attractive playing field for the global automakers. As there was a gap in the passenger car market in before the 1980s, all the domestic manufacturers mainly at that time only produced trucks and buses for transportation, tractors for agriculture, and jeeps for military. Thus, the entry seems very necessary to supply this gap in the market; the early entry will help them to win the first move advantage. For European and U.S. automakers, the entry into China has become part of their global strategy. They strive to build up a business base in the Far East that will limit the dominance of Japanese firms.

From a global strategy point of view, the step of entry into China seems very necessary; however, China's unstable institutional environment and different kinds of regulation limit the speed of entry. What the Chinese government wants to achieve through publishing the regulations to foreign funds, is to foster its own automotive industry and is not interested in turning China into an expansion base for European, American and Japanese auto industries. Simply, the government does not want to lose the control on this pillar industry while it opens to the world. Till the mid-1990s, the auto industry was still highly protected in China; high tariff and non-tariff trade barriers, screening, foreign equity limits and local content requirements are several common obstacles to the entry of foreigners.

In the past, many researchers have studied the policies in China's automotive industry, but most of them mainly focus on two questions:

how does the protection environment in the auto industry affect the utility of domestic consumer by limiting their access to the cheaper import car?; and, how does the protected environment limit the development of the industry? Most of articles argued that the policy environment in China provides too much protection and is not good for the growth of domestic manufacturers. However, there are few studies focused on the foreign perspective; this paper would change the angle from the domestic side to foreign side. This paper looks to explore the link between policy regulations and entry model selection. In order to analyse this link, two famous joint ventures in the China automotive industry has been selected for study, the Shanghai Volkswagen and Guangzhou Peugeot. In the case, three dimensions about the entry strategy of these two companies will be analyzed. Finally, this paper is going to answer the question of whether the regulation is the main factor affect foreigners' entry model selection and whether the limited availability of the entry model would be the important factor that affects the performance of joint ventures.

In this paper, there are four main sections: Literature review, Methodology, Research analysis, and Conclusion. In the literature review section (Chapter 2), all the related theories and models about the entry model selection and entry strategies will be presented. The methodology (Chapter 3) will explain the research method of this research applied, the way to access the data, and the limitation of this research as well. Research analysis is a large section. All economic factors and regulations related to how foreign funds get in China's automotive industry will be analyzed in Chapter 4. The case studies of Shanghai Volkswagen and Guangzhou Peugeot will be shown in Chapter 5 and Chapter 6 respectively; the three dimensions of entry strategy of each joint venture: partner selection, control over alliance, and conflict management will be fully analyzed here. Finally, this paper is going to present some implications through the comparison of Shanghai Volkswagen and Guangzhou Peugeot cases, and end with a conclusion: Regulation and Policy, in some degree, limit the number of available entry model choices to the foreigner, but any limitation on the entry model selection should not fully be responsible to the performance of the foreign funds in this industry. By implementing and designing a 'right' entry strategy based on the assumption of limit entry model choice, the foreign funds can still perform very well.

Part Ⅰ

Chapter 2 Literature Review

There are two main parts in this chapter, the first part (section 2.1) will have a discussion about what and how factors take into account when making the choice about entry mode selection. The attractiveness of the locational factor make foreign companies like to enter China, however, the limitation by regulation make Joint Venture become the most popular mode of entry. Thus, the second part of the literature review (section 2.2) will mainly focus on three dimensions of the entry strategy of forming Joint Ventures: Partner selection (section 2.2.1), Control over alliance (2.2.2), and conflict management (section 2.2.3).

2.1 Entry mode selection

"A mode of entry is an institutional arrangement chosen by the firm to operate in the foreign market. This decision is one of the most critical strategic decisions for the firm. It affects all the future decisions and operations of the firm in that country market. Since each mode of entry entails a concomitant level of resource commitment, it is difficult to change from one entry mode to another without considerable loss of time and money" (V. Kumar & Velavan Subramanian, 1997, p. 53)

2.1.1 Dunning's eclectic OLI framework

John Dunning's (1988, 1993) eclectic OLI framework of foreign direct investment as applied to entry mode choice suggests that firms will select their entry mode structure by considering three sets of variables: Ownership advantages, Location advantages, and Internalization advantages. In the light of the research on determinants of entry mode selection, scholars tend to agree on these three basic categories of factors that a transnational corporation (TNC) should take into account in selecting an entry mode, but there is an alternative theory also examines the economic rationale of entry mode selection, it is Williamson's (1975) transaction cost theory. Transaction cost mode state that by choosing the lowest cost mode of operation, firms can maximize their performance, however, it is reasonable to argue that OLI paradigm is superior to transaction cost mode, Andersen (1997) suggests that transaction cost theory applied to entry mode selection has typically needed to be modified to include non-transaction cost benefits, and Tse et al. (1997) state that transaction cost theory stresses firm-specific variables, but ignores the impact of locational differences.

Dunning's eclectic framework improves the transaction cost approach by including ownership-specific, location-specific as well as transaction variables (internalization) in the entry mode decision (Anderson, 1997). The first factor include in OLI framework is ownership (O). It is argued that TNCs possess proprietary assets that enable them to compete with both companies in the home market and companies in the overseas market, and that the choice of entry modes depends on the nature of the proprietary assets that TNCs possess, ownership advantages are concerned with the control issue, the costs and benefits (risk) of inter-firm relationships and transactions. The second is related to location (L). It is proposed that countries have specific location characteristics and TNCs should choose their entry modes on the basis of the location characteristics of the country it wants to enter, location advantages are concerned with resource commitment issue, the availability and cost of resources. The third is related to internalization (I). It is suggested that different amounts of transaction costs, and TNCs should choose their entry modes on the basis of the transaction costs involved.

Empirical research and studies to OLI

Several studies have empirically examined Dunning's OLI factors and mode selection. Brouthers et al. (1996) examined the impact of ownership and location variables on entry mode selection in the U.S. computer software industry. They found that as ownership and location advantages increased, firms tended to utilize more integrated (wholly owned) modes of entry, supporting Dunning's framework. Tse et al. (1997) examined the impact of ownership, location and internalization factors on mode selection within China. They also found that, as OLI advantages increased, firms tended to utilize more wholly owned modes of entry, again supporting Dunning's framework. Further, Tatoglu and Glaister (1998) examined Dunnning's ownership, location and internalization factors for firms investing in Turkey. Their study was limited to wholly owned and joint venture operations. They also found support for Dunning's OLI framework to explain mode choice

Therefore, it is reasonable to believe that OLI model is the best model applied for making entry modes choice both on theoretical and empirical level.

2.1.2 Approaches to addressing how to take OLI factors into account

After discussing the basic categories of factors that TNC should take into account in selecting an entry mode. It's necessary to know there are two broad approaches to how to take these factors into account while making the decisions.

The first is a simultaneous approach, which looks into all entry modes simultaneously as if they are all associated with, and influenced by, a set of factors at the same level in the same time-span. Chu & Anderson (1992), for example, consider entry modes as being associated with such factors as resource commitment, risk exposure and control, and take all entry modes as a continuum, from exporting to wholly owned subsidiaries. The position of each entry mode in the continuum is determined by the degree to which to entry mode is subject to the influence of these factors.

The second approach is a hierarchical approach, which examines market entry modes sequentially as if they are at different levels of a hierarchy. Kumar and Subramaniam (1997) for instance, argue that a natural hierarchy exists among market entry modes. All entry modes can first be classified into equity and non-equity entry modes: equity entry modes include joint ventures, acquisitions and Greenfield investments, while non-equity modes include exporting and contractual agreements. At the next level, the equity modes and non-equity modes can be each further divided into groups of entry modes, and so on. There are different groupings of factors that affect the selection of market entry modes at different levels of hierarchy. Underlying this approach is an assumption that managers consider the choice of entry modes sequentially, and consider only a few of the critical factors at each level of hierarchy.

Theoretically speaking, the two approaches both have strong points and weak points. Practically speaking, however, the simultaneous approach is very demanding in terms of the data needed to gain relevant information and the time consumed to collect the data, because it takes into account all entry modes and all influential factors at the same time. But in the real business world, manager may not have the enough resource and time to collect all the data on all entry modes and all influential factors, and have to make the decision under the constraints. Differently, the hierarchical approach obviously offers managers a convenient framework with which to do so, because it takes into consideration only a few entry modes and a selection of key influential factors at any one time. So in this dissertation, it is mainly concerned with strategy making in the real business world, we therefore use the hierarchical approach as a framework for the analysis of the selection of entry modes in china.

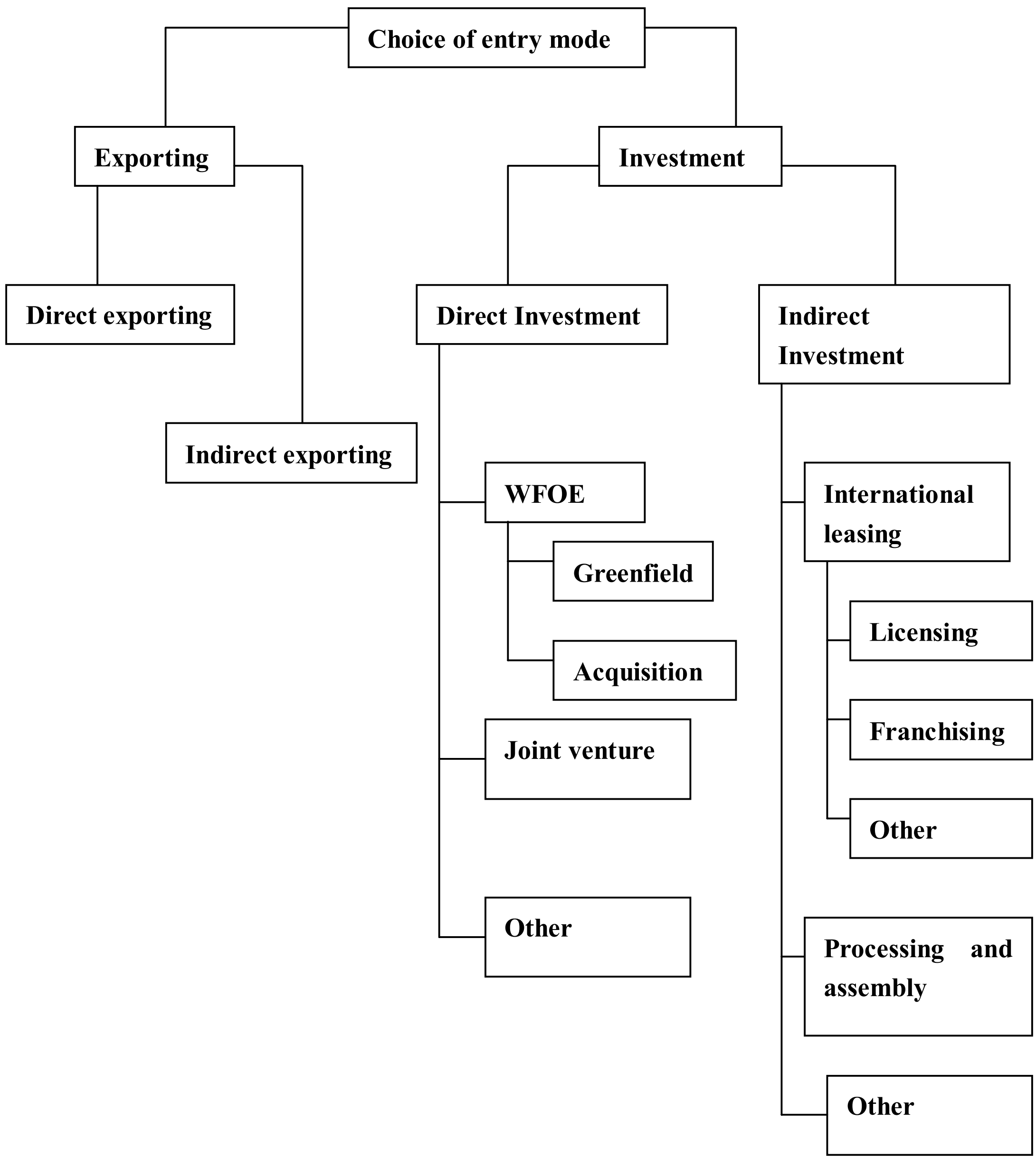


Figure 2-a

Source: Tian, 2007, p.75

Refer to figure 2-a, Tian (2007) proposed hierarchical approach to the classification of entry mode. In the below chapters, the analysis will follow this classification. At the first level of the hierarchy is the division between exporting and investment. The difference between them is that exporting is related to the output, or the product, that is to be sold once and for all, while investment is related to investing in the production process, and is expected to yield a lasting income. At the subsequent levels, however, some explanations are in order. We begin with the division between foreign direct investment and foreign indirect investment. According to United Nations conference on Trade and Development and the Organization for Economic Co-operation and Development (OECD)

"Direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor." (OECD, 2008)

But OECD did not define foreign indirect investment, but acknowledge that the crucial difference between foreign direct investment and foreign indirect investment is that the former involves effective foreign equity ownership of the production facilitates in China while the latter does not, such as franchising and licensing.

In Tian's (2007) new hierarchical model of entry modes, he argued that the crucial difference between foreign direct investment and foreign indirect investment whether the foreign investor directly invests in and owns either all or an effective share of the production facilities in an enterprise operating outside the economy of the investor so as to acquire a lasting interest. The threshold for an effective share is considered to be 25 per cent of the total equity stakes of an enterprise in china, although it is normally considered to be 10 per cent or so in other countries (UNCTAD, 2005). In a sense, therefore, the distinction between direct and indirect investment can be considered as a distinction between equity and non-equity investment. The distinction is critical, because it indicates a fundamentally different degree of resource involvement in the recipient country by the foreign investor. Once a decision has been made to invest in a foreign market, a question that immediately follows is whether to invest in a foreign market, a question that immediately follows is whether to invest in directly and own the production facilities in that country so as to acquire a lasting interest, or whether to make an indirect investment in that country in the form of licensing, franchising, processing, compensation trade or others.

2.1.3 Main considerations for entry mode selection

In the discussion, we use the hierarchical mode illustrate in figure 2-a as an analytical framework. We assume that there are different sets of factors determining entry mode selection at different levels of the hierarchy, and that managers should pay attention to the most relevant factors in their selection of entry modes at any given level of the hierarchy. Following this line of thinking, this part will discuss entry mode selection from high to low level of the hierarchy, mainly focus on 1.Exporting versus Investment, 2.Joint venture versus wholly foreign-owned enterprise, and illustrate the most crucial factors at each level of the hierarchy. In here, Dunning's eclectic model as the main framework of reference and classify all factors into three categories: location, ownership, and transaction cost, therefore, TNCs should take into consideration the most important factors in these categories in relation to the crucial differences between the entry modes under comparison at the same level.

2.1.3.1 Exporting versus Investment:

The key difference between exporting and investment is that the former involves the short-term sale of goods produced outside china while the latter involves long-term investment in facilities that produces goods inside China. In choosing between exporting and investment, TNCs should, fist take into consideration location-specific factors. For example, China, has a large population and plentiful natural resource, hence, build the factor in China can access the resource and reduce the cost of produce, as well as access the largest potential market in the world. For TNCs, if it is cheaper to produce goods in China than in home country, it is in the interest of TNCs to make an investment in China to producing goods there rather than producing goods at home and then exporting them to China. For the TNCs from less developed countries, however, where the labor force is cheaper even than that in China, would find exporting to China more attractive than investing there. Except the factor of resource availability, another location-specific factor is country risk. If a country is considered to be a country with high risk, investing in this country would be less attractive than exporting. For example, less company is willing to invest in Afghanistan or Iraq now, because no one know whether their factories are bombed in one day. The political risk is also important, the easily changing policy during the political battle would influence the corporate strategy a lot.

Transaction cost (Internalization advantage) is another key consideration at this level. Mostly, if a country places costly tariff and non-tariff trade barriers in the way of the products that a TNC produces and exports to this country, i.e. the transaction cost of exporting would be very high, therefore, the TNC would be more willing to invest in this country so as to produce and sell the products there. Alternatively, if the tariff and non-tariff trade barriers are low, the TNC may find it attractive to produce goods at home and export them to this country. So a country's policy may have the ability to affect the decision. China is good example, the high tariff and non-tariff barriers that China maintained in the 1980s and early 1990s played a key role in 'attracting' foreign investment to the country.

Relatively speaking, ownership considerations play a less important role in selecting entry modes at this level than location and transaction cost considerations. Nevertheless, ownership cannot be completely excluded here. If a TNC has very strong core competencies in its marketing network rather than in production, for instance, it may find that exporting is preferable to investment. On the other hand, if a TNC has its core competencies in production as opposed to its marketing network, it may find that investment is a better choice.

2.1.3.2 Joint Venture versus Wholly foreign-owned enterprise (WFOE)

The key difference between joint venture and a wholly foreign-owned enterprise is that the former involves a local partner while the latter does not. In choosing between two entry modes, therefore, it is crucial for TNCs to take transaction cost into consideration first. A local partner in host country normally has local knowledge and local network that may help TNCs reduce transaction cost when they venture into the host country market. On the other hand, conflicts between partners may occur due to the difference of management system, culture…etc. which increases transaction cost. Hence, the TNCs should think carefully about the advantage and disadvantage of the joint venture option in terms of transaction cost. If the transaction cost of establishing and managing a joint venture is greater than establishing and managing a WFOE, it is in interest of a TNC to establish a WFOE to internalize its business activities.

Ownership-specific factors should also be taken into consideration. It is very difficult for a TNC to protect its technology from leaking to a local partner in the setting of a joint venture. If a TNC's core technology is easily be copied by a local partner in a joint venture setting, therefore, it may find more beneficial to establish a WFOE than a joint venture. In China, many local companies have indeed successfully made use of joint ventures to learn about advanced technology and management know how from transnational corporations, such as Haier and TCL, have already managed to establish their own brand names, and begun to compete with their foreign counterparts in international markets. It is, therefore, quite reasonable that TNCs should now have become cautious about technology leaking in the setting of joint ventures.

Moreover, location-specific factors such as country risk should be taken into consideration as well. In a joint venture, a TNC can share the costs and risks with a local Chinese partner. If the risks of investing in China are high, a TNC may find joint ventures preferable to WFOEs. If the risks are low, on the other hand, a TNC may find joint ventures less attractive, as it does not need a local partner to share the risks. The decline of Joint ventures reflects, in a sense, the perception that China is no longer a high-risk country.

2.2 Entry strategy

2.2.1 Partner selection

It is assumed that firms only alliance when the perceived additional benefits of exercising the alliance option outweigh its expected additional costs. One of the key notions in the international joint venture (IJV) is that these additional benefits will accrue only through the retention of a partner who can provide the four 'Cs': Compatible goals, complementary skills, cooperative culture, and commensurate risk (Luo, 2000). Partner selection determines an IJV's mix of skills, knowledge, and resources, its operating policies and procedures, and its vulnerability to indigenous conditions, structures, and institutional changes. In a dynamic, complex, or hostile environment, the importance of local partner selection to IJV success is magnified because the right partner can spur the IJV's adaptability, strategy-environment configuration, and uncertainty reduction.

During the process of IJV formation, foreign parent firms must identify appropriate criteria for local partner selection as well as the relative importance of each criterion. They are divergent depending on firm, setting, and time. Broadly, the criteria can be classified into three categories related to 1. Tasks or operations 2. Partnership or cooperation 3. Cash flow or capital structure. Conceptually, the selection criteria can be classified into strategic, organizational and financial fit three forms, Luo (2000) summarize these in Figure 2-b, such classification is imperative because each group affects a different kind of fit (strategic, organizational, and financial), thus influencing different dimensions of IJV performance.

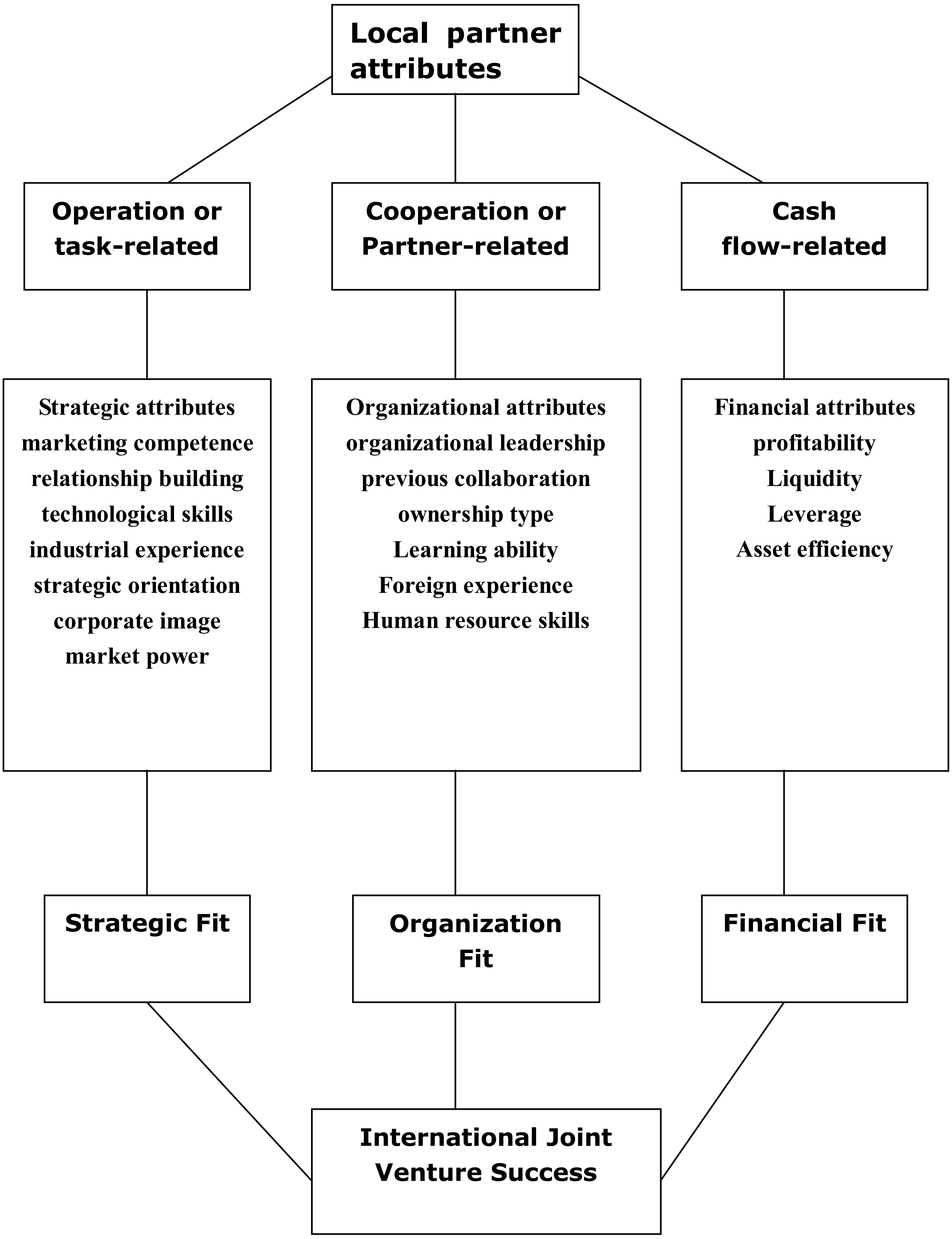


Figure 2-b

Source: Luo, 2000, Partnering with Chinese Firms, p.48

A partner's strategic traits influence the operational skills and resources needed for the joint venture's competitive success, organizational traits affect the efficiency and effectiveness of inter-firm cooperation, and financial traits impact the optimization of capital structure and cash flow. A partner with superior strategic traits, but lacking strong organizational and financial characteristics, results in an unstable joint venture. The possession of desirable organizational attributes without corresponding strategic and financial competence leaves the joint venture unprofitable. A partner with superior financial strengths without strategic and organizational competencies can lead to an unsustainable venture

In the selection process, international managers may use this scheme to examine the strengths and weaknesses of the potential partners and to determine whether partner attributes fit their own in strategic, organizational, and financial arenas. There is one additional point need to mention here, what the partner has like the core competencies, corporate image, and personal network would influence the performance of IJV in the same way as financial factor, thus, there is incentive to modify the financial fit criteria as capacity fit criteria which include financial strength as one factor. (Tian, 2007)

2.2.1.1 Strategic fit

To evaluate the strategic fit, it is necessary for the TNCs to assess the extent to which the strategic objectives of the partners are compatible and complementary. Clearly, a company forms an alliance with another company in order to achieve its strategic objectives, yet, more often than not, partners in an alliance have different strategic objectives, but still want to achieve their respective strategic objectives through the alliance. Thus, in selecting a partner, a company can hardly expect that partner to have exactly the same strategic objectives as itself, but it can hope that the partner's strategic objectives are different from, but compatible with and complementary to, its own.

To know whether the strategic objectives of the partner are compatible and complementary, it is useful to assess the criticality of the alliance to the partners by asking two main questions: 1. how important is the alliance to the partner, and 2. will the partner depend on the alliance in order to achieve its own strategic objectives. Positive answers to these questions demonstrate that the alliance is important for the partner and that the commitment of the partner to the alliance is high, which often indicates a good strategic fit. In selecting a local partner, hence, a TNC need to know whether what it has is really what the partner needs and what his partner has is what he really wants.

2.2.1.2 Capacity fit

To assess the capacity fit, TNCs need to evaluate the extent to which the partners in the alliance will be capable of meeting each other's needs, and capable of helping each other to reach their own targets. Although partners in an alliance may have what each other needs, the alliance may still fail if they do not have the capacity of making use of what they have to meet these needs and help each other achieve their objectives. The capacity is comprehensive and is related to a wide range of areas, only core competencies, corporate image, personal network and financial strength would be discussed in here. In selecting a local partner, its useful to ask whether that partner has the capacity to help them achieve their strategic objectives through the alliance, and asses the capability of the partner in these areas in detail.

Core competencies: It is essential to pay the attention on what the local partner has in key functional areas that will affect the ability of the TNC to achieve its strategic objectives through the alliances. For example whether the partner have the qualified human resources to undertake the kind of work required by the alliance, the capability of finding better local suppliers for the alliance, the capacity to promote the goods and services produced, the information have about the local market.

Corporate image: Attention should be paid on whether the local partner enjoys a good reputation for its products, after-sales service, social responsibilities, etc. As mentioned by Luo (1998), for instance, Panda Electronics Group, the local partner of Philips, was very famous in China for producing high-quality products in electronics and for providing good customer service. The good corporate image of the local partner helped greatly to promote the electronics products that the alliances manufactured in China.

Personal network: A TNC usually weak in the personal network when he firstly entry the country, hence, it is very important for them to select a local partner that has well-established network, not only with the people in the business world but also with officials in government. This kind of personal network (Guanxi) usually plays a vital role in the success of international business alliance in China.

Financial strength: This is an important area to focus on is whether the local partner has enough financial capacity to carry out the work needed by the alliance. In addition, poor financial resources often indicate weaknesses and shortcomings in major areas of the management in a company, which are also detrimental to an alliance.

2.2.1.3 Organization fit

To evaluate the organization fit, TNCs need to assess the extent to which the organizational attributes of the partner in the alliance are conducive to the operation of the alliance. For example the organization leadership, ownership type, learning abilities, foreign experience and human resources management skills of local partners. All these organizational attributes affect the partner's capacity to meet the needs of the alliance, and thus have a significant impact on the performance of the alliance. Thus, while selecting the partner, it essential for the TNCs to ask themselves whether that partner will have organizational attributes that are conducive to the alliance and that can help achieve their strategic objectives through alliance.

Organizational leadership: Berlew (1974, p.22) define that organizational leadership is 'the process of instilling in others shared vision, creating valued opportunities, and building confidence in the realization of the shared values and opportunities'. As such, leadership is crucial to a business organization. Good leadership can provide the foresight and vision that guide the organization in the right business direction well before others, and thus enhance that organization's chances of success.

Ownership structure: This is important, especially in China. Since the economic reform started in 1978, and has diversified subsequently.

There are many different forms of ownership in China today, but they can be roughly classified into three basic types: state-owned, collective-owned and privately owned. TNCs need to know the advantages and disadvantages of each of the ownership types, and look for a local partner with the ownership type that helps to achieve their strategic objectives.

Learning ability: In a dynamic, complex or hostile environment, the learning ability is very important, because whether the local partner has the ability to learn how to adapt to the rapidly changing business environment would influence the success of the alliance. In an international business alliance, for instance, a local partner is supposed to acquire knowledge of advanced technology and management know-how from the foreign partner, and use the learnt knowledge in the day-to-day operation. To make an international alliance work, hence, it is crucial that the local partner has the ability to acquire, process, assimilate and integrate new knowledge and skills.

Foreign experience: It is closely related to learning ability, foreign experience is also an important organizational attribute that may affect the performance of a local partner in an international business alliance. TNCs normally bring new business concept and management style to a host country, if the local partner has plentiful foreign experience, it may be able to communicate with the foreign partner in an international business alliance, and thus avoid unnecessary misunderstanding and conflicts within the alliance.

Human resource management skills: It is crucial for the local partner to have the skills to manage the employees in a cross-cultural setting, to collaborate with the foreign partner in managing human resources in the alliance. These skills cover a wide range of areas, such as recruiting and retaining valued employees, training and career development. Thus, in selecting local partner, TNCs need to ask themselves whether the local partner has the ability to manage employees in a cross-cultural environment.

2.2.2 Control over alliances

Partners in an international business alliance often have different strategic objectives, as discussed earlier, so each side tend to seek control over the alliance in order to run the alliance in a way that best serves its own interests. However, the poorly designed control structures often lead to conflicts between partners in an alliance, disappointing performances or even failure, thus, it is important to recognize that not always achievable, or even desirable to control over alliances (Tian, 2007) In theory, two factors are often crucial to determine whether a partner should take control the alliances, and they are the host country government regulations and the relative strength of the partners in the alliance.

2.2.2.1 Host-country Regulations

Governments in host countries, particularly host countries is the developing country, the government tend to worry about the possible loss of economic independence if foreign companies move in and gain control over these pillar industries in equity terms, and therefore they often set strict restrictions on equity-involved alliances in these industries.

The issue of foreign control over an alliance in equity terms is particularly sensitive in China, where the Communist Party has been in power for many years and is trying to pursue economic reform in such a way that economic development is achieved without jeopardizing the Party’s control over the economy (Tian, 2007). As acquisitions and mergers are highly restricted in China, the issue of foreign equity control over an alliance relates mainly to alliances in the form of joint ventures. The government has set restrictions on foreign control over joint ventures ever since 1979 when the Law of the people’s republic of China on Sino-Foreign Equity Joint Ventures was issued. In 1995 the Regulations on Guiding the Direction of Foreign Investment and the Guidance Catalog of Industries with Foreign Investment were issued, clearly specifying the industries in which foreign control over joint ventures through majority shareholding is not permitted.

The Regulations and the Guidance Catalog divide all Chinese industries into four categories: Encouraged, Restricted, Prohibited and Permitted. In the category of Restricted industries, one of the restrictions is that TNCs have to enter these industries in the form of a joint venture with ‘the Chinese party as the controlling shareholder’ or ‘the Chinese party as the relatively controlling shareholder’ (Lo and Tian, 2005) That is to say, the foreign party can neither have more than 50 per cent of the equity share of the joint venture nor have an equity share that is higher than that which its Chinese partner has in the joint venture. However, along with the progress in economic liberalization and opening up, the government gradually relaxed its policy on TNCs in the restricted industries.

Control over an alliance, particularly an alliance in which equities are involved, is a very sensitive issue in a host country if the alliance happens to be in an industry that is considered to be of vital importance to the country-one of the so-called Pillar industries. The Automotive industry in China is one of the pillar industries, and then there are different regulations to restrict the foreigner to entry freely more about these policies are discussed in the Chapter 3- Policy analysis.

2.2.2.2 The relative strength of partners in alliances

Just as what we mentioned early, even the regulation is allowed to have the control, but gaining control of alliance is not always desirable. According to resource dependence theory of business organization, the ability of one party to command the key resources in an organization gives the party control over it (Pfeffer and Salancik, 1978), thus, that is to say, the partner that commands the key resources alliance, while the partner that does not have the resources should not take control.

Drawing on resource dependence theory, international business scholars break down not only control but also resources into different categories. It is argued that control can be classified in two categories: strategic control and operational control. Strategic control refers to control over the overall direction and operation of an alliance, including the appointment of board members and board chairman, and the command of key financial resources. In contrast, operational control refers to control over specific functional areas in the alliance, such as sourcing, product quality, promotion, distribution…etc. Resources can be classified in two categories: equity resources and non-equity resources. Equity resources refer to all kinds of tangible assets, including land, building and plants, cash, etc. Non-equity resources refer to a wide range of intangible assets, including management know-how, technology, local knowledge, sourcing networks and social connections (guanxi in the Chinese context).

Child and Yan (2001) argued that equity shares in an alliance primarily determine the degree to which partners in the alliance to have the right to strategic control over the alliance, and non-equity resources in an alliance primarily determine the degree to which the partners have the right to operational control of the alliance. TNCs that seek strategic control of an alliance should obtain a majority equity share, while TNCs that seek operational control over an alliance should, first and foremost, provide the key non-equity resources for the functional areas that they wan to take control of. However, this model ignores one important issue-Key success resources (KSRs), that is the specific key resources needed for the success of an alliance. This issue is important, because these key resources are indispensable for the success of an alliance, and whoever has them should assume the strategic control of the alliance through a majority shareholding. Thus, other things being equal, whether or not a partner should take strategic control over an alliance depends upon the relative strength of the partner in provision of the KSRs for the alliance. If the KSRs are the proprietary technologies or global marketing networks in which a TNC has obvious strength, the TNC should seek strategic control of the alliance through a majority shareholding. If the key success resources are the local service support systems or local connections in which a local partner has obvious strength, on the other hand, it may not be in the interests of the TNC to seek strategic control of the alliance through majority shareholding. If the TNC seeks strategic control despite its obvious weakness in providing the KSRs, the Chinese partner that commands the KSRs may be reluctant to collaborate with the TNC, which often results in disappointing performance, or even failure of the alliance.

In sum, control over an alliance is a very important and complex issue. TNCs need to think carefully about the conditions under which control over the alliances is not only achievable but also desirable. That is, they need to examine minutely the current restrictions on foreign majority control of alliances in China, and assess realistically whether they command the key resources that are indispensable for the success of the alliance.

2.2.3 Conflict management

Conflicts often occur between partners in alliances, particularly in international business alliances, where the partners are from different countries and cultural backgrounds. Therefore, managing conflicts is a daunting task for the partners in international business alliances, and TNC need to pay particular attention to the major sources of conflicts, appropriate approaches to conflict resolution, and cultural differences between the partners.

There are many factors that can lead to conflicts between partners, but three in particular stand out. To begin with, conflicts may be related to problems to do with the partner per se. Partner-related conflicts often occur when a TNC selects an ‘unfit’ partner with strategic objectives that are in contradiction with those of the TNC, with and organizational structure that is not conducive to the functioning of the alliance or without the capacity to fulfil its commitments to the alliance. In addition, conflicts may be related to cultural differences within an international business alliance. Cultural differences may lead to misunderstandings and divisions between the personnel of the two partners, and thus result in conflicts between different groups of people within the alliance. Cultural related conflicts may occur regardless of whether a TNC has selected a 'fit' local partner in terms of strategic objectives, organizational structure and capacity. This kind of conflict may occur, moreover, regardless of whether a TNC has made an appropriate control structure arrangement for the alliance. Furthermore, conflicts may be related to the environment in which an alliance is located. For example, since 1978 China has been undergoing a transition form a command economy to a market-based economy, and has witnessed profound changes in social and political systems in this process. The transition will inevitably be a prolonged process because of the complexities that China has inherited from the past, and in the interim the business environment is full of irregularities, which puzzles business people form other parts of the world and can lead to conflicts within an international business alliance. (Tian, 2007)

No matter what the roots of such conflicts are, TNCs need to take the appropriate measures to resolve them. In the literature on managing conflicts of these types many resolution strategies have been proposed, four of which are the most important ones: 1.a problem-solving strategy 2.a compromising strategy 3.a forcing strategy and 4.a legalistic strategy. In fact, the four strategies can be grouped into two broad approaches to conflict resolution: soft-line approaches and hard-line approaches. Under a soft-line approach, a partner takes into account what the other partner thinks and feels, and resolves conflicts through compromises, open and friendly negotiations, and reasoned argument and persuasion. This approach roughly corresponds to the problem-solving strategy and the compromising strategy. Under the hard-line approach, one partner imposes its will on the other party, sometimes by having recourse to the law, and resolves conflicts through non-compromising confrontation. This approach roughly corresponds to the forcing strategy and the legalistic strategy. Lin & Germain (1998) find that the more similar the partners are in cultural traditions the more likely they are to adopt a soft-line approach. For example, TNCs form Singapore and Hong Kong are more likely to adopt a soft-line approach in China than TNCs from western countries. In addition, the evidence from them also show that the greater power and strength a partner has in the relationship the more likely that partner is to adopt a hard-line approach, the more key resources a TNC holds the more likely to put pressure on the Chinese partners through legal channels. Except what these finds show, the choice of conflict solution depends primarily on the root cause of the conflict: if the fundamental problem is a lack of willingness or ability on the part of the Chinese partner to fulfill its commitments to the alliance, for example, the adoption of a soft-line approach may not lead to a result in the best interests of the TNC, and adopting a hard-line approach may be the best option.

Part Ⅱ

Chapter 3: Methodology

This chapter is going to answer the question of “what research method has been applied on this research?”; “where the data from?” and indicate the limitation of this research.

3.1 Qualitative Research Method

Qualitative methods are generally considered capable to present richer and softer data, compared with quantitative research methods (Silverman, 2000). However, the reliability and validity of qualitative methods have always been questioned; more specifically, the subjectivity of qualitative research seems to be the main cause of the above problem.

Objectivity is the basic criterion of any social science research. Subjectivity is unavoidable in all kinds of research methods (Silverman, 2000). Therefore, qualitative research should be conducted under several guidelines as to obtain the rigor, such as systematic data collection, record-keeping and data analysis (Silverman, 2000), and the most important rule is never treat a participant’s opinion or a single aspect as an explanation of the phenomenon that is being studied (Silverman, 2000)

According to Banister et al. (1994, p.2), “qualitative research is the interpretative study of a specific issue or problem in which the researcher is central to the sense that is made”, qualitative research is not only closely linked with social, cultural and historical context (Halloran, 1998), but a kind of crafting that reflects the researcher’s aim and style (Watson, 1994).

Research method is a tool for the researcher to conduct the research, which method to be used should depend on the research context, that is, depend on the research problems and study objects. In this dissertation, since the objective is to try to understand whether the limitation of host country regulations would finally lead the failure of international joint venture, and how does strategies play an important role in the success of international joint venture, the qualitative method is able to play an important role to serve this purpose due to its grounded, discovery-oriented, explanatory, expansionist, descriptive and inductive features (Deshpande, 1983).

3.2 Case Study Approach

The Strengths of case studies have been explored by many researchers. Merriam (1988) concluded that the case studies have an advantage in resulting a rich, thick description and analysis of a phenomenon which may be desired. Jankowicz (1995) thought that the case studies facilitate intimate knowledge of the sample group, their thoughts, feelings and actions by experiencing their environment which gives depths to the study from a limited number of subjects, and suggested the case study method is appropriate where the research design focuses on a set of issues within one organization, this paper is going to explore the entry strategy in two joint ventures and which fully meet suggestion of Jankowicz. Yin (1994) argued that the case study approach method is appropriate in understanding complex phenomenon in a real-life context by answering 'how' and 'why' questions, he also agreed that case study can more effectively analyze causation than quantitative cross-sectional research.

Therefore, it is helpful in understanding the strategic issues in operating a successful JV in China's automotive industry.

Compared to the single case study, multiple-case studies is considered to have clear advantages over single-case design in the evidence of multiple-cases shows more comprehensive and robust (Herriott, Firestond, 1983), and it further lead to enhance generalizability and deepen understanding and explanation (Miles, Huberman, 1994). The logic underlying the use of multi-case studies is: each case selected must be either (a) predicts similar results or (b) predicts contrasting results but fro predictable reasons (Yin, 2003). Therefore, this can explain why this paper is going to apply the multi-case studies, why it chooses Shanghai Volkswagen and Guangzhou Peugeot as the research objectives, because both of two foreign companies came to China in 1980s to form a joint venture with one local partner but they have a completely different performance.

3.3 Secondary Data

Secondary data is very important to the research (Chisnall, 1991) and has been adopted as the research method in this research. Secondary data is the data that have already been published by or are available from existing resource. Hyman (1987) takes the view that when researching on contemporary issues, the secondary data covers a wide range of material related various areas and perspectives, as result, it can assist in generate a more comprehensive and depth scope than the sing perspective of primary data. The secondary date employed in this study is collected from various resources. Previous literatures access through public and university libraries and website in the form of articles, journals and textbooks. The more specific industry information has been collected through government publications, official reports, and business news. Company's annual report, business analysis, and case studies of the previous literatures contributed a lot to the specific information about the company. Besides data explored above, various other secondary data has been available through the internet, the official press release from company's official websites, as well as newspaper, which are likely to provide more up-to-date information. All these valuable secondary data provide a genuine and deep understanding of the research context and studying subjects.

An important reason for using secondary data is the difficult to access first-hand data. The research objective of this paper is the policies, the joint ventures, as a normal Master student, it is difficult to directly access the information from government department, government website is the only channel to get the detail of these regulations. And one case study objective in this paper is Guangzhou Peugeot Co., which have not exist since 1997, so it becomes more difficult to access the first-hand data, secondary data from other's article is the only channel to get information about this company.

3.4 Limitations

The first problem is the limitation of data collection. The secondary data available is limited; mainly the public ones, may be some really valuable data related to research are unknown to the research or inaccessible. A second problem is there is potential fro research bias when using the case study method, although the case study enables a more comprehensive review and analysis of a single situation than other methods (Jankowicz, 1995). Try to illustrate the whole industry with the information focus on only three companies may be biased. Third, some data may be due to the information constraints although the researcher tried to get the latest ones. And finally, as this research is based on qualitative research method, which is often complaint by "anecdotalism" that questions the research's validity. According to Bryman (1998, p.77), 'there is a tendency towards an anecdotal approach to the use of data in relation to conclusion or explanations in qualitative research….. There are grounds for disquiet in that the representativeness or generality of these fragments is rarely addressed'. While Silverman (2000) also argued that qualitative research is easy to be lack of reliability.

Despite these limitations, the researcher believes that the chosen research method is an appropriate method of the study considering the aim and objectives of the research subject.

Part Ⅲ

Chapter 4: Research context

Economic factors about China's passenger car market, government's expectation on automotive industry development and government's regulation on automotive industry are the three main factors going to be pointed out in this chapter, the analysis of these three factors will provide an description of the research background, and answer the questions of why foreign funds like to invest in China's passenger car industry?; and which regulation will be strategic /barrier for their entry?

4.1 Economic factors about the passenger car market in China

Why TNCs like to entry? A simple answer to this question is that because they except the entry will bring themselves profits now or in the future, most of them come to China because of the location advantages. The location advantages mainly reflect on two aspects: the huge domestic market in China and Foreign companies are superior to domestic manufacturers on technology, management and marketing aspects.

4.1.1 Huge domestic market

"China offers the greatest potential market in the world and that's why everyone is coming" -Nissan's contact person in China, (China daily, 11/14/94, 2)

In 1949-1979, although the domestic vehicle plants had technologies to produce cars, they mainly produced trucks and buses for transportation, tractors fro agriculture, and jeeps for the military. As private cars were regarded as luxury goods, they were not produced or imported for the general public (Qiu, 2005). Thus, after China opened to the world, TNCs like to enter quickly to occupy the passenger car market and win a first move advantage. China's passenger car market is blank at the beginning of 1980s, any firm like to entry would expect the success of entry bring it a new opportunity to growth. Income, one important factor that affects the demand for automobiles in China, will be discussed. Reviewing of the historical data of income would prove that China does have a location advantage if the foreign companies can have a right forecast of the growth of the automobile market.

While making the entry decision, it is necessary to take the location-specific factors into account first. China has an obvious advantage in its cheap labor force and the largest potential market in the world. The central intelligence Agency issued a report in December 2004, it stated that by 2020 the world's geopolitical center of gravity will tilt toward Asia, especially China, the economy of which will have surpassed Japan's to become second only to that of the U.S. (Qiu, 2005). Another study show that the motorization rate in China has increased from 1.70 vehicles per 1000 people in 1980 to 9.37 vehicles per 1000 people in 1996 and predict that China's motorization rate would grow to 54 vehicles per 1000 people by 2020 (Riley, 2002). Undoubtedly, the demand for automobiles remains strong in the long run.

Income is the major factor in affecting the demand for sedans, and the whole country's economic activities affect demand for all types of motor vehicles. Table 4-1 (Qiu, 2005, p.15) shows that China had the highest GDP growth rate compare to other countries or regions in East Asia. An increase in national income implies a rise in living standards and purchasing power, which should generate robust demand for automobiles.

Table 4-1 GDP Growth Rates in China, Hong Kong, Korea, Singapore and Taiwan (%)

	China	Hong Kong	Korea	Singapore	Taiwan
1995	23.19	6.46	23.32	10.30	8.49
1996	16.27	10.46	12.48	9.31	9.24
1997	9.41	11.04	9.48	8.93	8.09
1998	5.23	-4.81	-1.43	-3.22	7.00
1999	4.59	-2.63	9.38	0.62	4.10
2000	9.50	3.39	9.29	14.33	4.56
2001	8.47	-1.43	7.51	-3.57	-1.10
2002	8.17	-1.77	9.99	2.41	3.00

Source: *China Statistical Yearbook and International Financial Statistics* (2004)

Personal income is a more specific factor in affecting the demand for private cars (passenger car) than a country's total GDP level and growth. Table 4-2 (Qiu,2005, p.16) shows a three-year time data series, the correlation between per capital GDP and sales of motor vehicles is 0.96 and the correlation between per capital GDP and sales of sedans is 0.94. This indicates a strong positive correlation between the demand for automobiles and personal income. Note in 2002 China's per capital GDP was still below US$1,000, and experience shows that there will be a big boost in automobile demand once a country's per capital income reaches US$3,000, but because China has a huge population and the income inequality is large, we do not have to wait until China reaches this common critical income level to see robust demand for automobiles (Qiu, 2005).

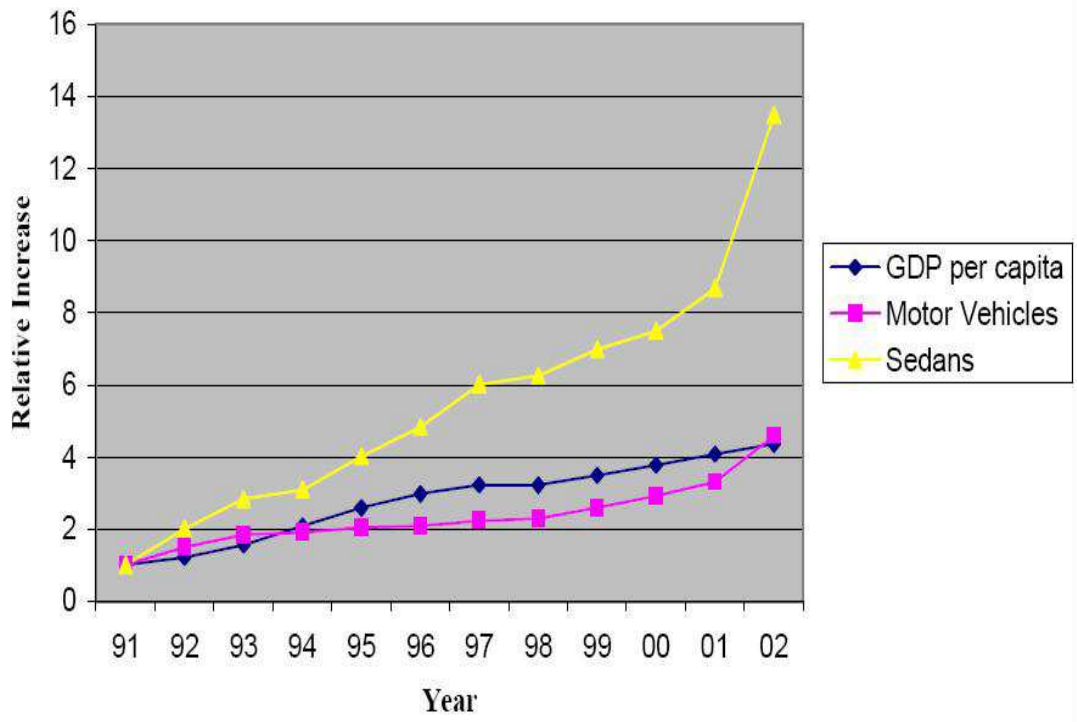
Table 4-2 per capita GDP, Sales of Motor Vehicles & Sedans (Yuan), 2000-2002

	per capita GDP	Total Sales of Motor Vehicles	Total Sales of Sedans
2000	7086	2078382	614411
2001	7651	2371089	721463
2002	8184	3248511	1126468

Source: *China Automotive Industry Yearbook* (2002 and 2003)

However, the per capital GDP of China increased from 460 Yuan in 1980 to 8184 Yuan in 2002, with an annual growth rate of 25% on average, the demand for automobiles increases together with economic growth as people's purchasing power increases over time and more and more people jump from the necessity-consumption group to the luxury-good-consumption group. They purchase cars for business or private use. At the same time, as a result of high economic growth, the society has more money to develop and improve its transport network and road infrastructure such as highways. Therefore, demand for automobiles is further boosted. The effects of economic growth on automobile demand can be seen clearly in figure 4-1 (Qiu, 2005, p.17), which depicts the following three indices with 1991 as the base year: per capita GDP, total motor vehicle sales and total sedan sales. It is clear that the income effect on sedan demand is stronger than that on all motor vehicle demand. This graph may serve as a base for forecasting future demand for automobiles in China once we have the forecast for GDP growth. (Qiu, 2005)

Figure 4-1: Indices of GDP per capita, Total Motor Vehicle Sales & Sedan Sales



Sources: *China Automotive Industry Yearbook* (2003) and *China Statistical Yearbook* (2003)

4.1.2 Competitive advantage in Infant Industry

Before 1980s, there are not so such experience for the domestic auto maker on making passenger cars. Even China's automobile industry ranked the ninth in the world in 1999, a big gap still exist between China and world leading countries in terms of production, productivity, sales and R&D investment.(Qiu, 2005) Therefore, any TNCs from leading countries like Germany, Japan, U.S.A., and France have the obvious advantage on technology, marketing, quality management…etc, which are accumulated from their long history on manufacturing, are easy to win a share of the market if there are no other force (government) to intervene. Both two main strategy positions are suitable for the TNCs: 1. Cost advantage: produce the product more efficiently than domestic manufacturer, because TNCs has more efficient production procedure, advanced technology. 2 differentiation advantage: produce the product which is different from better than the domestic manufacturers', because TNCs have the newest design and most advanced technology.

4.1.3 Summarize

The weak competitive ability of the domestic manufacturer make the TNCs easily reduce the barrier of entry and find their competitive positions in China's infant auto industry, plus that the huge potential domestic market in China, most TNCs would think the success entry would bring them a new growth in East-Asian region, and from the point of global strategy view, success entry and win the first mover advantage would provide them more spare space to compete with their global competitors.

4.2 China's Expectations on Automotive Industry Development

China's open policy began in 1978, and it was same as the policy of the other developing countries, whose purpose was to supplement the shortage of domestic saving and take in technology and management know how from more advanced foreign countries. In the passenger car field, China has had taken the same policy as other developing countries which was basically an import substitution of finished products, then in accumulating ability in R&D, and finally in developing independently. During this process, China expected foreign enterprises to first transfer technology through semi knock down (SKD) and then through complete knock down (CKD) (Lee, et al.). Then China hoped to develop a parts industry and finally cooperate in independent development through introducing technology for both production and development.

What the Chinese government trying to do is to foster its own automotive industry and is not interested in turning China into an expansion base for European, American and Japanese auto industries. This intention of the Chinese government is made clear by the fact that foreign companies are not allowed to have majority (over 50 percent) share holdings in joint venture projects for the production of finished vehicles. In other words, business in China for foreign auto manufacturers means they will never have more than the role of assistance provider and are strictly limited to helping the Chinese auto industry to develop independently (Lee, et al.), this is the basic attitude and expectation of the government on the development of automotive industry

4.3 Related regulations and policies on the foreign entry

In the below sections, more policies which related to foreign funding enter China automobile industry will be discussed, and the related policies will be classified into two categories, (a).Regulations and Policies related to 'Exporting V.S. Investment' and (b) Regulations and Policies related to 'Joint venture V.S. Wholly foreign-owned enterprises'.

4.3.1 Regulations and Policies related to 'Exporting V.S. Investment'

Refer to the literature review in chapter 2, it is necessary to consider the factor of transaction cost while making the entry choice, importantly, this is the factor which affect mostly by government policies. China's automobile was far behind the advanced countries in the late 1980s and 1990s. It is clearly an infant industry. There is no doubt that given the large technology gap, without import protections, foreign entries will easily wipe out the domestic player. As to protect this infant cars making industry and develop it into an internationally competitive one, the State Planning Commission (SPC) announced the Industrial policy for the Automotive Industry on 19 February, 1994. This policy was issued based on Korean Industrial policy in 1970s, which aimed to attract foreign direct investments, technology and management to modernize its less developed automotive industry (Wang, 2001).

The Automotive Industry Policy mainly contains three important elements that have significant impact on foreign direct investment.

4.3.1.1 Industry Development Control

The automotive industry policy controls the industry development by requiring automakers to manufacture products within a list of approved product mixes that the government has shown that interests. Authentication of the product is issued by only producing product within the list of product category. Authentication is very important for the automakers, since they need the authentication before their products could be sold in the market legally. Only authenticated products can enter into the nationwide catalogue which is used by public security bureaus to issue licenses for motor vehicles

(Nee, 2002). Therefore, through the product development control, the government guides the industry to focus on certain product mixes deemed critical by the central government, preventing automotive enterprises from developing other things less desired by the government.

4.3.1.2 Foreign Direct Investment Screening and Approval

All foreign direct investment must be screened and approved by the government; they must fulfill the requirement of the automotive industry policy regarding foreign direct investment. For the foreign investors who want to set up JV with local automakers, they must have: (Source: China's Formal Policy on Development of Automotive Industry, Chapter 6, Clause No. 28)

- Global product patents and trademarks
- Sophisticated product development and manufacturing technology
- Independent world wide sales and distributions
- Strong and well developed financial capabilities

And the policy also laid out some requirements for the JV formation: (Sources: China's Formal Policy on Development of Automotive Industry, Chapter 6, Clause No. 31 and 32)

- Set up a research and development (R&D) centre in China
- Products must confirm to the international technical and quality standards
- Be able to balance their foreign exchange independently under the foreign exchange control system in China

- Chinese partners must have more than or equal to 50% of the shares of the JV
- Preferential status must be given to the local parts and components manufacturers
- Technology must be transferred to the JV for product development
- Only JV product can be exported to foreign markets

4.3.1.3 Import control

In order to develop the domestic motor vehicle industry and encourage technology transfer, the Chinese government imposed strict licensing requirements and heavy tariffs on imported vehicles. High import tariff is imposed on all the imports, such as cars, auto parts and components, the import tariff may be 100% higher than the original value (Table 4-3). And only four seaports were allowed to import foreign cars, they were Dalian, Tianjin, Shanghai and Huangpu. All imported car must pay custom duties on top of the high import tariff. Despite the tariff, the government also set a quota of imported vehicles every year, this ensured the local automotive industry well protected. The procedures for importing foreign vehicles are complicated as well, the imported vehicles have to be inspected for quality, if they can meet the quality standard, and "inspection and Quarantine Certificate for Entering Commodities" and "Car Attaching Inspecting Certificate" will be issued. However, the process of inspection and issuing of certificates may take a long time, and this resulted an unpredictable lead time.

Table 4-3: Several important Tariff rate changes for imported cars From 1980s to the early of 2000s Source: China Xinhua News (2006)

Tariff rate	**the car engine's capacity lower than 3 liter**	**the car engine's capacity higher than 3 liter**
1986	180%	220%
1994	110%	150%
1997	80%	100%
2001	70%	80%
2002	43.8%	50.7%

The import control is not only on complete car import, but also on auto parts, the policy laid out the local content requirement for the automotive JVs. The local content and technology transfer requirements are imposed to pursue two of its most important policy goals: a complex industrial development and self-reliance (Wang, 2001).The import tariff of foreign vehicles, auto parts and components were determined by the percentage of local content of the goods. If the imported goods have a high percentage of local content value, a lower tariff would be imposed, vice versa. And the import tariff was further increased in 1997. The following Table 4-4 shows the new tariff rates in 1997.

Table 4-4 Local Content and Import Tariff

Local Content	**Tariff for Imported components**
Above 80%	40%
60%-80%	60%
Below 60%	75%

Source: Import vehicle market handbook, Beijing Transportation

Press 1997

4.3.1.4 The significant Impact of this policy

One of the significant impacts of this policy was the reliance of foreign investors on its local JV partners. The Automotive Industry Policy was not incorporated into law, it just used as an internal code for practice in selecting JV partners and setting up JVs. Since it did not instituted into law, foreign investors would not know about the detailed requirements and issues of setting up JVs in China, this made them heavily rely on their local China partners who have a more clear understanding regarding these issues. For example, General Motors did not have much information about how the customs would apply the local content rules on tariff for imported auto parts and components when it was considering setting up a JV in Shanghai. Its only source was its local partner, SAIC, which had experience in importing foreign auto parts into China and was probably involved in the policy making process of Automotive industry policy (Nee, 2002). This is one of the reasons the foreign investors need to seek for a local China partner when they entering China's automotive market through investment form, and whether able to cooperate with different cultural background partner should be one consideration of them, mostly, the inefficient and misunderstanding communication would lead the failure of the international alliances.

4.3.2 Regulations and Policies related to 'Joint venture V.S. Wholly foreign-owned enterprises'

While making the Choice between the Joint venture and WFOE, the literature review in Chapter 2 states that it is crucial for TNCs to take transaction cost into consideration first. In most cases, the TNC from foreign countries would bring a new management style and culture background, all these difference between the TNCs and its Chinese local partner would easily lead the misunderstanding and division between the personnel of the two partners, hence, WFOE may be a better Choice compare to Joint venture. There are some important policies which limits the choice to TNCs while they making this decision.

4.3.2.1 Guidance of Foreign investment industries

The Catalogue for Guidance of Foreign investment industries has one article clearly state that:

'Notes for Catalogue of Encouraged Industries:

> *5. Manufacturing of automobile and motorcycle: the proportion of foreign investments shall not exceed 50%' -Catalogue for the Guidance of Foreign Investment Industries (Attachment)* [1]

This article which states that TNC can only invest in China auto industry through the form of Joint Venture and they can only hold maximum 50% shares of the Joint venture, this is due to China government want to control over the pillar industries and to benefit from FDI technology transfer.

The article limit the Choice to the TNC, but it's impossible to say that this is a bad thing, because Joint venture also has its advantages while TNCs enter China. As what mentioned above, A Chinese partner

[1] Source: CHINAdaily, available at http://www.chinadaily.com.cn/bizchina/2006-04/20/content_572219.htm

normally has local knowledge and a local connection (Guanxi in Chinese context) that may help TNCs reduce transaction cost when they venture into the Chinese market. Furthermore, it's necessary to remember that the article state that Auto industry is one of Encouraged Industries, so it can also benefit from the encouraged industry policy. In the Regulation on Guiding the Direction of Foreign Investment, the Chinese government clearly defines the three categories of foreign investment projects. There are 'encouraged', 'restricted' and 'prohibited' three categories. And all the encouraged projects enjoy the preferential tax treatment given by the relevant laws and administrative regulations. (Appendix I)

4.3.2.2 Pillar industry policy

Furthermore, the 15th Plenary Session of the Central Committee of Central Communist Party clearly placed automotive industry as one of the important pillar industries of the national economy in 1987. This policy clearly stated out the strong supports of the Chinese government to develop the automotive industry. The central government had funded USD60 billion to those pillars industries including electronic, automotive and construction materials (BXA, 1998). As being one of the pillar industries, automotive industry has received lots of funding, assistance and supports from the government, such as access to capital and priority approval in forming JVs. The Chinese government has played an important role in helping the local automakers to attract, negotiate and select foreign partners for forming JVs.

Except the pillar industry policy, there are more articles that related to auto industry investment (Refer to Appendix II), they also state that government would like to provide a lot of favorite policies to the TNC who can bring their new technology, management system. For the local government, they also like to give a favor policy to its favorite firms; for example, Shanghai municipal government once required that every city taxi be Shanghai-VW's Santana model. It will levies in its suburban areas. (Sit and Liu, 2000)

4.3.2.3 The significant Impact of these policies

China's policy strictly restricted the choice of TNC, Joint venture will be the only form of FDI they can choose to entry, but while government close the door to the TNC, they also open the window to the TNC, because forming the joint venture with the local partner in China, they can access the resources which his partner has e.g. the knowledge of the local market, Guanxi…etc. as well as they can benefit a lot from the favorite policies, whatever the centre or local government would like to provide a lot to support the advanced technology transfer to China. Qiu (2005) indicated that Local producers did not worry too much about pure domestic entrants because they would not be genuine competitors. Neither were local producers afraid of pure foreign automakers from imports since imports were heavily restricted. However, they faced serious entry threats from FDI. Due to the joint venture restrictions, local firms were competing in forming joint ventures with foreign partners. This unique characteristic of the market environment gives the local industry a dilemma: they don't like new entrants, but they are in a hurry to find foreign partners to come in the market. Thus, under this situation, TNC mostly have strong bargaining power with his local partner or government.

Chapter 5 Case study- Shanghai Volkswagen Automotive Company Ltd. (SVW)

5.1 Company background:

Shanghai Volkswagen is one of the largest single foreign-invested projects ever conceived in China and has proven to be a successful development. Compared with Beijing Jeep and Guangzhou Peugeot's course, the German venture's progress was steady and smooth. In 1997 Shanghai Volkswagen headed the list of the top 500 foreign-funded enterprises operating in China. (Luo, 2001)

VW had started to negotiate a major project for the annual production of 150,000 vehicles in China in 1978, when China announced its reforms and the open door policy. By 1981 the Chinese government had approved a smaller project with annual production of 20,000 units, and by 1985, approximately 1,000 Santana models had been assembled from completely knocked down (CKD) kits. Finally, in the spring of 1985 the Shanghai Volkswagen Automotive company limited (SVW) was established (refer to Table 5.1) (Boyer, et al., 1998)

Table 5.1 the Development of SVW

1978-85	Negotiations between VW and Chinese authorities
March 1985	Founding of Shanghai Volkswagen Automotive Company Limited
1985-90	Construction state: April 1990 production capacity of 60,000 finished vehicles and 150,000 engines per year
1989-90	Difficulties owing to China's domestic political environment
1990-96	Further construction
1993	Production capacity 100,000 units
1995	Production capacity 160,000 units
1996	production capacity 220,000 units
1997	production capacity 300,000 units (117,000 Santana; 3,000 Santana Variant; and 180,000 Santana 2000)

By establishing SVW in the mid-1980s, Volkswagen sought to open up the Chinese market and in the medium term to develop 'a useful toehold for exports to South East Asia'. Because in 1983, Volkswagen attempted to collaborate with Nissan to produce the Santana model in Japan had been less successful. At the time, the Chinese government saw modernizing the production of passenger cars as one of the main bulwarks of economic modernization. The government believed that Volkswagen was more willing than other firms to transfer modern technology, management and training methods to China. (Boyer, et al., 1998; Luo, 2001)

5.2 Partner Selection

Volkswagen established its joint venture in Shanghai in 1985 namely Shanghai Volkswagen. The new joint venture was owned 50 per cent by Volkswagen, 25 per cent by the Shanghai Automotive Industrial Corporation (SAIC), 15 per cent by the bank of China's Shanghai Trust and Consultancy Corporation, and 10 per cent by China National Automotive Industry Corporation (CNAIC). The diversity of partners revealed careful forethought: the Bank of China could provide or guarantee needed loans, SAIC would have an interest in solving local problems, and CNAIC could be a link to the central government (Harwit, 1992).

5.2.1 Strategic fit

Volkswagen has an aim as part of its global competition strategy to build up a business base in the Far East that will limit the dominance of Japanese firms. Its strategy is for China to become a big export base for the whole of Southeast Asia (Luo, 2001). On the other side, Shanghai government has an aim to take in technology and management know how from more advanced foreign countries, as well as encourage the related industries to develop. Although the two sides had different motives for forming the joint venture, both realized that the increase in production domestication could help them reach their respective goals.

5.2.2 Capacity fit

Shanghai can be seemed as a home for heavy industry, it has one biggest steel plant- Baosteel Group Co., and its neighbor province-Jiangsu has a large number of factories, thus local in Shanghai is a not bad Choice. But in 1980s, the industrial infrastructure in the automobile industry was poor, and imported components faced high import tariffs of 25 to 40 percent. The technical standards of Chinese automobile-component suppliers in 1986 were nearly thirty years behind component manufacturers of

Europe, Japan and U.S. Local government and Volkswagen both work together to develop the auto parts industry. During the "the Ninth five year plan", the auto parts industry policy indicated that the government gives first preferences to 25 kinds of key project in passenger car parts production through a low interest fund. The government reduces or exempts from investment tax and promotes introduction of foreign capital to the above parts makers (Lee…et al) For the Volkswagen, the development of local capabilities was incredibly important to their ability to compete in the market, in order to improve the capabilities, Volkswagen worked with their European parts manufacturers to encourage their entry into China. Volkswagen's technical staff supported them by assisting with the identification of possible Chinese partners for the various parts to be manufactured (Luo, 2001)

Therefore, Volkswagen enter China face a same problem as his competitor- the poor infrastructure, but it recognize the importance of local capabilities, and have a good corporation with the government, they are on a right way to the future.

5.2.3 Organization fit

SAIC is the largest auto manufacturer in china in 1980s, it is a stated-owned company, it has no previous experience to corporate with foreign companies before alliance with Volkswagen, China has implemented the closed doorism policy from 1949 to Deng Xiaoping's open door came out in 1978, hence, there was not big difference between the domestic auto manufacturers in 1980s, they were all stated-owned, had no previous foreign experience and all human management system seemed in the same form.

5.2.4 Summarize

Organization fit does not seem as an important criterion in partner selection in 1980s because all domestic partners in China do not have big difference at that moment. strategic and capability fit were more important, Volkswagen made a good selection base on these two criteria to alliance with the SAIC and built its plant in Shanghai- the most developed industrial area in China. Volkswagen and SAIC have the compatible and complement objectives, to develop the auto industry and occupy the market. Volkswagen also recognize the importance of local capability development, it can not grow without the development of its related supplier.

5.3 Control over alliances

5.3.1 Host-country (China) regulations:

Refer to Section 4.3.2, the regulation of catalogue for guidance of foreign investment industries and the pillar industry policy have clearly stated that Automotive industry is one of the pillar industry in China, and the proportion of foreign investments in Manufacturing of automobile and motorcycle shall not exceed 50%. Therefore, foreign companies would not be able to obtain more control over the alliance through holding higher percentage of shares (>50%).

SVW, capital investment was contributed on an equal basis by Chinese partners (mainly SAIC) and Volkswagen A.G. The equal membership on both board of directors and the executive management committee allows the Chinese side to hold the positions of president and

Managing Director, while the German side to hold the other two important positions of Commercial Executive Director and Technical Executive Director. Power of control seems equally distribute between two sides of China and Volkswagen.

5.3.2 The relative strength of partners in SVW

Tian (2007) mentioned that whether or not a partner in an alliance should take control depends upon many factors, but two of them are crucial: the host country government regulations and the relative strength of the partners in the alliance. Regulations' restriction normally are not allowed to be changed, what the TNCs can do is to gain control on the side they are good at, and not seek to control what they are not good at. Lee…et al indicated that the cooperation between central and local governments and the maker, Shanghai-VW, were an important factor in success. SVW has a very good distribution of control, the local partner have the specific local information, and one most important thing is it has Guanxi, has a good Guanxi with the government, the joint venture would benefit more from the policy support, For example, in 1988, The mayor Zhu Rongji, took several steps to aid SVW, including encouraging the development of a municipal taxi company that exclusively used the joint-venture cars (Harwit, 1992). On the other side, Volkswagen has better knowledge on the Marketing and Technology development, and then the representative would in charge these two departments.

5.4 Conflict management:

This section is going to illustrate the relationship between partners and have an introduction of the conflict management system in SVW.

5.4.1 Good relation with government, good policy treatment

The accomplishments of Shanghai-VW have been achieved with the support of the Chinese central government, which determined the company's "pioneer status" in the automobile industry (Lee, et al.). The government not only offered SVW preferential advantages in taxes, but also provided convenience in foreign currency and material supply in the early period. In the meantime, the Shanghai Municipal Government has ranked the automotive industry as "the first important industry", and supported SVW. The cooperation between central and local governments and the maker, SVW, were an important factor in its success.

Some special treatments to SVW

1. As mentioned, the Germans were to import Santana Kits, and localize parts production over the first few years of the venture. A key element of the agreement, moreover, was that VW would be allowed to exchange its RMB profits for hard currency, at the official exchange rate, until 89,000 cars were produced. (Harwit, 1992, p.153)
2. In 1988 the Chinese central government approved a domestication tax levied on the sale of cars made by SVW (28,000 Yuan [about US $3,400] per car) to alleviate its revenue shortage. (Yeung & Li, 2000, p.632)
3. After Zhu Rongji becoming Shanghai's mayor in 1988, he took steps to aid SVW, including encouraging the development of a

municipal taxi company that exclusively used the joint-venture cars. (Harwit, 1992, p.155)

5.4.2 Conflict Management system in SVW

Conflicts inevitably arise within the alliance, then how to solve this problem and maintain a good relationship with partner becomes a serious question.

The most serious conflict occurred in 1988, when China National Automotive Industry Corporation (CNAIC), led by Chen Zutao, complained about the slow pace of component localization and asked Volkswagen to raise its local content utilization to 80 per cent as soon as possible. At that stage the local content level was only 12 per cent, and it was unrealistic to try and reach the CNAIC target in a short period of time as local suppliers could not provide high-quality components because of the low level of technology they were using. Disregarding these difficulties, CNAIC decided to curtail raw material supplies and limit the joint venture's output until the required local content target was achieved. This decision was not in conformity with the joint venture contract, in which it was clearly specified that the Chinese side was responsible for locally supplied high-quality components (Harwit, 1992; Tian, 2007).

West German experiences with Socialist East Germany have contributed to an understanding of command economies and their shortcomings. Therefore, "Volkswagen representatives already knew what and how to negotiate with the Chinese partners" (Luo, 2001, p.148). To resolve the conflict, Volkswagen did not choose a forcing or legalistic strategy to confront CNAIC openly through media-based or legal procedures. Instead, Volkswagen adopted a problem-solving strategy, explaining patiently to CNAIC the difficulties in content localization, and persuading the Chinese side through reasoned arguments to look for a solution to the problem. The soft-line approach worked. The Chinese partners stopped blaming Volkswagen, and worked together to form a suppliers association to resolve the technical problems in providing high-quality components. The joint venture survived the crisis, and is now understood to be doing well (Tian, 2007).

Except the soft-line approach worked, the good foresight and precise contract provided some respite for the Germans, as it indicated that the Chinese, rather than the foreign partners, were responsible for the speed of developing Chinese-made parts to meet the Volkswagen standard (Harwit, 1992)

Conflicts inevitably arise during the alliance period due to different reasons. However, the good foresight, the previous similar experience, and the soft-line approach to conflict management made Volkswagen more easily solve the conflicts arise during cooperation compare to other TNCs in China (e.g. Beijing Jeep, Guangzhou Peugeot)

Chapter 6: Case study-Guangzhou Peugeot Automotive Co., (GPAC)

6.1 Guangzhou Peugeot Automotive Co. (GPAC) background:

The company was launched in the mid-1980s by Peugeot (22 per cent) and Guangzhou Automobile Group Company (46 per cent). China International Trust and Investment corp. hold 20 per cent, and French bank and finance companies hold the remaining 12 per cent. GPAC manufactures 504 and 505 Peugeot pickups and sedans. Production started off slowly, with only 940 units in 1986, the first full year of manufacturing production was only 5,666 cars by 1990, but reached 30,000 units in 1993.

In April 1997, Peugeot's management declared its intention to pull out of the GPAC joint venture. At the time, this announcement had the effect of a thunderbolt in the business world, because this was not the recognized failure of an inexperienced small company with no back-up, but that of Europe's second-ranking automobile manufacturer, an investor with an international reputation and experience, particularly in developing countries. Hubler and Meschi (2001) think that Peugeot case is interesting because it sums up all the problems met by foreign partners in joint ventures, and its that case, Peugeot's unfortunate experience is not unique and it serves as a warning to present and future foreign investors in China.

6.2 Partner Selection

Peugeot made a wrong decision in choosing local partner and another wrong decision in setting up JV in Guangzhou instead of other Chinese provinces, all these led to poor sales and low productivity.

6.2.1 Strategic fit

Peugeot estimated the purchasing power of China was strong enough to bring it a new opportunity to grow in Asia. Its strategy is to enter as soon as possible and win the first mover advantage. For the local government in Guangzhou, it had an aim to take in technology and management know how from more advanced foreign countries, and try to push the development of its heavy industry. They try to use the example of Peugeot's entry to persuade more FDI in heavy industry area to come in. Although the two sides had different motives for forming the joint venture, both realized that the increase in production domestication could help them reach their respective goals.

6.2.2 Capacity fit

As what motioned in the literature review, capacity fit is one important criterion in selecting the local partner, to access the capability fit, TNCs need to evaluate the extent to which the partners in the alliance will be capable of meeting each other's need, and capable of helping each other achieve their respective strategic objectives. Obviously, Peugeot's Chinese local partner can not meet this requirement, Tian (2007) mentioned that Guangzhou Automotive Manufacturing did not have the competencies in skilled workers to produce the quality components that Peugeot needed, which became one of the main reasons for the termination of the alliance. Hubler and Meschi (2001) mentioned that the Chinese managers in charge of distribution and marketing sometimes did not even know the number of vehicles in stock, accounts were kept in a vague manner and marketing was paralyzed by administrative conflicts with central authorities.

This joint venture was also affected by rivalry between Guangzhou and Guangdong Province itself. As a *jihua danlie* (independent planning unit), Guangzhou reported its economic plan directly to

Beijing, thereby establishing a significant degree of financial independence from Guangdong Province. There was, therefore, some disincentive for the Guangdong government to use its own resources to help Guangzhou's urban industry. In fact, sources report that Guangdong originally opposed the establishment of the Peugeot venture, fearing that it would siphon off money destined for Guangdong. Former governor Ye Xuanping is said to have given little personal support to the project, and provincial authorities reportedly chose to develop the Sanxing automotive group in the southern Guangdong city of Zhanjiang over Peugeot, to avoid a Guangzhou monopoly in the vital industry (Harwit, 1992)

In addition, according to Hubler and Meschi (2001), Guangzhou did not have real industrial tradition, sufficient base of industrial suppliers and equipment manufactures, for example, there is no one big steel plant in Guangdong province, they are located in Shanghai, Wuhan…etc. And taking other reasons into account, such as frequent stoppages of the plant due to lack of suppliers, breakdowns of badly maintained robots, and the productivity was less than 50 units per day in early 1990s.

6.2.3 Organization fit

Just as what mentioned in SVW case, there was not big difference between the domestic automotive manufacturers before 1980s, they were all stated-owned, had no previous foreign experience and all human management system seemed in the same form, and Guangzhou automotive Group is not an exceptional case, it is one of them.

6.2.4 Summarize

Organization fit does not seem as an important criterion in partner selection in 1980s because all domestic partners in China do not have big difference at that moment. Strategic and capability fit were more important, however Peugeot has not made a good choice base on these two partner selection criteria, Peugeot made a wrong decision in choosing a capacity 'unfit' local partner and another wrong decision in setting up JV in Guangzhou instead of other Chinese provinces, all these led to poor sales and low productivity.

6.3 Controls over alliance

6.3.1 Host-country (China) regulation:

Refer to Section 4.3.2, the regulation of catalogue for guidance of foreign investment industries and the pillar industry policy have clearly stated that Automotive industry is one of the pillar industry in China, and the proportion of foreign investments in Manufacturing of automobile and motorcycle shall not exceed 50%. Therefore, foreign companies would not be able to obtain more control over the alliance through holding higher percentage of shares (>50%).

In the GPAC, Peugeot took only a 22 per cent share, and took 6 of 11 board seats (Harwit, 1992), same as the SVW, the foreigner unable to gain the absolute power on controlling because of the limitation by regulations in China.

6.3.2 Relative strength of partners in GPAC

According to Child and Yan's (2001) idea, the distribution of operational control of the alliance should depend on whether the partner have the strength on that control.

In GPAC, that Chinese manager in charge of distribution and marketing, and sometimes did not even know the number of vehicles in stock (Hubler & Meschi, 2001). In 1980s, China was transferring from the command economic system to the free market economic system, undoubtedly, Peugeot as the second largest automobile manufacturer in Europe, it had more experience and knowledge on marketing under the free economic system, and thus it may be better for the France side to head the marketing department. This is the example to illustrate that GPAC did not fully take advantage of each partner's strength. Furthermore, there is one more problem about the issue of control; Chinese is in charge the public relation department, to build a good relationship with the supplier, local and central government. Undoubtedly, China side representatives have the advantage because of the same cultural background, but the conflicts between Guangzhou city and Guangdong Province governments make that GPAC can not benefit too much from the policy, hence even follow the right instruction to allocate controls, the result may not come as expectation due to some other problems (Choosing 'unfit' partner).

6.3 Conflict management

This section is going to illustrate the common source of conflict in GPAC, and have an introduction of the conflict management system in GPAC, try to explain the poor relation between partners.

6.3.1Problems Related To Culture Issues and Communication

Cultural issues have long been a challenge to IJVs, which accounts for the poor relations between partners (Lane and Beamish, 1990; Zeira and Shenkar, 1990). According to Hofstede's Model (1980), Chinese's culture is very distinctive and characterized by Confucianism while the western possess a very different set of culture value. Poor management of cultural diversity in PGAC had led to a poor relation and misunderstanding between the partners, the problems of cultural diversity are examined below.

6.3.1.1 Different Interpretation of Power and Capital Sharing

The cultural differences between the Chinese partner and foreign partner led to different interpretation of power and capital sharing in GPAC. There are two reasons make the Peugeot think it should have a superiority attitude within Peugeot over the local partner. First, the tangible asset such as human resource and installations of the Chinese partner were depreciated by the foreign partner as they were not productive and obsolete, however, the Chinese partner have an important intangible assets, local market information and a good relation with governments, and these assets are undervalued by Peugeot as its value was difficult to determine and open to subjective judgment (Hubler and Meschi, 2001). Second, the tangible asset of Peugeot was over-valued as it is calculated at its full capacity, however, it was never operated up to that potential level due to insufficient demand and highly fragmented market. Due to these reasons, Peugeot think it was the one who can make this JV work and it should have majority control of the JV, even it have less share than its local partner. Differently, the Chinese partner did not see things this way; it assumed the sharing of power should according to the value of the capital, instead of the importance of superiority of the capital. The different interpretation of power and capital sharing in GPAC led to cultural clash that severely harmed the harmonious relationship between the partners.

6.3.1.2 Importance of 'Guanxi' and 'Mianzi'

The cultural differences also led to another problem in GPAC that was divergence of aims and the importance of the 'Guanxi[2]' phenomenon (Hubler and Meschi, 2001). In most of the IJVs, foreign partners only concern about financial returns and performance, but Chinese partners often have objectives in economic, social and political side as well. According to Chieng (1999, p.111, in Hubler & Meschi, 2001, P.169), 'the foreign partners see the investment as impersonal figure while the Chinese partners see it as their region, their parents, their friends, and their society where they live. The Chinese partners may have an interest in the private lives of their employees, forms a family with his customers and suppliers, and if they succeed, their successes give themselves responsibilities towards society and their representatives.'

Except 'Guanxi', 'Mianzi[3]' is another important concept of Chinese culture. Chinese regard face as "dignity, self-respect and prestige, one's social standing and position, as perceived by others" (Chen, 1995, in Hoon-Halbauer,1999), "to be polite is to be face-caring"

[2]'Guanxi' describes the basic dynamic in personalized networks of influence, and is a central concept in Chinese society, In Western media, the pīnyīn Romanization of this Chinese word is becoming more widely used instead of the two common translations—"connections" and "relationships"—as neither of those terms sufficiently reflect the wide cultural implications that Guanxi describes.
[3] 'Mianzi' represents social perceptions of a person's prestige

(Hoon-Halbauer, 1999), causing someone to 'lose face' is a kind of disrespect. Some foreign personnel in the JV may not understand this concept and lead to some misunderstanding and unhappy experience. They may cause the local employees to 'lose face' by 'hammering on the table' and 'yelling their employees in the public' (Hoon-Halbauer, 1999), these actions may lead to resentment towards the foreign partner.

6.3.1.3 Problems in Communication

Cultural barrier was one of the failure causes of GPAC since language barrier existed in communication between the foreigners and the Chinese staff members in the JV. Foreign managers in GPAC normally could not speak Chinese and they could only communicate with their Chinese colleagues through a third party interpreter, thus many misunderstanding happened. Therefore no genuine, direct communication between the two parties can take place; 'heart-to-heart' talks are unlikely to take place (Hoon-Halbauer, 1999). Misunderstanding may easily emerge, especially when the interpreter is inexperienced, distortion of meaning may be happened during translation. Furthermore, French and Chinese are two extremely divergent cultures; poor translation will often result in catastrophe, even to the extent of both parties becoming downright hostile to each other, because their underlying assumptions, concepts and ways of thinking deviate so markedly (Hoon-Halbauer, 1999).

Under the lack of open and direct communication, mistrust had also emerged between the French and Chinese. In GPAC, expatriate manager work with their respective Chinese deputies, when a Chinese staff-member had some problems, he approached his fellow manager who spoke the same language, instead of going to his immediate French superior (Hoon-Halbauer, 1999). In this case, though mutual understanding can be easier to attain when speak in same language, but mistrust may arise by contacting others instead of the French superior.

6.3.2 Conflict management system in GPAC

Peugeot also prefer to apply the soft-line approach to solve the conflicts, but compare to the Volkswagen, it lacks two things: experience and positive attitudes. The experience in here is about the experience of how to negotiate with Socialist partner. West German experiences with Socialist East Germany have make Volkswagen understand of command economies and their shortcomings and then how to negotiate with its Chinese partner, however, Peugeot has no this kind of experience before its entry to China. There is one example to illustrate this problem, seeing that sales were not taking off, Peugeot proposed to its two Chinese partners that they should widen the range of models in production and start assembling private cars. Even the Peugeot was finally given the permission to launch the saloon car version of 505; it had taken no leas than three years to negotiate (Hubler and Meschi, 2001).

Another thing is about the positive attitudes, it refer to a sensitive attitude to national a corporate cultural diversity, strong commitment by top and lower level management in the JV and mutual trust. Cultural diversity is a serious problem in GPAC, and in fact, cultural differences generated automatically during the normal functioning of an IJV, it exists in all IJVs, such as Shanghai-VW, BJC (Beijing Jeep Co.,), and it can eliminated by suing cultural management within the

JV, such as providing cross-cultural education, training and workshop for the personnel. In the case of GPAC, its primary goal was short term and financial oriented, it did not pay attention to the cultural differences between parents as well as between the Chinese and foreign personnel. These dysfunctions emerged and increased over time since GPAC did not give so much attention to 'relational' problems when compared with financial issues (Hubler and Meschi, 2001). Mutual trust actually is the best thing to solve the management, but it is what Peugeot did not have.

Part Ⅳ

Chapter 7: Implication by comparison and conclusion

7.1 Brief conclusion of difference

Based on the case study in Chapter 5 and 6, we can conclude there are several differences between the two different JVs in China's auto industry; their differences can be concluded and present in Table 7.1

Table 7.1

Company:	SVW	GPAC
Partner selection	Invest in Shanghai, an attractive industrial city in China; Shanghai Automotive Group Co. basically meets the requirement to form a joint venture.	Select a capacity 'unfit' partner, and an 'unfit' location.
Control over alliance	Regulations restrict the foreigner gain full control over alliance. Different partners take control of different aspects of the operation depend on what they are good at.	Regulations restrict the foreigner gain full control over alliance. Have not allocated the control power based on partners' strength.
Conflict management	Good communication leads to good corporation. Soft-line approach.	Lack of communication, cannot benefit too much from the corporation with government. Soft-line approach, but lack of

		experience and positive attitudes.

7.2 Partner selection:

"A partner with superior strategic traits but lacking strong organizational and financial characteristics may result in an unstable joint venture. The possession of desirable organizational attributes without corresponding strategic and financial competence may leave the joint venture unprofitable. A partner with superior financial strengths without strategic and organizational competencies can lead to an unsustainable venture" (Luo, 1998). The comparitive cases of SVW and Guangzhou Peugeot, illustrates the importance of selecting a 'fit' partner to the survival and growth of foreign companies active in China.

A foreign investor may not able to find a local partner possessing superior attributes in all three categories (strategic, organizational, and capacity). Nevertheless, the importance of specific attributes within a category is dependent on what the foreign company wants to pursue from its venture.

Volkswagen opted for Shanghai Automotive Industry Corporation which is supported by local and central governments as its local partner, thus it could take advantage of partner's local information about the market and its Guanxi. Peugeot also chose to cooperate with a local partner to entry China, however, its local partner-Guangzhou Municipality is only supported by the local regional government, and not the Province government, thus, chose it as a partner to also ensure that Guangzhou Peugeot is affected by rivalry between Guangzhou and Guangdong Province itself.

Furthermore, producing a car needs more than ten thousands parts; it is an industry depends largely on the supplier. One problem Guangzhou met was procurement of locally produced parts of sufficient quality. In addition, the facilities at Guangzhou Auto Manufacturing were outdated and its workers poorly trained, and that Guangdong had lack of minerals and natural fuels which traditionally was home to light industries. Consequently, Guangzhou is not a 'fit' location and Guangzhou Auto Manufacturing is not a capability 'fit' partner. In contrast, Volkswagen selected Shanghai as its base in China, which is a city that has a long history on heavy industry development, even its suppliers cannot meet the standard of joint venture immediately, but at least it can spend less effort and resource on developing it as compared to Guangzhou.

In sum, it is understandable that SVW performed better than GPAC, because Peugeot had lost at the beginning process - partner selection.

7.3 Control over alliance

China's regulations strictly restricted that foreign companies cannot hold more 50% shares of the joint venture and it finally made both Volkswagen and Peugeot unable to gain the absolute power of control.

Volkswagen got 50% equity shares, and it had the same power as the China representatives, sometimes they can affect the important decision of the joint venture. However, Peugeot took only 22% share and took 5 board seats, if the Chinese representatives could implement any policies that can better serves their objectives and may hurt partner's benefit; Peugeot may be unable to stop them. Thus, compare to Volkswagen, Peugeot lose the bargaining position at the first stage.

For operational control, Hubler & Meschi's paper (2001) mentioned that the Chinese manager in charge of distribution and marketing, in the 1980s, China was transferring from the command economic system to the free market economic system. Undoubtedly, Peugeot was the second largest automobile manufacturer in Europe, it had more experience and knowledge on marketing under the free economic system, thus it may better for the Peugeot's representative to be in charge of the marketing department, and to have control over the respective individual functional areas they are good at. In contrast, SVW had a good distribution of power on its different functional areas; Volkswagen had the control on the marketing and technology department, and China's representative had the control on the public relations department: the same cultural background made it easy to communicate with the local, central government and its suppliers…etc.

7.4 Conflict management

Both foreign companies faced the cultural divergence problem, but through different communications, the results of them are very different. Harwit (1992) thought that the success of SVW was largely dependent on foreign and local cooperation and what the most important thing in cooperation was communication; good communication can lead the both parties to understand each others' difficulties, and when there are some conflicts between them, communication can speedily and efficiently solve the conflicts.

In GPAC's case, under the lack of open and indirect communication, mistrust had also emerged between the French and the Chinese. And when the conflicts arise, what they do is to complain of each other rather than to actively communicate with each other and find a way to solve the problem. In SVW case, both foreign and local parties attempted their best to cooperate with each other to reach their objectives. There were two factors that Harwit (1992, p.155) mentioned in the success of SVW, one of them was that 'the shanghai government, itself partially represented through its SAIC partnership in SVW, took earnest steps to solve problems that were not anticipated by the contract'.

7.5 Managerial Insight of Successful JV

7.5.1 Positive Partner Attitudes

According to Faulkner & Child (1999), for a JV to be effective the partners must have positive attitudes towards the alliance. Positive attitudes refer to a sensitive attitude to national and corporate cultural diversities (Kanter, 1989), strong commitment by top and lower level management in the JV and mutual trust (Anderson & Narus, 1990). Inkpen and Crossan (1995) found that if the partners do not have positive attitudes towards each other, learning in JV such as technology know how and management expertise cannot be facilitated, thus lead to a larger possibility of JV failure.

7.5.2 Clear Organizational Arrangements

A clear organizational arrangement is a key to successful IJV (Faulkner, 1994, in Dalton et al., 2006)

- Establish a clear dispute resolution mechanism
- In a JV alliance, clear authority should be vested in the chief executive
- An appropriate legal form
- Agree on a divorce mechanism
- Set up processes for wide dissemination of information within the alliance

7.5.3 A Learning Philosophy

According to Faulkner (1994, in Dalton et al., 2006), a philosophy of constant learning must be adopted by the IJV. If both partners have a prime objective to learn from each other, the prognosis for the future is much brighter. Especially, in China, the success of JV depends on transfer of knowledge, such as technology know how and management expertise. If a constant learning philosophy is not adopted, the JC may fail.

7.6 Conclusion

TNCs like to enter China's auto market because most of them think that China has a location advantage – the largest potential domestic market, and given the large technology gap, without protections, foreign entries will easily wipe out the domestic player. They can find they have advantages on a lot of aspects compared to the domestic manufacturers. On the other side, China government also welcome the entry of TNCs, but it is conditional. What the Chinese government try to do is to foster its own automotive industry and is not interested in turning China into an expansion base for TNCs. Thus, a variety of regulations and policies are established by government to conditional restrict the entry of TNCs, and these policies can be seem as an important limitation for TNCs to select an entry model. The import control increase the transaction cost of import, the 50% maximize share holding regulation made the TNCs necessary to alliance with the domestic manufacturers if they choose to invest in China. However, while the government close the door to the TNCs, it also opens a window for them. There are many favourite policies given to the IJVs if they can meet the requirements of the government.

The host country's regulation and policies do have an effect on TNCs' entry selection, but the magnitude of the effect may not be as large as most people think; if the companies can choose a right strategy while they entering, the bad aspects can become positive. Volkswagen is a good example: the positive attitude and sufficient communication to the partner and SVW benefited quite a lot from the special policy treatment and this is what GPAC could not gain during its operation time. Instead of complaining that the regulation's limitation lead to the failure of entry, it is better to see regulation as a certain condition. All foreign companies can make the most appropriate reaction strategies to this condition. This paper focused on discussing the entry strategies of international joint ventures, how to select a 'fit' partner, allocation of control, and conflict management, are three issues discussed above, and by case study two IJVs: SVW and GPAC, it found that regulation and policy is not the only thing taken into account while making an entry choice. The intricacies of the entry strategy is more important. By comparing the two cases, we see that select a ‘fit’ partner can help TNCs get something what they did not have before and reduce the probability of conflict arising in the future; better allocating different operational controls can fully take advantage of each partners’ strength; having positive attitude and sufficient communication to the partner can make both parties know more about each other and lead to a better corporation in the future.

In sum, regulations and policies cannot be deemed as the only factor which leads to the failure of IJV; it’s difficult to judge that China’s policy as strategic barriers or motives for TNCs to enter China’s automotive market. Excepting policies, companies’ different strategies seemed as a more important factor to determine the success of IJVs. Implementing the ‘appropriate’ strategies can translate the policy from as a barrier to a motives, and help the IJVs have a more healthy environment to continually grow in the future.

Appendixes

I: Catalogue of Encouraged Foreign Investment Industries

19. Communication and Transportation Equipment Industries

(1) Manufacturing of complete automobiles (foreign investments shall not exceed 50%)and construction of automobiles research and development organization

(2) Manufacturing of automobile engine, reused manufacture of engines and construction of engine research and development organization：gasoline motor with output per litre not lower than 50kw, diesel motor with output per litre not lower than 40 kw and discharge capacity below 3 liters, diesel motor with output per litre not lower than 30 kw and discharge capacity above 3 liters, motor driven by such new resources as fuel cells and compound fuel

(3) Manufacturing of key spare parts for automobiles as well as research and development of key technologies: complete disc brakes, complete driving rods, automatic gearboxes, fuel pumps of diesel engine, inhalant supercharger of engines, adhesive axial organ(used for four-wheel drive), hydraulic tappet, electronic cluster gauge, crankshaft and connecting bar(diesel motor above 8 liters), Anti－Lock Brake System(ABS, ECU, valve body, sensor) , ESP, BBW, electronic braking distribution system(EBD) , driving control system, gas generator for automobile airbags, electronic fuel injection system, sprays technology on fuel common rail technology(utmost spray pressure above 1600 pa) , VGT, VNT, discharge control equipment of motor meeting the pollutant discharge standard of the fourth phase of

China, ITM and coupler assembly, Steer-by-Wire System, Diesel Particulate Filter(DPF), intelligent cylinder, special rubber automobile components

(4) Production as well as research and development of automobile electronic devices: engine and underchassis control system as well as key spare parts, in-vehicle electronic technology (automobile information system and navigation system)，automobile electronic network technology (limited to equity joint ventures)，components for the input (sensor and sampling system) and the output(actuator) of electronic control system, EPS electronic controller(limited to equity joint ventures) ，embedded electronic integration system(limited to equity joint ventures or contractual joint ventures) ，electronic-controlled air suspension, ECS，electronic valve system equipment，electronic throttle, power cell(NiH and Li-con) and control system(limited to equity joint ventures) ，integrated motor and control system(limited to equity joint ventures) ，wheelboss motor, multifunction controller(limited to equity joint ventures) ，fuel cell and spare parts thereof, hydrogen storing systems for automobiles， testing system for experiment and maintaining of automobile and motorcycle models

(5) Manufacturing of key parts for motorcycle：technology of electrical control fuel injection for motorcycle(limited to equity joint ventures or contractual joint ventures) , engine discharging device which satisfy motorcycle discharging criteria stage Ⅲ of China

Source: Invest in China, [online], available at: http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=87372

II: Law on Sino-foreign Cooperative Joint Ventures

Article 4. The State shall encourage the establishment of export-oriented or technologically advanced production-type co-operative enterprises.

Article 20. A co-operative enterprise may also enjoy favorable treatment in the form of a reduction of or exemption from tax payments, following its payment of taxes due in accordance with the relevant State regulations.

Source: [online], available at:
http://shenlawfirm.com/china/laws/cjvl.pdf

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