

**Tango, a Cell Phone Manufacturer from US Considering Doing Business in China-Sell Cell Phones in Chinese Market**



**International Business Management**

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**Abstract**

The purpose of this report is to advise Tango's senior management on the viability and mode of entry in China. The methodology used is based on the analysis that covers several relevant aspects pertaining to the business and its implications in reference to Chinese national business system, cultural differences, exchange risks, corporate social responsibility, competition, intellectual property protection, trade and investments patterns. It accounts the differences between business environment in China and the United-States of America, and also includes potential risks associated with investing in China and possible ways to mitigate them. Based on the findings, Tango should move into the Chinese market due to industry prospects and great potential to generate huge profits. Abundance of cheap raw materials required in the cell phone's production process, low-priced qualified labour force, market size and trends, and current governments' incentives to attract foreign firms makes China an attractive environment for investment.

**1. Introduction**

Tango is an American cell phone manufacturer, which is considering doing business in China. It is specialized in the production of cell phones with basic and advance features, having cutting age technology and applications to meet demands of customers' needs with various expectations and income levels. In addition, Tango also produces cell phones related to compartments for all the models of company's products.

Tango is looking forward to engage in a foreign direct investment and open a manufacturing factory in Shenzhen, China's special economic zones to sell cell phones and associated compartments into the Chinese market. Advantages for moving into this location are close access to the port and airport, and also the availability of inexpensive qualified employees in the area.

China has the largest cell phone market in the world. The number of cell phone users has reached almost 900 million. The market value accounts close to \$25 billion and is projected to rise consistently in the coming years. Having this in mind along with favourable legislations and business environment related incentives offered by the government makes it a perfect destination to conduct business and make profits in there.

China's customers are price sensitive and they do have positive preference in their cell phone purchasing decisions for foreign brands. Competition in the market is very high, top world's cell phone manufactures such as Samsung, Nokia, Apple, Motorola, and LG have already moved in and set up their factories and operations. They have been performing well and dominate over indigenous competitors.

Lack of intellectual property (IP) protection is an issue of concern for Tango because government does not have clear legislation and do not undertake steps to fight such a phenomenon. In addition to this, exposure to the currency exchange due to the trend and unpredictable policies can impact profit margins of the company.

## 2. National Business Systems

What makes US national business system different from Chinese is the established political system, which directly influences political economy. Enacted policies within Chinese government are designed and tend to serve primarily the interests of inner cycle of individuals within the Chinese Communist Party (CCP) and other close actors associated with the regime (Martin, 2010). Key differences between both systems are shown below.

Decisions in regulating macroeconomic activities in China are taken top- down starting from central, provincial, local, and city. They are coordinated and controlled by party-state instruments throughout different governmental layers. It is imperative to establish good relationship with government officials from various levels, as they are involved in different activities such trade associations, licenses, financing, access to land and capital. Another important feature within China's national business system that differs from US is the party-state involvement in the control of labour unions and financial system (Coen, et al, 2011).

Government officials dictate local banks their terms in allocating financial resources to support business within domestic economy (Heri court and Poncet, 2006; Asia Monitor, 2011). A study that was conducted from 1998 to 2005 concerning financial constrains in China concludes that foreign companies do not face limitations to finance their projects due to presence of the international banks in China's market. However, there are constrains to access capital from local banks for all foreign and private domestic businesses (Vandenbussche, et al, 2010).

Lack of relevant bodies in China serving as advocacy groups and unbiased watchdogs in policy formulation and implementation of national business system accounts a significant difference comparing to the national business system in US (Davidson, et al, 2011).

Concerning culture differences in the economy, China's business system is build up on pattern of authority and mutual trust rooted in their cultural heritage. Confucian values based on humanism doctrine play a significant role in business. Therefore, individual business activities are expected to contribute to the interest of society versus individual needs in comparison with US (Coen, et al, 2011).

In spite of differences, national business system in China will not create an obstacle for our company to get into the market and run smoothly our operations. It is worth of adapting to the China's business system in order to have access in such a large market. What is relevant for us is China's accession to WTO in 2005 that has led to the cell phone market being liberalized (Hu and Hsu, 2007).

## 2.1 Cultural Influences on Pricing

Chinese customers in general are price sensitive. In general, they have preferences for cell phones with essential functions and affordable prices (Myers and Yuan, n.d). Chinese customers when purchasing a cell phone are influence by other users concerning latest models. Playing games and sending text messages are the main benefits that Chinese customers seek when buying a cell phone. On the other hand, Western mobile phone users such as from US look and compare the latest technological applications and the feasibility of associated functions versus the actual market price (Wuzhou, 2003).

## 2.2 Differences in Management Practices

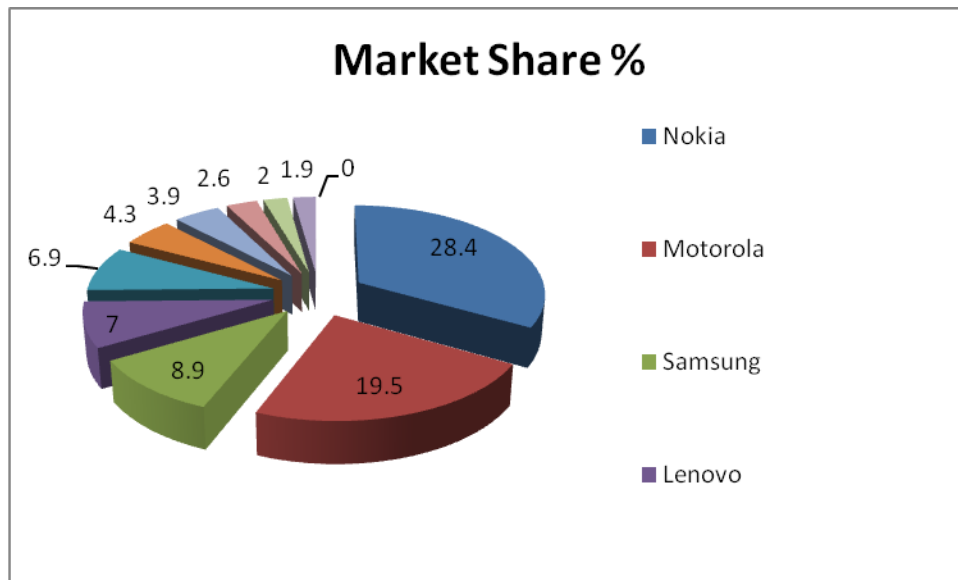
Managers across Chinese companies have different organizational practices comparing with US. While American employers emphasize the quality of work when rewarding their employees, their Chinese counterparts pay more attention and are sensitive in relationship of employees with the rest their peers. In addition, Chinese managers also look at employees individual needs when providing bonuses at their workforce (Zhou and Martocchio, 2001). Capar and Chinta's (2007) study on the difference in managerial values of Chinese and US managers reveal that Chinese are less individualistic. In addition, key differences of Chinese managers have been noted in high power distance, higher ethical values and uncertainty avoidance as oppose to their counterparts from US.

## 2.3 Competition

Degree of competition in China is overall high. There are domestic and foreign companies competing against each other to increase shares and maximize their profits. The strength of foreign brands lies in marketing, distribution, sales and R&D. In contrary, service and manufacturing are the comparative advantages of domestic firms (Chang, et al, 2009).

Chinese government provides indirectly support for indigenou competitors of cell phones made domestically by Chinese owned enterprises in order to strengthen development and research to compete against foreign firms (Cheung, 2005).

Competitive environment is favourable for our company to penetrate in Chinese marketplace regardless of China's support in R&D for domestic brands. Local perception for foreign cell phone brands seems positive considering percentage of market share held by international manufacturers.



(Source: Based on CCID, 2006 cited in Chang, et al, 2009, p490)

## 2.4 Intellectual Property (IP)

Enforcement of IP Protection laws still remains an issue of high concern in China. In comparison with US, China's government does not take all necessary precautions to safeguard various registered patents and trademarks (Kotler, 2010).

There are several factories that produce mobile phones pirated and imitated from world's best-known brands called Shanzai. Domestic market in China during 2009 was covered with around 30% of Shanzai mobile phones. Out of 600 million cell phones sold from different brands, 145 million were out of Shanzai factories (Medeiros, 2011).

Berrel and Wrathal (2007) advise foreign companies to be due diligent and alert in order to protect their IP. Regardless of the environment and ambiguous legislations, it is still possible to protect IP through the judicial system if there are enough support and evidence for the case. There are many cases where Chinese courts have ruled out in favour of foreign firms.

## 2.5 Labour

Labour force in China in the cell phone market is cheaper comparing to USA. They have been educated by local and foreign educational institutions, and do possess necessary knowledge, expertise and set of skills to meet demands of both indigenous and foreign companies (Passerini, et al, 2007). Torstensson et al. (2008) report funded by European Union confirms the inexpensive labour market in the mobile phone manufacturing sector in China. Thus, moving into China will enable Tango to minimize costs and become more competitive in the market.

### 3. Patterns of trade and investment

China and US have a liberalized market concerning cell phones. There are no tariff level of protection against imports from either country. During 2008, China has accounted for 40% of US imports on cell phones ( US International Trade Commission, 2010).

As far as non-tariff barriers, China's regulations in the cell phone industry require that foreign and domestic manufacturers and suppliers acquire certifications from Ministry of Information Industry (MII) Examination Center and Standardization of China. Any manufactured product should pass through designated tests in terms of connectivity, electromagnetism and product approval before items can be sold legally in the market. Licenses need to be obtained for both production and sales of cell phones from respective authorities within MII (Hu and Hsu, 2007).

In China, raw materials required in the manufacturing of cell phones are cheaper. China already produces 95-97% of world's supply of rare earth metals that are essential in manufacturing hi-tech goods (POST, 2011). Existing US cell phone manufacturers in China are Motorola and Apple. Both of them besides selling their products in Chinese market, they also export to US (US International Trade Commission, 2010). On the other hand, research does not reflect any Chinese cell phone company manufacturing in US.

Trade and investments trends can risk sustainability of Tango cell phones in US due to free trade and competition coming from China by US based manufacturers. Therefore, having access to cheaper labour and raw material costs in China will strengthen competitiveness of Tango company. Key competitive advantages required to succeed in Chinese market for Tango mobile company are quality cell phones, reasonable price, distribution, expertise in sales and marketing.

There are two available modes of registrations for foreign firms seeking investments in China. It can be either Joint Venture (JV) which requires a Chinese partner to have stake into the business or in the form of wholly foreign-owned enterprises (WFOE's). The latter does not require a Chinese investor to have stake in Tango's venture. The license can be obtained through Ministry of Foreign Trade and Economic Cooperation (MOFTEC). The idea behind this is to stimulate investments made on long-term basis. Changes and modifications on the structure and ownership of FDI's cannot be made without the permission of MOFTEC. Disposal of investment is allowed in restricted forms under current and regulations. (Allan, et al, 2002). Either form of registration will have implication in Tango's operations. While JV would ease the process of setting up the factory to start manufacturing, the negative sides are shared profits with Chinese partner and inability to safeguard company's core technical values and expertise.

#### 4. Exchange Rate Risks

According to Begg and Ward (2009), China is governed by fixed exchange rate regime whereas the US by floated. Having fixed exchange rate, Chinese government continuously either buys excess supply of its currency from the FOREX market or sells to keep the value of Yuan fixed against the other basket of currencies for exporting purposes. China relies on exports as it has an export driven model. On the other hand, US government does not interfere in the market to dictate depreciation or appreciation of US dollar, but rather supply and demand in the markets reflects its fluctuations against other foreign currencies.

Current interest rate in US are between 0 to 0.25% according to Federal Reserve (2011). On the other hand, interest rates in China are 6.56% for borrowings and 3.5% for deposits (Wassener, 2011).

US still remains the largest economy in the world. However, the stability of its economy has been shaking in recent years. The recovery after 2008 financial crisis is not completely back on track. Expected economic growth rate ranges from 3.3 to 3.7% (Federal Reserve, 2011). On the other hand, China's economic stability is very solid, it is the second largest economy in the world. It has managed to retain a consistent level of high growth in the past decade. Its GDP growth rate in 2011 was 9.5%, and is anticipated to have a growth of 9 % during 2012 (IMF, 2011).

Below graph from yahoo finance (2012) shows currency exchange rates between US and China for the past 5 years. Yuan has been appreciating relatively against dollar. Potential effects of future exchange rates on Tango may impact negatively its profit margins if the trend continuous.



Source: Yahoo Finance (2012)

However, measures to offset these exchange risks in China can be done through non-deliverable option (NDO) and non-deliverable forward (NDF) contracts as suggested by Noble (2010):

- Based on the NDO, a premium in the form of insurance will be paid in exchange for flexibility to exchange the currency at higher rate. At the same time, in case of negative net fluctuations, possible losses will be protected by insurance policy.
- NDF- our company will be able purchase Yuan up to 1 year forward from a financial institution at the current NDF rate as reflected currently in the market.
- Upon contract expiration, regardless of the appreciation/or depreciation of the currency, this will enable net dollar settlement will result neither in loss nor in gain.

### 5. Do business or not and if yes – how?

Business environment in China is favourable; the industry Tango is seeking to get into is liberalized and dominated by both foreign and local manufacturers. China's market offers great opportunities for Tango to do business. It has the largest market in the world. The market value in this industry has accounted a total of \$ 24.8 billion during 2010. The trend is positive and the growth expected to double by 2014 (Datamonitor, 2010). Having access to such a huge market through FDI will allow Tango company to maximize profits and strengthen its positions in the global market in the immediate future.

Year	Market Value (\$ billions)	Million Units
2009	23.1	196
2010	24.8	219.5
2011	29.1	258.3
2012	34.8	314.3
2013	42	385.6
2014	50.9	477.3
Based on Datamonitor, 2010, p29-30		

With Chinese accession in WTO, the sector of cell phone manufacturing has been liberalized. There are no barriers to entry; the licenses for manufacturing and selling Tango's cell phones in China's market will be obtained from MII. Tango mobile will establish a Wholly Foreign Owned Enterprise. The reason why this has been chosen is due to the fact that it does not require a local Chinese investor to be part of its business venture (Allan, et al, 2002). In this way, Tango will minimize exposure of locals to company's strategic plans and asset values and ensure a higher degree of protection

China has established unique economical regions and zones to promote investments and attract FDI's for potential investors planning to invest in electronics industry. In addition to this, ports and

bounded zones are available free of charge for potential investors. Hi-tech related investments are of high interests for the governmental officials. Therefore, straightforward negotiations with pertinent authorities are essential to obtain various incentives concerning tax reliefs. Upon successful outcome of negotiations, incentives and benefits include reduction in import and export duties, land fees, and income taxes on both local and national level (OECD, 2000).

Therefore, Tango's manufacturing facility will be located in the Shenzhen, which is a special economical zone located in south of China. Shenzhen is a key hi-tech manufacturing base. It has among the biggest port throughout the world and one of the largest airport in China. Many successful cell phone manufacturing companies such as Nokia, LG and Siemens are running their manufacturing operations in Shenzhen. There is an abundance of cheap labour force available seeking employment. They come from China's poorer regions and some of them do receive as much as \$ 100 on monthly basis working on the manufacturing factories across Shenzhen (RoyChoudhury, 2010)

## 6. Corporate Social Responsibility (CSR)

CSR in China is in the developing stage and is not standardized across the country (Wang, et al, 2010). The problems of establishing and operating an effective CSR policy are of economical, political and institutional nature. China's economy relies heavily on the manufacturing industry. Corporations avoid CSR compliance due to additional costs that ought to incur in terms of labour and environment; because it weakens their low price comparative advantage in the world's markets. China's government consistently seek ways to attract foreign companies for investment purposes. They accommodate the needs of MNC's to exempt from compliance of labour and environmental requirements. Therefore, local government across regions in China lacks the courage to undertake steps for enforcement and monitoring of existing CSR legislation. There are also gaps within CSR framework policies. Responsibilities among businesses and government are not clearly stated. As a consequence, this enables corporations to find flaws within the legislation and avoid compliance (Lai, 2005).

Research done by Torstenson et al. (2008) shows breach of code of ethics in labour treatment in China by cell phone manufactures to include Nokia, Siemens, LG and Motorola in the following areas:

- Underage female employees from 16 to 18 years old are exposed in risky and physically demanding jobs to perform their duties in day-to-day operations.
- Employees' over time per month ranges from 120 to 180 hours. Law allows a maximum of 36 hours.
- Manufacturers institute excessive disciplinary measures in salary reduction if anyone breaches existing work instructions.
- Employees complain on the inadequate personal property equipment provided such as gloves to handle various sprays and toxic materials that pose health related risks.



## 7. Conclusion

China's national business system in spite of differences comparing to US still offers great opportunities for foreign companies to conduct business. Government structure and hierarchy in China along with close CCP involvement in country's political economy affairs does not pose risks and negative implications for Tango's engagement in FDI to manufacture cell phones in order to sell into the Chinese market.

With the accession in the WTO, China has liberalized cell phone market, it has removed restrictions concerning manufacturing limitations and lifted tariffs for telecommunications products. All tariffs barriers between US and China as far as exports and imports of cell phone products have been completely removed. On the other hand, Tango still needs to comply with non-tariff barriers imposed by MII in order to manufacture and sell in the domestic marketplace.

China has a very large market; the number of cell phone users has almost reached 900 million. The market value accounts close to \$ 25 billion and expected to reach \$ 50.9 by 2014. Foreign companies dominate the cell phone market. Domestic manufacturers besides having expertise in manufacturing and service, they lack knowledge in field of distribution, R&D and marketing in comparison with foreign brands.

Availability of qualified inexpensive workers and raw materials along with relatively weak requirements and enforcement of labour laws provide a comparative advantage for foreign firms to relocate in China to make profits. Having all this into consideration, it is highly recommended that Tango senior management undertake the decision to open the cell phone-manufacturing factory in China in order to sell its products into the Chinese market.

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