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ITALIAN SMES IN CHINA: RISK AND OPPORTUNITIES OF INTERNATIONALIZATION

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Introduction

The idea behind the realization of this thesis has matured in recent years. When I started to move my first steps in the university, I did not know what I liked. I used to study passively, without passion. Only during my third year of bachelor, I started to notice a sort of "tickle" in my brain while facing innovation topics. I decided to indulge that tickle, which eventually led me to enroll at Entrepreneurship and Innovation Master, here at Padova, and also led me to know better China and its innovation ecosystem, because, to me was and is clear, that China will "host" next Silicon Valley so it is impossible to say innovation without saying China.

So, when I discovered Professor Mauro Giacomazzi's class I immediately was caught up. The class taught me that our "business conception" of China is often a misconception, driven by clichés, and that there is a huge underused potential for many western companies there. Italy should look at east, aware of the threats and the challenges but also with hope and the willingness to do that characterizes our entrepreneurial class.

Objective of the thesis.

I built this thesis to better understand the challenges and opportunities an Italian small-medium enterprise (SME) may face during its journey toward Chinese markets. I covered the existing literature for what concerns the internationalization process (meant as export and establishment of new venture) and the difficulties and advantages may arise from it. Then, I compared the literature with data coming from the real scenario of Italian company that want to move or export to China.

Finally, without any presumption of writing an experimental thesis, I decided to interview two actors who are involved in relations with China, to listen to their opinions and to assess whether the solutions or the obstacles provided by the literature are actually felt "close" to reality of everyday business.

1. Definitions and Literature.

1.1. The SME definition.

The concept of small-medium enterprise has not always been the one we know. While there was not a unified definition for every European state, each country had its own criteria to mark what was to be considered a SME and what not. Italy considered a company to be small-medium enterprise when it had fewer than 250 persons as staff, while Germany used to apply the same definition for companies with less than 500 persons. With the Commission Recommendation 2003/361/ EC, as published in the Official Journal of the European Union L 124, p. 36 of 20 May 2003, the European Union put the foundation for what is to be considered a unified definition, that provides:

- Staff headcount lower than 250
- Annual turnover equal or lower than 50 million of euro
- Balance sheet total equal or lower than 43 million of euro

While the staff headcount is mandatory to be lower than 250 for the firm to be considered SME, the same rule does not apply to the other two points. Indeed, the company may choose to meet either the annual turnover or the balance sheet total ceiling, exciding one of them without losing the status of small-medium enterprise.

Whenever a company may exceed the threshold for headcount or financial ceiling during a financial year, this will not affect its status of SME. This warranty, provided by article 4.2 of the Recommendation, has the aim of providing stability and certainty to those firms that are close to the limits. However, the status is lost when a company exceeds the limits for two financial years. The same rule applies also to larger companies who present a reduction of headcount and financial numbers. They will gain the status of SME only after two years.

1.2. The internationalization theories.

The economic literature has struggled to find a precise and well-defined theory of internationalization. Different scopes and different concepts of broadness may be applied to the definition, making internationalization a “smoky” concept. Different “schools of thought” have emerged during the years, following the developing and the progress of globalization. These streams of studies can be summarized in (Ribau, Moreira, & Raposo, 2015): the Uppsala model, the eclectic paradigm, the network internationalization theory and the new ventures born global theory. While presenting all the models here listed, this thesis will focus on the network model.

Uppsala model.

The Upsala model is a model that conceives the internationalization as a slow process that takes place over time. It has been mainly developed by the Nordic School, with the wok and studies of Johanson and Vahlne (1977). The model is based on the presence on some mandatory stages the company must face in order to go international. Although is one of the most cited and analyzed theories in the modern economics this school received critiques because it could not find empirical proofs. In addition, it has been criticized because described as too static, not focused on the seeking of international opportunities but rather focused on the steps/activities the company goes through. Indeed, with the Upsala Model, the company goes international when it receives the first order from abroad. Before this particular condition there are three elements that keep the company from internationalizing:

- Lack of knowledge of foreign market.
- Risk aversion.
- High perceived uncertainty.

Once overcome these three factors and after the first international sale, the company “tastes” what is like doing business abroad, hence develops knowledge and can go on with the process. The literature has found this model particularly suitable for SMEs, especially after the model was revisited basing it on the network model (that I will cover later).
These are the steps the company faces:

1. No regular export activities
2. Export via independent representatives
3. Establishment of a foreign sales subsidiary

4. Establishment of foreign production/manufacturing unites

The eclectic paradigm.

The eclectic paradigm, also called OLI (ownership, location and internationalization) is theory developed by Dunning in 1977. It is based on macroeconomics and it has as its base the transaction cost elements and robust market theories.

The eclectic paradigm is a simple but deep framework that center the theory on the relationships between three variables. The first ones are ownership specific (O). They include tangible and intangible assets. The second variable is related to the location of the firm in particular country. They matter because allow the firm to exploit barriers, dynamins and political situation to develop its business. The last variable that create competitive advantage for the firm is internationalization (I). It consists in exploiting the ownership advantages internally rather than through other firms. It is based on four decision criteria:

- Risk
- Control
- Return
- Resources

The eclectic paradigm has found consistent results in different sectors, especially for what concerns FDI, but after the years 90s with the increase of level of globalization a new element of interconnection between O, L and I was stressed by Dunning. As Cantwell and Narula (2001) pointed out, the interconnection between the three elements is manifested through MNEs cross-border activities.

From this theory, other interesting theories evolved, like for example the OLMA paradigm (ownership, location, entry modes and adjustment) by Guisinger (2001) or like an advanced version of the eclectic model by Dunning and Lundand (2008) which includes the institutional variable.

Again, as for the Upsala Model, the OLI model receives critiques for what concerns the explanation of why company internationalize, without stressing the differences between advantages that are typical of the ownership and advantages that are typical of the firm.

The network model.

The network model of internationalization is defined as the establishment, maintenance and development of relations with network participants on foreign market (Johanson & Mattsson 1988; Turnbull & Valla 1986). According to Johanson and Mattson (1988), the position in the network, that could be domestic or foreign, determines the level of relations with other participants and hence the degree of internationalization.

The starting point for internationalization is given by the position occupied by the company inside the network. A company may decide on:

- International extension, that is the decision to establish new relationships with foreign markets.
- International penetration, that is the decision to extend and develop the networks in country in which it already operates.
- International integration, that is the decision to coordinate relationships in various foreign markets.

Johanson and Mattsson (1988) also provide four possible variants of internationalization, keeping in mind that in the network model, it should be considered not only the individual company (and its assets) but also the network in which it is collocated (so the market assets).

The scheme is the following:

		Degree of market (network) internationalization	
		low	high
Degree of company internationalization	low	*Early starter*	*Late starter*
	high	*Lonely international*	*International among others*

Table 1. Network model positioning. Source: Johanson and Mattsson 1988.

The first quadrant is characterized by a low internationalization level both in company and market. The company in this position is an "early starter" and does not have any relevant connection with foreign markets. This condition applies also to the market, that is composed by entities that do not have enough knowledge of foreign dynamics to start a dialogue and exchange know-how to internationalize. To get enough expertise to start a project abroad, companies require resources to be invested and usually it leads to hiring an agent for a foreign market similar to the domestic. As Johanson and Mattsson emphasize, the "early starter" get some knowledge thanks to the agent and is able to invest directly in the country.

After this stage, the "early starter" becomes a "lonely international", that is a company with a high level of internationalization, not supported by and adequate level of internationalization of the market. At this point of its evolution the company is able to carry out large networks of relationships in the foreign country, often exchanging information of domestic market with foreign players. These relationships allow the firm to expand its business activities also in markets different from the domestic one. Because of the low level of internationalization of the market, the "lonely international" acts as a spur to increase foreign knowledge between domestic competitors.

The third company position of the quadrant is occupied by the "late starter". Like the early starter the late starter has a low level of internationalization, but the maturity of the market differs completely. In this case, the market presents a high level of internationalization, which put the firm in very disadvantageous position. Indeed, in this case, all the competitors own the knowledge and expertise to internationalize, element which lacks in the late starter. However, according to Johanson and Mattsson, if the late starter is a SME, it may possess the right flexibility and specialization to launch joint ventures operations, finding niche market yet unexplored. On the other hand, large companies find themselves in a very complex situation, because usually they cannot bear the risks of new venture or new partnerships in a foreign country.

If both the company and the environment is characterized by a high degree of internationalization, we have an example of an "international among others". In this case, increasing even more the level of internationalization does not bring radical improvement in market penetration. On the other hand, international among the others have the task to balance the coordination between various foreign market, due to inevitable changes in demand of supply. This balance represents the greatest difficulty for a company of this kind, but also

the huge opportunity to spot opportunities and threats in advance. Furthermore, an international among others may resort to a vast number of resources and relationships, that often result in collaborations and joint ventures.

After having briefly explained how the internationalization process is framed by the network model, it is possible also to explain why it has been selected as thesis model. Recent economic literature has identified the network model the most relevant model to explain SMEs internationalization. SMEs are characterized by a lack of resources and expertise, that do not allow them to internationalize. In this sense, the network model allows them to "act and think big" (Selz, 1992), overcoming their isolation. This has been confirmed also by the studies of Rutashobya and Jaensson, who found the networks and relationships as key for small exporting business to internationalize. In Italy, the network model has been demonstrated to be an effective theory to explain internationalization of Italian small businesses. According to Tavoletti (2011) the model is coherent with Italian management tradition, where thousands of small firms build a web of relationships. Battaglia Corsaro Tzannis (2006) confirmed the importance of networks for Italian firms.

The new ventures and born-global.

The rapid changes in business and globalization obliged some firms to adopt a completely different approach to internationalization. These firms are not captured by the traditional model, which may appear static compared to the new paradigm. These firms are "born global" which it means that they expand in foreign market since their birth (Knight and Cavusgil 2004). Despite the different names given to them like "global startups" (Oviatt & McDougall, 1994) or "infant multinationals" (Lindqvist, 1991), the new phenomena, typical of 21st century SMEs, has the following characteristics:

- Global vision from the outset.
- Previous international experience of the management team.
- Access to international networks.
- Technology based firms.
- Knowledge intensive firm.
- Highly specialized firm.

1.3 Entry modes.

The choice of entry mode is one of the most fundamental steps, if not the most important, a company overtake in order to internationalize. The entry mode is defined as the process of establishing the set of procedures through which the firm transfers its products, resources and activities to a foreign market (Root, 1994). Two important reasons shall make companies select accurately the entry mode. First of all, it is very costly to reverse (Kumar & Subramanian, 1997), and as I have previously said, the SME is characterized by a low level of resource availability. Secondly, the future of the business will be influenced by this choice, involving a large commitment of the company that may result pointed in the wrong direction (Kumar & Subramanian, 1997).

Many pages have been written to explain and describes different entry modes. In this thesis I am going to use the modes as provided by Root (1994), one of the most cited authors in this sense. According to Root, a company can internationalize through these four ways:

- Exporting
- Licensing
- Joint Venture
- Wholly owned subsidiary

Exporting does not involve the physical presence of the domestic firm on foreign land. It could be direct and indirect. The direct way does not require the presence of an intermediary between the domestic firm and the foreign market, while the indirect method often consists in a trade company who take care of the process on behalf of the domestic firm.

Licensing is a non-equity contractual mode. The contract is between the licensor (domestic firm) and the licensee (foreign firm), with the latter who benefits of following property: patents, trademarks, company name, technology, and/or business methods in charge of a fee or a percentage of sales.

Joint venture is an equity entry mode that consists in establishing a venture in the foreign country together with a partner who will "split" assets, management activities, profits and losses. As I will explain later, the danger of this kind of mode is in the risk of undesired

"knowledge spillover", due to the inevitable sharing of information and know-how between the two partners.

Wholly owned subsidiary is an equity entry mode that involves the exclusive presence of the domestic firm in the foundation of a new venture. While with this method the risk of knowledge spillover is avoided, the wholly owned entity will bear a higher risk, due to the lack of foreign market knowledge that a partner could have contributed.

In the selection of the entry modes, the company should differentiate according three characteristics (Maigman & Lukas, 1997) (Woodcock, Beamish, & Makino, 1994):

- Quantity of resource commitment required;
- Amount of control;
- Level of technology risk.

The quantity of resource commitment are the dedicated assets that cannot be employed for other uses without incurring costs. Resources may be intangible, such as managerial skills, or tangible, such as machines and money. The amount of required resources varies dramatically with the entry mode, ranging from almost none with indirect exporting, to minimal training costs in licensing, to extensive investments in facilities and human resources in wholly owned subsidiaries.

Control is the ability and willingness of a firm to influence decisions, systems, and methods in foreign markets. In a franchise type of licensing agreement, control over the operations is granted to the franchisee in exchange for some type of payment and for the promise to abide by the terms of the contract. Thus, the licensor has little direct control. In a joint venture control is shared formally according to level of ownership, as when equity ownership over 50 percent gives one of the partners the largest number of directors on the board. However, informal control mechanisms may also be exerted as when one partner possesses and uses knowledge and information that the other lacks. Wholly owned subsidiaries are attractive to many companies because this mode enables the firm to exert the most control in decision-making.

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Export

While it is common to see the sale director of an Italian company to manage both domestic and foreign sales from Italy, it is not possible in the case of exporting in China. Exporting in China requires ad-hoc figures that must be chosen with attention. Indeed, between the Italian firm and the Chinese market there is an intermediary, which is located on Chinese land, that “helps” the company to find the right distribution channels, set the right promotions and find the right business partners. It is a “low-risk” choice that obviously has a negative side. The company which resort to the Chinese intermediary has little control on the exportation process and it is limited in selecting its own strategy.

As I have explained in the paragraph related to the entry modes, Italian company basically face two choices: being directly present of Chinese land or exporting. Exporting is the most used entry modes for Italian SMEs. This choice is characterized by the low risk and investment faced by SMEs which have few resources. In fact, if the valuation of the market results wrong, the company can always “exit” without notable frictions.

The exportation in China can be explicated in two ways: direct exportation or indirect exportation. The first one has the intermediary on the Italian land, while in the second one the intermediary is resident in China. Indirect exportation cannot be considered a real internationalization mode, because they do not allow the company to undertake a strategic and constant presence in China. However, this choice is suitable for the early stage of internationalization, when the company is still moving its first steps in the foreign market. For this reason, this kind of exportation is not relay diffused between Italian SMEs.

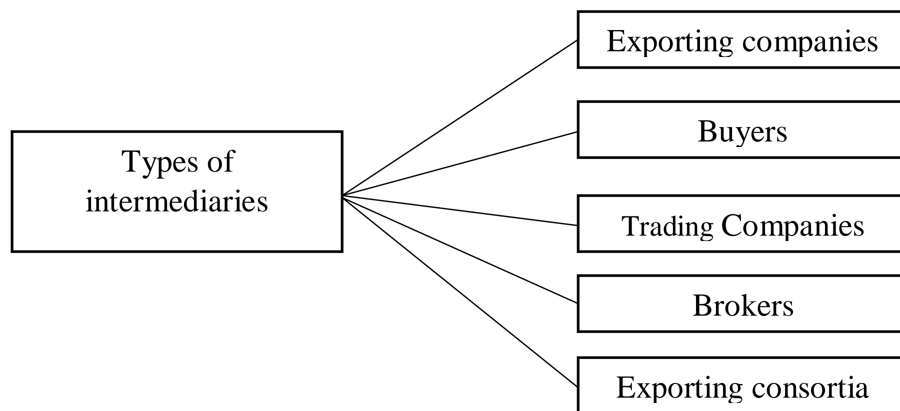


Table 2 Types of Intermediaries. Source: Vianelli, De Luca, Pegan.

Export companies are usually companies who belongs to the same supply chain of the exporting company. They are chosen by those companies who have a sale office in their organization, but lack of an export office. While it is common to see the sale director of an Italian company to manage both domestic and foreign sales from Italy, it is not possible in the case of exporting in China. Exporting in China requires ad-hoc figures that must be chosen with attention. Indeed, between the Italian firm and the Chinese market there is an intermediary, that "helps" the company to find the right distribution channels, set the right promotions and find the right business partners. It is a "low-risk" choice that obviously has a negative side. The company which resort to the Chinese intermediary has little control on the exportation process and it is limited in selecting its own strategy.

Buyers are typically independent sales actors, who keep solid contacts between Italian and Chinese firms, helping them to select the right products for the market. They are extremely helpful when it is about to export Made in Italy products, that are peculiar and may need dedicated assistance when crossing the boarders. They also help exporting companies by providing showrooms and verified distribution channels. The great disadvantage of this choice is due to the instability of the relationship between the Italian firms and the buyers. Buyers can decide in any moment to work for another company, making all the past efforts in building a long-term strategy, vain.

Trading companies are usually big companies who assist not only the mere exportation of the Italian good, but also the finance, logistics and distribution behind it. Often, they provide feasible analysis and market research for the selected good.

Brokers behave as link between exporter and importer, offering also advices. Brokers do not operate on foreign land and they are not involved directly in the buying and selling process. They should not be considered as stable parts of the strategy, because their work is often related to batches of products.

Export consortia are voluntary aggregations of firms operating in the same sectors. They can be mono-sectorial or pluri-sectorial, they can be promotional focused or selling focused.

The direct exportation has the company managing the export process directly in China. The majority of the SMEs undertakes this path which is synonym of more stable intentions for expansion in foreign market. The direct exportation can occur in three ways: directly dealing with the client, without intermediary; using a structured sale network; using intermediaries.

In the first case, the company is able not only to manage the sale process, but often provides after-sale services. It is the typical case of an e-commerce company. In the second case, the company uses a sale network. The network can be direct, that means the presence on foreign land of company representatives, who may work with or without a stable representative office. The network can also be indirect. In this case the "representatives" are Chinese agents working on behalf of the Italian firm. Finally, the direct exporting firm may resort to intermediaries. Those intermediaries can be distributors, importers and dealers. Distributors offer the highest level of service and they often represent a long-term resource. They are wholesalers who buy foreign company's product (so they own them) and often benefit of an exclusivity agreement. The distributor is involved in the logistics and distribution process, has a sale price corridor and organizes promotion activities together with the exporting company. The benefits and advantages of resorting to the distributor have also some side effects. First of all, the distributor, as we have seen, has great control on the price and on the promoting activity related to the imported good. The Italian firm should always control its activities in order to check whether they are always on the right track. In addition, to work the distributor needs some warranties about the exclusivity of the contract. In fact, in many cases the distributor does not trust the ability of the Italian firm to control for the absence in China of other second-hand resellers, who mine the work of the official one.

The second intermediary is the importer. Importer is a figure similar to the distributor, but with a few and fundamental differences. First of all, it always requires the exclusivity agreement in

a determined region. Secondly, they usually represent vary foreign companies even of the same sectors, with negative effects on the market penetration of a specific good.

Finally, the dealer is the last intermediary. The dealer also presents many similarities with the distributor, with the difference that he is not only a wholesaler but also a retailer. From the practice, emerges that dealer is the most difficult figure to “deal” with. Due to their relationship with the final consumer, they often tend to ignore the policies set by the exporter, bypassing their control.

Contractual modes.

When companies deal with foreign and far countries, with high entry barriers, export may not be the best choice due to the lack of control. Firms can select a partner and share with it the risk of the activity. This is the case of contractual entry modes, where there is no share capital involved. The main contractual modes are:

- International licensing
- International franchising
- Piggyback
- Contract manufacturing or outsourcing
- Assembly contract and OEM
- Management contract
- Turnkey contract
- Strategic alliances

International **licensing** is “the process of transferring the rights of a firm’s products to a foreign company for the purpose of producing or selling. For a set royalty fee, the licensor allows the licensee to use its technology, trademarks, patents, characters and other intellectual property in order to gain presence in the markets covered by the license” (The main advantage for SMEs lies in the few costs. The Italian firm bears low risk with the possibility of growing quick in the foreign market. In addition, the franchisee is usually a firm that already has its network in China, so the Italian firm does not have to set up one. Then, the Italian SME can extend the life cycle of the product by licensing the technology. It is not uncommon that products that are considered “mature” in the domestic market, eventually find new life in foreign markets. The main risk linked with licensing is related to control. Due to the great independence of the licensee, that is

a separate company, the licensor may find difficult to control the image positioning of the licensee. Indeed, a wrong strategy and comprehension of the market by the Chinese company may result in ruining definitely the image of the Italian brand in that market. Furthermore, there is big risk also linked to the intellectual property protection. Even if the license contract is binding, the licensee can acquire knowledge and insights that may result in transforming the licensee in a new competitor. In the following table (table 3) are summed up all the advantages and disadvantages a SME faces during licensing.

Advantages
Royalties.
Bypassing regulations and tariffs.
Limited investment in the foreign market.
Fast market access.
Risk is mainly taken by the licensee.
Licensee can suggest marketing adaptations for the local market.
Licensor can profit from a mature technology.
Disadvantages
Licensee acquires technological and marketing skills from the licensor and can become a future competitor
Licensee in an independent entrepreneur: risk of limited control over market and revenues for the licensor
Brand image not homogenous across country countries

Table 3 Advantages and disadvantages of licensing. Source: Alon, Jaffe, Prange, Vianelli.

International **franchising** is the contract through which "the company (franchisor) enter a foreign market by giving to a foreign independent company (franchisee) the right to operate its business". It is a similar contract to licensing, but with greater control for the franchisee compared to the licensee. In the case of franchising, the franchisee not only has control on the trademark, but also on the production and services activities. If well built, the franchising provides a win-win situation for both the players. The franchisor enters a new market with low risk, while the franchisee is able to run a well-known business. Even if the franchising is typical of big multinational companies, there is space, especially in eastern countries, for smaller

companies. For example, franchising is still relatively new in China where has been authorized only in 2004. Franchising can be direct or indirect. Direct franchising has the domestic company, in our case the Italian SMEs which operates from Italy dealing directly with the franchisee. The distance, obviously, has an impact on the level of control. This is model A. The Italian company, on the contrary, can set up a branch or a subsidiary in China and from it deals with the franchisee. Indirect franchising is intermediated by the creation of contractual joint venture (strategic alliance) or an equity based joint venture. In the following table (table 4) is possible to see the main advantages and disadvantages of the franchising mode.

Advantages
Royalties.
Relative quick development of store chain.
Investment is mainly made by the franchisee.
Greater control than export modes.
Risk is mainly taken by the franchisee.
Rapid increase in brand awareness within the country and in different foreign countries.
Franchisor can gain local market expertise from the franchisee
Franchisee can suggest marketing adaptations for local market.
Economy of scale in production.
Disadvantages
In some country the legal system is not stable.
Identification of a good franchisee is not easy.
Reliability of the relationships with the franchisee.
High investments to identify the best adaptation of the franchising format in each foreign country.
Limited control over markets and revenues.

Table 4 Advantages and disadvantages of franchising. Source: Alon, Jaffe, Prange, Vianelli.

Piggyback means to be carried by someone. It is the contract with which the domestic company "uses" another company which may be domestic (indirect piggyback) or foreign (direct piggyback) to export in another country. With this formula, the domestic company transfers the

weight of the export to a more powerful company. It is a good way for small and medium enterprises to approach foreign markets without losing the control of the distribution channel.

Contract manufacturing (outsourcing) has gathered attention in the recent years due to its appealing for foreign companies and the controversy related to the reduction of internal job demand. It consists in the production of part of the product or the whole good using cheaper labor, present in foreign country. The benefit for the contractor, which is the company which outsources production, are related to lower costs and the possibility of entering a foreign market with very few investments. On the other hand, outsourcing has raised problems and questions related to the production quality. Famous are the case of American multinationals like Nike, which have seen their brand damaged by such practices.

Choosing the outsourcer, it is a very delicate process. The company should select the partner by the quality offered, the on-time supply, financial solidity and experience in dealing with western companies. However, the risk of having the know-how stolen is quite high.

Assembly contract is the contract with which the domestic company sends semi-finished products abroad to be finished and then takes it back to sell it.

The **Original Equipment Manufacturer** (OEM) contract has the domestic company buying products that are produced by a foreign firm and subsequently selling it appearing as the official producer in the market.

Under a **management contract**, a company uses the expertise and knowledge of a foreign company for running its business for a set time and fee or percentage of sales. It is very common in the hotel sector, where the big chains of the sector use the management contract to allow the foreign companies to run the daily hotel operations, without managing ownership, strategic and financial decisions.

Turnkey contracts are called in this way in relation to the readiness of the business. Indeed, the turnkey contracts involve operations, design, construction and equipment of large facility and often the training of the personnel by a foreign company, which turnover the key to the foreign company which has only to run a ready-to-go business. These kinds of contracts are carried out by government, which may set general conditions, a corridor in which the exporter has the freedom to act (self-engineered turnkey) or may set very specific and strict rules where the exporter has no margin of freedom. Of course, in the first case, the liability for the failure of the project relies in the importer, while it is the opposite in the second case.

Finally, there are the **strategic alliances**, that are contractual (non-equity based) joint ventures. In this situation, two players, the foreign and the domestic company share resources to pursue a common goal. Usually, the shared resources are trademarks or technology with the aim of reaching the same goal as if they were equity based joint venture. However, this operation does not result in the constitution of a new company.

While the advantages for a foreign company are many, the same can be said for the disadvantages. Obviously, the contractual joint venture allows the foreign company to drastically reduce risk while entering in a new market. The transaction cost can be reduced, and own resources can be leveraged with the resources of the other player to reach the goal. However, it is common for companies resorting to such mode, to find themselves in conflict with each other, due to differences in market power, goal and ability to fulfill their duties.

Equity-based agreements.

International joint ventures (IJV) are considered one of the most common way for internationalizing. They are equity-based, so they represent a form of foreign direct investment and has two companies contributing their resources for the constitution of third firm, collaborating in the production of goods and services with the intent of achieving a common goal.

The international joint ventures can be vertical or horizontal. The vertical JV there is when companies of different sectors cooperate with each other, while the horizontal JV occurs when the companies are from the same sector. Another distinction that can be made is on the final objective that companies want to achieve. In fact, the JV can be downstream, when companies join together to manage upstream activities. On the contrary, the two companies can join to work on the downstream of the chain, in the case of a downstream JV.

Furthermore, the JV can be defined according to the nature of the shared resources. If the resources are complementary, in the sense that the two parent companies share different resources that only as a whole work for correct running of the operations, the JV will be an X model JV. While the companies share the same resources and work together on the same "assets", the JV will be named as Y model JV.

As seen for the contractual JV, the main challenges to asses if a JV can work shall be made in the contractual phase. The differences between the two firms may lead two frictions. The aspects that should be analyzed are:

- Aim formulation.
- Cost-benefit analysis.
- Partner evaluation.
- Business plan.
- JV contract.
- Performance evaluation.

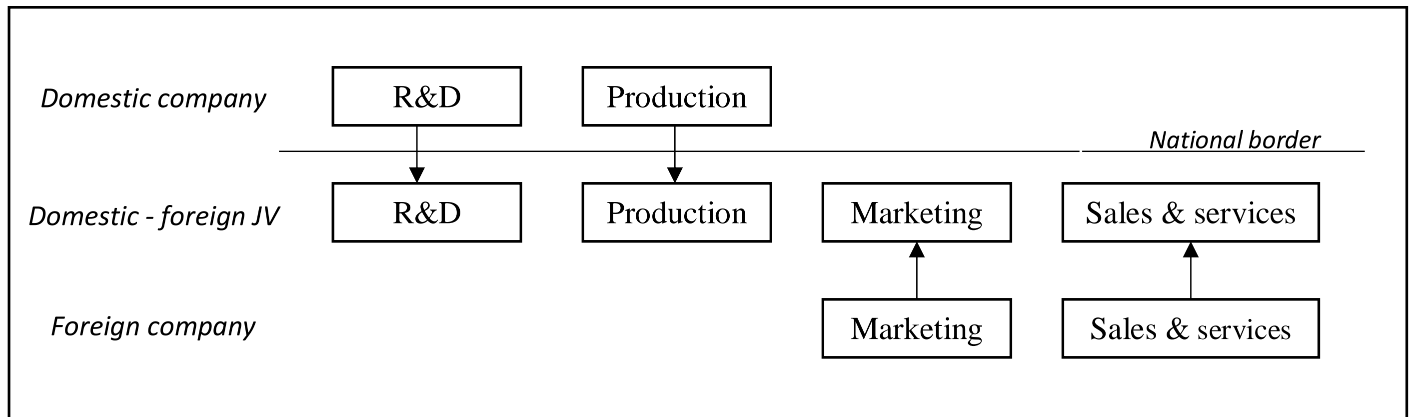


Table 5. X model JV. Source: Alon, Jaffe, Prange, Vianelli.

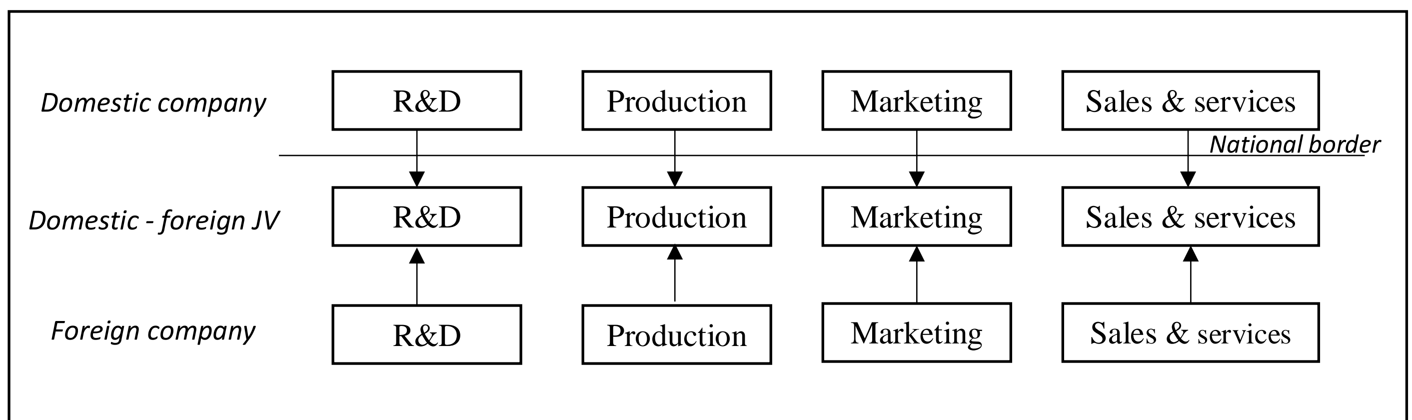


Table 6. Y model JV. Source: Alon, Jaffe, Prange, Vianelli.

These modes consist in the direct ownership by a foreign company of assets in another country. They are foreign direct investment and for this reason are considered riskier than contractual modes. However, they assure the highest form of control on operations.

The simplest form is the **representative office** (RO). The RO is a solution that allows the majority of the firm to set up a business in a foreign country easily and quickly. The RO should not be considered as a real equity entity, because it is merely a place in which the company carry out market research, without the possibility of generating profits. For that, the company

is forced to set up a **branch**. It is still an extension of the parent company but can generate profits. The **sale subsidiary** is not considered linked with the parent company and it may operate as importer or manage the distribution channel.

According to the entity of the stake of the foreign investor these entities may be classified in this way:

- **Wholly owned subsidiary:** the stake is 100% owned by foreign investor.
- **Subsidiary:** the foreign investor owns at least 50% of the company.
- **Associate or affiliate:** the foreign investor owns less than 50%.

However, shall always be kept in mind, that the definition provided by this literature are overlapping with definition provided by other authors. Furthermore, the clear definition of the theory not always has its respective twin in practice. This means that in the case of China, some of the options just seen may be united in one investment form. In the second chapter I will go the vary possibilities.

2. Doing business in China.

After having seen the theories and definition related to internationalization, is time to move to the practical analysis and see the technical aspects of doing business in China.

The People's Republic of China is a state located in Eastern Asia. It is the world most populous country with more than 1.4 billion of people and one of the largest with 9,600,000 square kilometers. Its capital city is Beijing (21,542,000 dwellers) while the most populous city is Shanghai with 24.2 million of inhabitants.

China's economy is one of the most flourish in the world. According the International Monetary Fund, the World Bank and the United Nations, China is the second country in the world for GDP, with approximately 13.5 trillion of dollars (90 trillion of Yuan). Even if with a declining pace with respect of past years, the GDP growth rate is still very high, with 6.1% of growth.

2.1 Recent history of China.

To deeply understand the actual economic and political situation in China, we should take a step behind. Explaining and analyzing the last one hundred years history of China is outside the scope of thesis, however it is necessary to provide some essential information. As we know, the People's republic of China is a communist country. At least on the paper. Its history RISALE at 1949, when the republic was born, after the Chinese Civil War. The undisputed leader of the communist party, Mao Zedong, who proclaimed the republic in 1949, found himself to rule an extremely backward country, predominantly rural and agriculture based. To bring China in modern time, Zedong launched strong campaigns, based on communism and collectivization of property, acted to reform the economy. From 1948 to 1959, the collectivization was gradual, but not without struggle. To promote the development of heavy industry, Mao decided to transform the agriculture in a state monopoly, allowing the party to buy at low prices and sell to foreign countries at higher prices, pouring the money surplus in manufacturing. Hence, farmers were forced to "spontaneously" accept the collectivization and the requisition of yields.

This stage brought very few results, with a general lower production of wheat compared to previous years with principles of famine in the north of the country. These policies, also known with the name of Small Leap Forward, were anticipatory of the Great Leap Forward, a period

of campaigns gone from 1958 to 1963, who saw an even stronger intervention of the state for a parallel development of agriculture and industry. As I am going to explain, the consequences of these policies were dramatic.

With the Great Leap Forward, Mao decide to transform the cooperatives into communes. 25000 communes were founded, each one composed by 5000 families. The communes were self-sufficient, with farms, schools and canteens. No retribution was needed, and workers were payed with “work points”. These communes were also provided with small furnaces, installed in the fields, to produce steel. Mao believed in domestic production of steel, based on his blind conviction of the power of the mass. He strongly affirmed that China would have been able to reach England’s steel production in 15 years. Obviously, the mass of poor people in the land, without any knowledge of metallurgy and with low quality furnaces, was able to produce only unusable steel. However, the toll they had to pay was very high. Millions of farmers were deployed to realize and operate the furnaces, with high pression coming from the party. Doors, furniture, kitchen’s tools and metal bed bases were requisitioned to be burned in the furnaces.

The belief in the power of the mass led to other questionable campaigns. Great works aimed to improve the floodgates of Yellow River and to build systems of dams and irrigation channels. Again, the inexperience of the workers, who were mainly poor farmers, brought tremendous results, with the addition of the impossibility for them to cultivate the land, due to the infrastructural projects in which they were deployed.

The absence of the farmers from the land, to produce steel and build infrastructures, which characterized the Great Leap Forward did not improved the productivity. Indeed, it is acknowledged as the main cause of the famine which stroke China from 1959 to 1962, who caused the death of 14 million of Chinese, according the national sources, who were probably more according international sources.

The negative results of the abovementioned policies started to crack the leader position of Mao inside the party. Internal opponents like Deng Xiaoping and Liu Shaoqi raised their voices against Mao’s leadership, guilt of damaging Chinese people life condition. To restore a central position in the party, Mao counterattacked, accusing his rivals of having lost the orthodoxy of the Marxist-Leninist thought. He, so, initiated the Great Cultural Revolution, a period gone from 1966 to 1976, characterized by the incitement to the population to criticize and oppose the party’s member who showed too much “embourgeoisement”. Ended with Mao’s death, the cultural revolution was able to eliminate the political opposition using the power and the will of the mass, especially through radical and violent students, called the “red guards”, who,

moved by the words of the Red Book of Mao, attacked any symbols of the communist China different from Mao's vision.

The death of Mao Zedong represented the end of an era. The control of the party over people's life diminished and gradually led to economic reforms. After Zedong, the role of leader was taken by Deng Xiaoping, who opted for a "softer" version of communism. He started a process of privatization of the fields, imposing also dual system for state-owned enterprise which implied both market and governmental prices. The good result of privatization of agriculture, who raised production by 25% between 1975 and 1985, allowed other sectors to undertake the same road. State-owned enterprise flourished and at the beginning of the 80s, the first private companies were born. It is important to remember the Open-Door Policy of 1978, through which the party allowed foreign business to set up in China. Special areas were destined to those firms, areas that will become the center of the Chinese economic engine.

For all the 80s, Deng laid the foundation for what will be called in 1992 "Socialist market economy" by Jiang Zemin. After Deng's death, the same route was overtaken by his successors, Jiang Zemin and Zhu Rongji, who were reformers. Tariffs and trade barrier were reduced, and China joined the World Trade Organization. During the 80s and the 90s its GDP grown of 9.4%, from 150 billion in 1978 to more than $1.6 trillion in 2004.

A change of route was carried out by president Hu Jintao in 2005, who presented ambiguous positions. His government was centered on the continuous search for harmony. He believed that Chinese economy should not have grown "at all costs", instead he prompted for the economic equilibrium, many times investing on those sectors of the population left behind by the economic push of the previous years. He is remembered for his management of the SARS crisis in Hong Kong in 2003, based on "hiding" the problem from western eyes, a choice that eventually led to a worsening of the situation and the difficulty in controlling the disease.

Xi Jinping succeeded to Hu Jintao in 2013 and since then he is the president of PRC. He created the expression "the Chinese dream" as contraposition of the American dream. The meaning of the expression is related to the birth of a Chinese standard of living in the world, like the American did in the last century.

He planned and dreamed of the transformation of the Chinese state in a modern state, similar to the western powers, as working example of the supremacy of the socialist capitalism. Even if the Chinese dream is always "attached" to the concepts of propaganda and nationalism, Xi Jinping had the merit to imagine the exportation of the "Chinese way" abroad. Indeed, the recent approach of China to the global affairs shows signs of new colonialism.

However, Xi Jinping currently faces many problems. The increasing difficulty in bringing together all the Chinese under one ideology, led to strong policies of censorship and active propaganda. In the years of social media and perpetual connection, such policies appear as a strong step behind for a country that as the will to impose its way of thinking all over the world. Furthermore, the protests in a city such Hong Kong (that technically is part of China since 1997 but still has a strong western identity) may carry a “germ” that, if not treated properly, can be spread all over China.

Finally, the slowing down of the economic growth, that seems natural and unavoidable looking at Chinese history of continuous growth, set new questions and doubts for the economy, that has to show to the world its ability to be dynamic in such changing contest.

2.2 State of Chinese economy.

It is common thought between the international analysts that Chinese economy is slowing down. According McKinsey, Chinese GDP is “cooling” with a growth rate of only 6.6%, the lowest value since the 1990. This new soften growth, that is believed to continue also next year, represent a challenge for a country that is not used to this slow pace and so it will be forced to find new way of balancing itself in the new state.

Behind this slowdown there are different factors. Consumption must be mentioned. Chinese consumption behavior has radically changed during the last years. Newspaper and international media had highlighted and showed the world a general plunge in multinationals and big companies’ sales, but in truth what we are seeing is a shift toward new pattern of consumption.

Firstly, consumption is still a strong driver of growth for Chinese economy. Forecasts estimate a growth by about 6 trillion of dollars from now to 2030. This enormous sum is equivalent to the combined consumption growth expected in the US and Western Europe over the same period, double that of India, and ASEAN economies together.

The abovementioned changes, concern mostly the retail sales, which have seen a drop in particular in the automotive and cosmetic sector. According the China Passenger Car Association, the drop of vehicle sales has reached the 6.6% since 2018 and it is showing any sign of trend inversion. This is mainly due to stronger regulations in terms of pollution and general weaker economy. The same negative period is striking also the electric vehicle market,

which has seen a reduction of governmental incentives. Service sector still represent the future of Chinese economy, with a contribution to GDP of 60%. The same can be said for online sales, which grew at a strong 24%.

The changes in consumption pattern is even stronger if we look at lower tier cities. These cities are generally poorer than tier 1 cities (Beijing, Shanghai, Guangzhou, Shenzhen), and, as the last world economic crisis teaches us, in a slowdown situation who are affected the most are the poorer. Consequently, lower market segment stores, as the discount Pinduoduo, are increasingly becoming a reality in China, showing excellent results in terms on online sales.

Another factor that is contributing to the economy slowdown is the uneasy access to credit. Since 2016 the government started a campaign of regulations aimed to reduce the easy access to credit that produced asset bubbles and excess of liquidity. Furthermore, years of deregulations after the financial crisis brought phenomena known as shadow banking and peer to peer lending, which have been blocked after the 2016. For these reasons, the access of credit registered a decrease in terms of growth from 17% of 2017 to 7% of 2018. Recently, the government is moving toward new ways of opening the credit tap, but more slowly compared to the after-crisis years, because small enterprises and companies in the lower tier cities are suffering the most.

Concluding, to understand the develop of Chinese economy, is crucial to study the signals of the next year. At the moment the China is at a fork: at one side the possibility of relaunching the economy, while at the other the possibility of a round of consolidation. For the foreign multinational both the cases could represent an opportunity, entering and opening new markets or “eating” the competition of companies caught in the credit squeeze.

2.3 Chinese Economy drivers.

In this paragraph, I tried to highlight what are the sectors that are driving the Chinese economy and that will drive it in the future.

Manufacturing.

The workshop of the world, this is the name that often in given to China when talking about its manufacturing sector. About 30% of the working population is employed in manufacturing, contributing for the 44% of the Chinese GDP.

The communist history of China has a strong influence on the sector. The focus on Chinese production has always been on quantity more than quality. This attitude, very often accompanied by government subsidies, has led to problems of over capacities that still affect the industry.

Smart manufacturing needs a separated mention. According to many analysts it may represents the key aspect for China to reach the world technology supremacy, with the United States forced to “pass the torch” to the Asian colossus. This drastic change does not involve only China, but more in general Asian countries. South Korea and Japan are pushing for the development of artificial intelligence technologies, with investments in the order of billions of dollars. The same for Singapore, which is planning to invest 100 million of dollars in this technology.

United States simply cannot keep up with the level of cooperation between Asian companies. This element has always characterized China and other Asian countries, where it was and is possible to see great level of cooperation between both between companies and government and companies. The joint operations between Baidu and Xiaomi for the development of IoT and artificial intelligence uses is a perfect example.

According to a report from Deloitte, the main area of development of smart manufacturing are:

- Digital factory.
- In-depth extraction of equipment and user value.
- Industrial IoT.
- Business model restructuring.
- Artificial intelligence (AI).

With the term digital factory is meant the digital management of data resulting from the manufacturing process, from the beginning to its end. Thank to modern technology, the process can be optimized to respond promptly to changes and dynamic allocation of resources.

Three types of data are at the center of the development of digital factories:

- Production process data. This data is generated between the “communication” of resources management software and on-field machines. The data coming from these exchanges allows to monitor constantly possible deviation from the standards and to intervene with maintenance when needed.

- Product data flows. These data cover the whole lifecycle of a product. Are essential, not only for understanding the habits and decisions of consumers, but also for designing new products that are more satisfying for the user and in less time. In addition, the presence of sensors and other connectivity tools, allows the construction of advanced after sale services.

- Supply chain data. This aspect is a sort of evolution of the latter. It is like stretching the collection of data to the entire value chain, from the resource acquirement to the interaction with the final user. The main result of this data is the construction of cross-enterprises platform carrying analytics about all the steps the product encounters.

The "in-depth extraction of equipment and user value" represents the new and constant research of manufacturing firm to extract new value from the clients. Due to very high competition and transparent price policies, the only route for manufacturing firm is to provide high level of customization or advanced after sale services. Being able to highly customize your car or providing predictive maintenance and 24h assistance is good example of the overall direction of manufacturing firms. This search does not apply only to clients, but also to equipment. Advanced analytics provide everything a producer should know on the exact value each component provides, whether it should provide more and whether it could be optimized.

All of this is possible thanks to IoT sensors, that keep the equipment "talking" 24h. This is especially true in sectors like the automotive one, where heavy use of assets is required, but data shows an increase in generation of "big data" also in new and unexpected sectors, like the pharmaceutical one

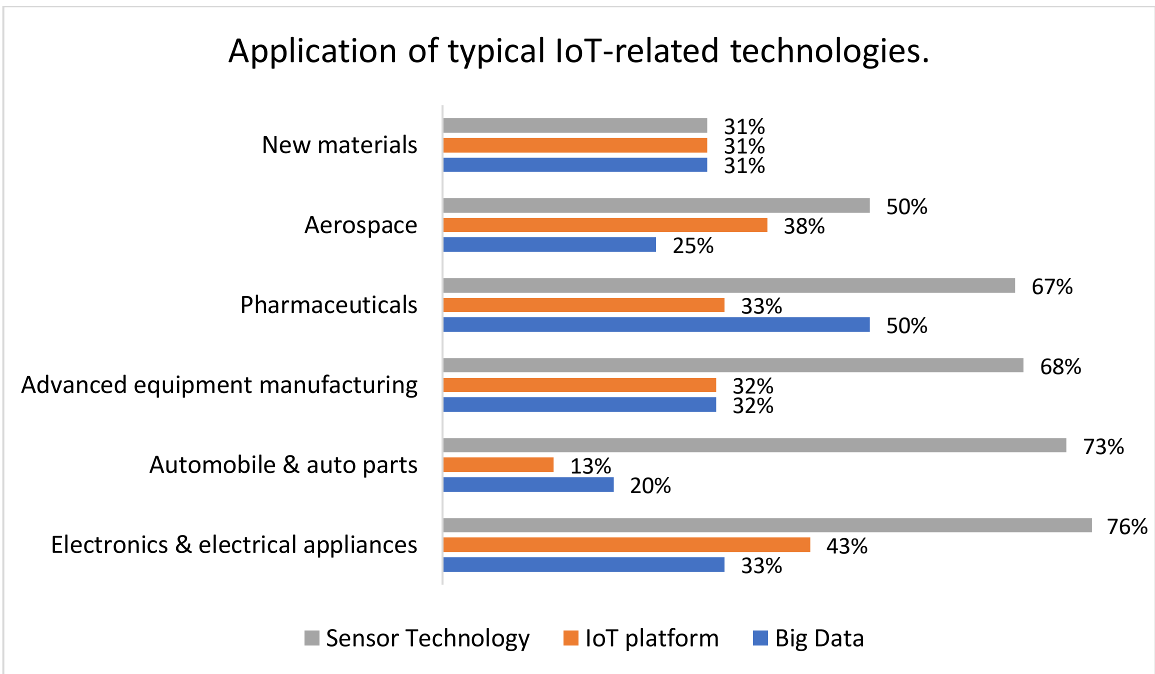


Table 7. Application of typical IoT-related technologies. Source: Deloitte

The massive presence of data and information allows the firm to rapidly adapt their business model thanks to insights that before were unthinkable.

The following graph shows the future distribution of business model in the Chinese manufacture.

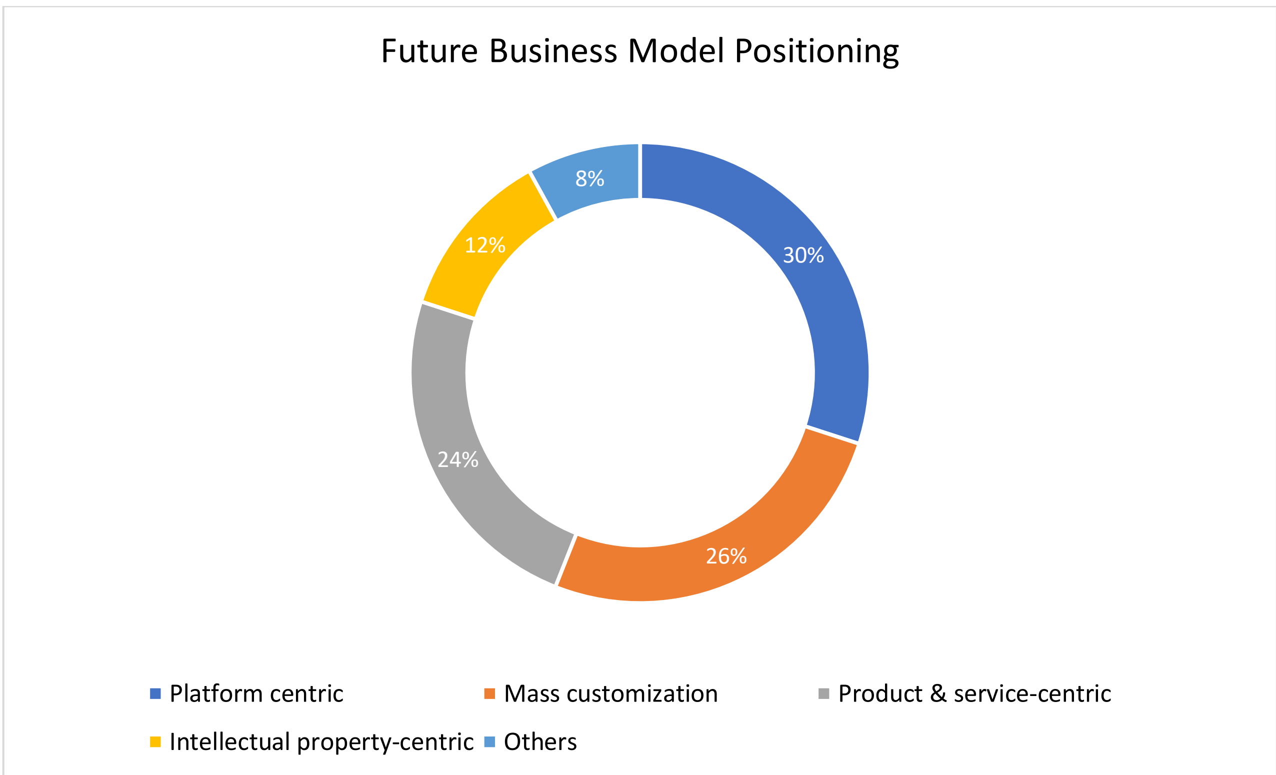


Table 8 Future Business Model Positioning. Source: Deloitte.

Finally, one of the protagonists of the smart manufacturing revolution in China is artificial intelligence. The Deloitte survey shows that half of the firms interviewed is already using artificial intelligence to improve the precision of the production line.

Indeed, the main advantages of AI in this sector lies on the ability of building intelligent predictions, making the machine "to think" which is the best way to produce. Again, statistical analysis and machine learning are fundamental to reach such forecasts, and the only way to get them is through sensors and data. Through an ongoing connection.

Although it may sound revolutionary, the development of AI for manufacturing is still in its early stage. The main problems companies are facing are due to the lack of precedents and business cases and a general comprehension of the subject. The whole ecosystem is still in formation and the progress are made for the promise of future benefits more than present fruits. For example, Chinese pharmaceutical companies, that are not characterized for massive use of robots, are now turning toward AI, for the promises of faster R&D and testing stages of new medicines.

The service sector.

The service sector represents a huge part of the Chinese economy. It represents the 50% of Chinese GDP and it has still room for expansion. From 2016 to 2018, the service providers have seen an annual increase in revenues of 13.3% with the service sector employees being 46.3% of the total workforce in 2018.

Nowadays the sector is living moment of doubt, after the expansion of the recent years. The 2018 has seen a decline of services and many analysts think the future holds a re-balancing moment more than a further expansion.

While the numbers show a strong impact of the service sector on the health of Chinese economy, it still lags the one of developed countries, with productivity of 20-50% of the OECD countries. Large part of the development of the sector will be linked to the satisfaction of new needs arising from consumers, that are becoming year after year, more sophisticated. Domestic brands are not always Chinese first choice because they are perceived as cheap and lacking safety.

Furthermore, the service sector is strictly connected to manufacturing in China. The recent slowdown of manufacturing has hit also the service sector, with a general decline of the whole supply chain, from the logistic to the retail store. The migration of value outside of China will likely continue, due to the trade war with US, and the sector that will probably face the worst consequences is the logistic one. Even if in the short-run the logistic will flourish because of the migration itself, in the long-run it will left alone with a domestic manufacturing sector not strong as in the past.

The remedy to solve the doubt related to the sector should come from the policy maker. To adjust the growth trajectory of the sector, new stimulus is required to boost consumers’ demand and to allow the intervention of private players.

A separated mention is needed to go further in the ITC sector of China. Indeed, the Chinese digital economy is believed by many being the key of success for the world dominance between the US. According many analysists the technology war against US, has already been won by Beijing.

In 2008, Chinese digital economy accounted for 15% of GDP. In 2017 the value was 33%. This increase has been due mainly to the integration of ITC technologies with “traditional” sectors like finance, entertainment and manufacturing.

The definition of digital economy can be meant ins a narrow or broader way. The narrow way includes in the definition the telecommunications, internet, IT services, hardware and software

etc. The broader definition includes the previous one plus extension of the traditional sectors that have been touched by ITC (like the digital manufacturing mentioned in the previous paragraph). The OECD usually uses the narrow definition, which measures the digital economy at 6% of Chinese GDP. On the other hand, a broader conception of ITC shows the digital economy part of GDP at 30%.

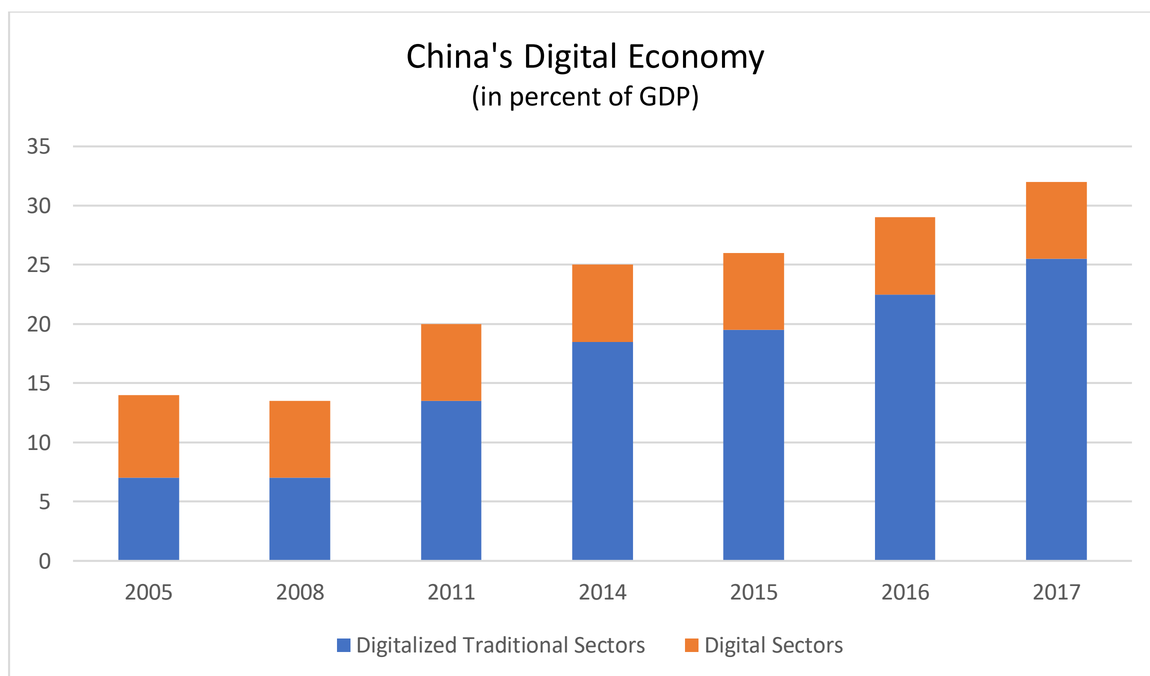


Table 9. China's Digital Economy. Source: China Academy of Information and Communication Technology.

While these numbers do not reward China and rank the country 50th on 131 countries based on the World Bank digital adoption index, the reality shows leadership of China in some technological sectors that could potentially mine US hegemony. In addition, according to Fletcher digital adoption index, China is fastest in their 62 countries sample.

The main expansion sectors of Chinese ITC are:

- E-commerce. Online Chinese transactions represents 40% of global online transactions, with a domestic penetration of 15% (U.S. accounts a penetration of only 10%).

- Fintech. The amount of online payments and the processing capacity of such payments is much greater than the US one. In 2016, online payments were 11 times the payments in United States with a processing capacity three times greater than the American one (comparing Alibaba with American leader company).

Furthermore, Chinese leadership in these two sectors has allowed an international expansion in various sub-sectors:

- Alipay and WeChat Pay, the most famous third-party payment applications in China are available in 28 countries outside China for Chinese tourists.

- Alibaba is present in more than 200 countries with a growth in terms of revenues of 200%. In addition, it promoted the economic development of the general industry investing in foreign providers in other countries.

- Alibaba cloud computing has 14 data center all around the world with revenues growing of 400%.

One of the key factors for such a rapid and disruptive expansion can be found in the government policies in favor of innovation. From the early stages of this expansion, the Chinese state has pushed for a light regulation. Big public investments and little concern for data privacy have also boosted the development of ITC.

Another important factor is the demographic composition and intern access. China has a large population of internet users (700 million) and 282 million of digital natives, eager and willing to be first adopter of new technologies. If we compare the number of users who access the internet in India, a country with similar population, we can see that India has 60% of internet users compared to China.

2.4 Belt and Road Initiative or the new Silk Road.

The Belt and Road Initiative, often referred as BRI or OBOR, is an international project promoted by the Chinese government with the official aim to improve its commercial links with Eurasia countries. As a modern "silk road" it includes two routes: Silk Road Economic Belts, that are the overland routes for road and rail transportation, and the Maritime Silk Roads that which consists in sea routes.

The initiative was announced during a visit of Xi Jinping at the Indonesian Parliament in October 2013. The plan is aimed to "to construct a unified large market and make full use of both international and domestic markets, through cultural exchange and integration, to enhance mutual understanding and trust of member nations, ending up in an innovative pattern with capital inflows, talent pool, and technology database." The main priority is to reduce the infrastructural gap of some of the countries involved (especially in Asia and Africa), hence, accelerating their economic growth.

The capital request for such project is enormous. Addressing in total 65 countries which represent the 40% of world GDP and 65% of world population, the initiative requires 900 billion of U.S. dollar to be realized. Forty billion of this money will come from the Silk Road Fund (China Investment Corporation, Export and Import Bank, China Development Bank). Other money will come from the Asian Infrastructure Investment Bank (AIIB), of which Italy is a member with a number of shares of two billion of U.S. dollars.

Many representatives of the media called the Belt and Road Initiative, the Chinese version of the Marshall Plan. While it is undoubted that such a reference has a huge mediatic impact, it is needed to go further in the analysis. A study carried out by Simon Shen and Wilson Chan analyze five elements of both projects to see when the two differ and when they follow a similar path. The five elements analyzed are: boosting exports, exporting currency, countering a rival, fostering strategic division, siphon away diplomatic support.

- Boosting exports. At the end of World War II, United States was a strong manufacturing country which faced a possible stagnation of the economy due to the saturation of domestic markets. With the Marshall Plan, U.S. "forced" European states to import American products as U.S investments. Something similar happened after the global crisis. China, which always had an economy focused on exporting goods in western countries, found itself in the impossibility of pursuing the same returns wo it had to look

for new engines for growth. However, the negative economic conditions in the West made impossible to boost consumption of goods, as during the Marshall Plan. Hence, China focused on structural investments and infrastructure.

- Exporting currency. With the Marshall Plan, United States was able to impose the dollar as an international and stable currency. After the war, there was a general consensus about the lack of a strong international value, able to support the reconstruction of the damaged countries. While some economist proposed the return of the Great Britain Pound, Great Britain was heavily indebted with a declining empire, so the dollar that was adequately backed by gold ended up as the obvious choice. China is only partly trying to do the same. At the moment the RMB is heavily a "domestic" currency, with almost no use outside China. In addition, even if Beijing is spreading its currency in "less western" countries, which are less under the influence of the dollar (Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Turkmenistan), it also true the China is imposing strict controls on capital circulation discouraging the global adoption of RMB. Finally, even if there is no capital control, imposing a value as international currency nowadays is very difficult, because the globalized western world is too attached to the "American way" with the dollar as backbone of the capitalistic society.

- Fighting a rival. At the end of World War II, communism was vastly appreciated between European people. The main actor on the European scene during the war was URSS, who fought Germans with the highest toll to pay. In conditions of economic instability many countries would have fallen under the URSS influence, so the Marshall Plan represented a way to export USA capitalism and politic vision of the world, against Russian one. In the specific case of modern China, there is no such direct rivalry. According many analysts China knows that at the moment is weight on the global scene is still secondary compared to USA, so its behavior is pragmatic and does not exclude possible collaborations.

- Fostering strategic division. The presence of Iron Curtain and the clear division of western Europe and Eastern Europe is mainly due to the Marshall Plan. As already stated early, the Marshall Plan represented wellness and cooperation for European people which were in the US side of the world. An interesting reading key is that

European Union as we know it is the result of the Marshall Plan and the US, which eventually won against US. So, the Plan fostered strategic division (together with the military presence of the NATO) who resulted in attracting the east with the fall of USSR. It is possible to say that the New Silk Road is trying to do the same in several way. It is trying to lower the stability of Asia-Pacific organizations, which are led by US and Japan. Furthermore, China has undertaken several actions with the Visegard Four (Poland, Hungary, Czech Republic and Slovakia), that are European countries which do not play a center role in EU.

- Siphon away diplomatic support. All that have been said, make the Marshall Plan as the perfect "leverage" to convince and attract non-capitalist countries to join the US alliance, with the exchange of aid. The BRI does more or less the same. It points weak countries, who feel no longer on the same path of US and which felt strong and long economic crisis, and basically offer them a new "standard".

The initiative has collected divergent opinions. In March 2019, Italy has been the first G7 country to sign the memorandum to join the new Silk Road initiative, with Luigi Di Maio as promoter of the project. According to him, Italy needs this kind of partnerships to boost Italian export toward China, while many analysts are of contrary opinions. The main concern is related to the ambiguous role of China. From one point of view, Beijing is surely a strong commercial partner, but as also the UE stated, China represents a competitor, a rival in the race for the world economy dominance. Alberto Forchielli, founder of Mandarin Capital, stated that the significance of the Italian participation is more related to the symbolic consequences more than the economic ones. According to the economist, Italy is in dangerous position because with this open move, it is sympathizing with a declared anti-American vision of the world. USA and NATO are still important partners to Italy, which now is at risk of being isolated in G7.

The economic aspect is secondary because at the center there is the political centrality of China in the global economy. China is already buying European and western assets; it does not need the "permission" of western countries. After the European recession, some countries like Greece has struggled to shown signs of recovery. This has led the perfect circumstances for China to buy in Europe at low price. Indeed in 2010, COSCO (which is controlled by the Chinese government) rented the port of the Piraeus for 35 years, making the port the Chinese door on Europe. This happened four years before the Road and Belt initiative.

In relation to this contraposition between China (eastern world) and USA (western world), Forchielli has described a new state of the globe that is becoming year after year more relevant. It is the “decoupling” that is the splitting and the consequent creation of a new supply chain. According to him, while until the early years of 2000 the world has seen a positive general acceptance of globalization, with vast and long value chain, after the global crisis the scent of cold war has returned. United States (and their historic allies with them) found themselves in a disadvantageous position against the economic and technology power of China. Considered for years just as a low-cost country for manufacture, China absorbed western knowledge and silently implemented its own business and technology, until the point to menace the historical American dominance.

Nowadays, with Chinese aggressive internationalization, western company should be suspicious in dealing with Beijing. This sense of suspect will inevitably lead to separated supply chain, with western companies no longer supplying in China, forced to find better and cheaper way in other countries. According to Forchielli, probably it is too late. If the situation is bad for United States, let alone Italy. Chinese supremacy for the 5G technology shows how it could be too late to totally avoid relations with China, therefore USA and European countries should now be aware of possible Beijing interference in domestic affairs.

2.5 Starting a business.

When facing the laws and procedures related to setting up a business in China, we should have in mind that there is a substantial overlapping between Chinese Company Law and the Foreign Investment Law (that, as we will see later has been recently updated).

Without considering yet the Foreign Investment Law, it is possible to state that the main two form for doing business in China are companies and partnerships.

Companies may be of two types:

- Limited Liability Companies (LLC), which is the most common form used by Chinese and foreign investors. This typology of business implies a “shield” between the assets of the owners and the assets of the company, which is considered as a separate legal entity. Indeed, the shareholders are liable only for what they contributed in the company.

The regulatory regime is more loose compared to JSLC, and the ownership can be easily transferred by transferring the shares.

- The Joint Stock Limited Companies (JSLC) which are similar to LLC but requires more stringent regulatory regime.

Partnerships may be of three types:

- General partnership, which are formed by general partners which are fully liable together with the company, which not provide the above-mentioned “asset shield”.
- Limited partnership, which are formed by general partners, fully liable together with the partnership, and limited partners, liable only for the part of share capital contributed.
- Special general partnership, which is similar to the general partnership but consists in professional service institutions providing a service requiring professional knowledge. Furthermore, the general partners of the special general partnership are shielded and liable only for the contributions they made.

For the specific case of constitution of Chinese company by foreign investors there is the Foreign Investment Law, that is a new law adopted on March 2019 and effective from January 2020. In the next paragraph we will see the main differences and benefits provided by the new law, which substituted the following law:

- Law on Sino-Foreign Equity Joint Ventures (Equity JV Law).
- Law on Sino-Foreign Contractual Joint Ventures.
- Law on Foreign-Capital Enterprises.

The main entry modes studied at the beginning of this thesis, find a concrete application in China in the following forms, that are, at the moment, the main investment form for a foreign investor. The options are

- Wholly Foreign-Owned Enterprise.
- Joint Venture.
- Representative Office.

Wholly Foreign-Owned Enterprise (WFOE).

The most used form to set up a wholly foreign-owned enterprise (WFOE) is the LLC. As the name states, these kinds of companies are formed for their entirety by foreign capital. Because they are usually LLC, they benefit from the separation of liability and asset shielding, making the foreign investor liable only for what he contributed.

The procedures for the constitution are complex and can be divided in pre-registration, the procedures before the company comes into existence in China and post-registration, the procedures that take place after the birth of the company.

Pre-registration procedures:

1. *Company name registration*. The name of the company must be in Chinese and it can be translated by another language phonetically and literally. The English name is not binding for Chinese law.
   The name chosen will be verified by Administration of Industry and Commerce and must include four elements: name, industry, location and entity form.

2. *Approval certificate and temporary business license*. The authorities will release a temporary business license after having assessed: the certificate of incorporation, a letter from the investor's bank assessing the stability of investor's financial status, photocopy of passport and photos of the legal representative of the investor company.
   The assessment will cover not only information related to the investor but also information about the constituting company. Indeed, it will be analyzed: Name of the company, business scope, registered capital, business term, lease contract, CVs, photocopies and passports of directors (in the case of a board there should be a minimum of 3 directors and a maximum of 13), feasibility study report, articles of association and environmental protection evaluation report (if applicable).

After having obtained the temporary business license, the newborn company must go through a number of registrations at various Chinese government entities. The post-registration procedures are:

1. *Tax registration*. 30 days from the obtainment of the business license, the company must file the tax registration form and the initial tax reporting form. The filing can occur at the state taxation bureau or at the local taxation bureau. After the fulfilment of the procedure, the company will be able to issue invoices (fapiao).
   This is also the moment win which trading and manufacturing company must apply for import and export duties.
2. *Application for seals.* In China companies use chops as company signature. The chop should be required and should be assigned to the company representatives.
3. *Opening of bank account.* Finally, the last step requires the opening of a bank account. The bank could be also foreign and should provide two accounts: a foreign currency account and RMB account.

The total duration of the process may vary, but in general the timing is the following:

Company name approval: 5-10 days

Certificate of name approval issuance: 5-10 days

Company registration: 30-60 days

Opening Bank Account: 10-14 days

Capital injection: 3-5 days

Tax account registration (including third party agreement), can be done at the same time as bank account opening: 60-90 days

Joint Venture (JV)

Joint Venture are usually LLC. As we have already seen in the entry mode paragraph, joint ventures consist in two companies joining together their resources to pursue a collective goal.

In China a joint venture is identified when a foreign shareholder owns more than 25% of shares of the business entity. In the past, many foreign companies used to resort to JV to set up a

business in China. However, due to the uncertainty related to IP protection, in recent years the western companies are setting up with WFOE.

The advantages of adopting the JV as investment form are mainly two. Firstly, with the JV is possible to access markets and sectors otherwise forbidden to a WFOE. By consulting the PRC Foreign Investment Industrial Guidance Catalogue is possible to asses which sectors require mandatorily a Sino-foreign equity company or a contractual JV. Secondly, JV brings vary benefits for western companies, that can rely on already consolidated distribution channels, knowledge about the markets and government relationships.

The registered capital for such investment is stated in the articles of associations of the company. The 15% must be deposited in a bank in the following three months since the obtainment of the business license. The minimum legal requirement is:

- 30.000 RMB (€ 3922,76) if the JV is formed by two or more foreign investors.
- 100.000 RMB (€ 13075,85) if the JV has only one foreign shareholder.

The timing required to set up a JV goes from 4 to 6 months. As for the WFOE, the registration process is articulated in a pre-registration phase and a post-registration phase. The pre-registration phase consists in:

- Selecting the name and applying for it at the State Administration of Industry and Commerce.
- Obtaining the certificate of approval of JV from Ministry of Commerce or Foreign Economic Cooperation Bureau (MOFEC)
- Applying for business license at SAIC.

After having obtained the license, which is temporary the newborn company proceeds to:

- Obtaining the chops (company's signature).
- Obtaining import and export license.
- Obtaining tax certificate.
- Opening bank account in foreign currency and RMB.
- Applying for permanent business license.
- Obtaining financial and statistic license.

Representative Office (RO).

Representative offices are the "lightest" investment option between the three. They do not imply the constitution of a legal form and hence they do not require a minimum capital investment. Furthermore, the RO can choose between a physical office or a virtual one.

These advantages come with many limitations. The RO cannot run business activities in the traditional way. In fact, it can only carry out marketing research or quality control operations, delegating the rest to the parent company outside Chinese border. Because of this, RO cannot issue invoices and generate profits.

Representative offices cannot hire directly, but they resort to government recruiting agency, and have the limitation of 4 foreign employees as maximum. Further requirements for the constitution are:

- The foreign company shall exist for at least two years before the constitution of the RO.
- The foreign company must sign a lease contract for the office for a minimum of 12 months.
- The name of the RO must follow the following criteria: nationality + Chinese name of foreign enterprise + name of the place where the office is located + representative office.

The procedure to set up the representative office are simple compared to the process for WFOE and JV. However, it is similar and follow the same steps.

In the following table (table 10) it is possible to see the main differences for all the three options.

	WFOE	RO	JV
Setup time	3-6 months	2-3 months	3-6 months
Capital requested	30.000 RMB (multiple shareholders) 100.000 RMB (single shareholder)	Not required	30.000 RMB (multiple foreign shareholders) 100.000 RMB (single foreign shareholder)
Scope	Trading, Consulting or Manufacturing	Market research and quality control	Trading, Consulting or Manufacturing
Office	Physical	Physical/virtual	Physical
Hiring capacity	Direct hiring	Hiring via gov. office (max 4 foreign employees	Direct hiring
Tax	VAT, EIT, local taxes and levies, taxes depending on the business, transaction taxes	VAT, EIT, local taxes and levies	VAT, EIT, local taxes and levies, taxes depending on the business, transaction taxes
Bank account	RMB and foreign	RMB	RMB and foreign
Invoicing	Invoicing from China	Not allowed	Invoicing from China
Receiving payments	Allowed	Not allowed	Allowed

Table 10. Comparison between different Investment form. Source: Thomson Reuters

2.6 Government interference.

As we have seen in the paragraph dedicate to the modern history of China, after Mao's death the country opened to a period of "de-privatization" and more freedom of business, attracting foreign companies and slowly increasing the impact of private companies on the economy.

With the election of the current president in 2012, Xi Jinping, a robust change of course occurred. It is important to bear in mind that China has always been a communist country, in which even in the "freest" time, the state always tried to play a role inside private companies. But after Xi election, the approach of the party became more invasive.

The general trend shows the will of the party to blur the distinction between private and state-owned firms, also for what concerns definition and regulations. In 2017, the party obliged big national firms to take into account the party by inserting it into the articles of association. The same thing happened for all listed companies (at home and abroad) in 2018. Furthermore, in a recent survey made by Central Organization Department emerged that 68% of China's private companies had party bodies by 2016, and 70% of foreign enterprises.

The recent affair between USA and Huawei is the perfect example of this state of interference. The national intelligence law of 2017 states that "any organization or citizen shall cooperate in national intelligence work". Enough to alarm western countries and in particular United States, for a potential activity of espionage outside China's border.

This burden affects also foreign companies. From Disney, to Walmart to Dow Chemicals, each of them has a party committee to which respond. In 2017, an article by Reuters stated that many of the members' committee wanted also to be incorporated in the executive committee and also wanted the firms to pay their expenses. And it should be clear that these companies do not have choice. If even BAT, i.e. Baidu, Alibaba and Tencent, the three behemoths of Chinese economy, had to be subjected to the party's punishment in the past, there is no room for maneuvers for foreign companies.

2.7 Relevant law for foreign businesses.

Foreign Investment Law

Promulgated on March 15, 2019 to take effect on January 1, 2020, the Foreign Investment Law (FIL) is generally welcomed by international analysts. It aims to solve important problems and uncertainties for foreign invested companies, like technology transfer and protection of intellectual properties. The FIL will replace the three existing PRC laws on foreign investment passed between 1979 and 1990, namely the Law on Sino-Foreign Equity Joint Ventures (EJV Law), the Law on Sino-Foreign Contractual Joint Ventures (CJV Law) and the Law on Wholly

Foreign Owned Enterprises (WFOE Law). The EJV Law and CJV Law collectively are referred to as JV Laws, together with WFOE Law, form the three FDI Laws). Even if it should be recognized the importance of the three FDI laws, with passing of time, they showed their limitation especially because of discrepancies between the laws and the national Company Law. In this sense the FIL represents the will of unifying the system and ruling the foreign companies under the Company Law.

Here I present a list of the main articles:

Article 4: Foreign investors will be treated not less favorably than national investors in the fund access stage, unless in the specified areas of Market Access Negative List.

Article 16: It is granted to foreign invested companies to present projects for public tenders

Article 17: Foreign companies con issue shares, bonds or other financial instruments to fund operations

Article 22: It prohibits any administrative agency or its staff to force technology transfer from foreign companies operating in China.

Article 23: Every governmental agency shall protect industrial and commercial secrets of foreign companies

Article 26: It provides complain tools to foreign investors

Article 39: The State will punish public staff who abuse of their authority, neglect their duties, abuse of their power for personal return or disclose commercial secrets of foreign companies or other. In case of crime, the government will search the criminal liability according to the existing laws.

Article 40: For any country or region which overtake prohibitive or restrictive measures toward PRC, PRC can overtake corresponding measures against the abovementioned country.

While these articles surely have the potential to boost foreign investment in China, FIL brought with itself a halo of vagueness. It is clear that will change the managerial organization of some companies, especially joint ventures, but it is not specified what will happen in the case of missed deal between Chinese and foreign actors of the ventures. It states that tools for protecting foreign investors will be present with the possibility of complaining, but not very much is said about the concrete functioning of these protocols.

So, it will be necessary to wait and see how FIL will be interpreted, to see whether it will be a real boost for foreign investment or just a mere smokescreen.

Foreign Investment Negative List

An important step forward is also due to the Foreign Investment Negative List, a list that provides a series o business sectors prohibited to foreign investments. The list has been reduced compared with the past and new business sectors are now open to foreign firms.

Important progress has been made for what concerns service industry. It has been deleted the restriction through which was impossible for foreign actors to control national maritime agents; also the gas and pipe for heating sector is now more open than in the past; limitations have been removed for the store-and-forward, call center and domestic communication; finally, it is easier to access the agriculture, mining and manufacturing sectors.

The new series of rules provide important elements also for what concern investments that are encouraged. The sectors who benefit are mainly high technological and ecological ones, with particular importance, information electronics and components for 5G communications.

2.8 Funding access and Investments in China.

To fully understand the dynamics behind the economic framework of China, it is necessary to study the "outbound" trend of money, that is made by the Chinese foreign direct investment in Europe.

The history of Chinese investment in Europe, it characterized by a rapid expansion in terms of money invested during the last decade. The peak was reached in 2016, with an overall investment in Europe of 37 billion of dollars. After that year, the trend was down going with 30 billion in 2017 and 17 billion in 2018. The 2018 levels represent the lowest level since 2014, with a percentage reduction of 50 % if compared to the 2016 peak. Furthermore, 2018

represented also the first year of "big sales" of European assets owned by Chinese, with estimated value of divestments of 4 billion euros of assets.

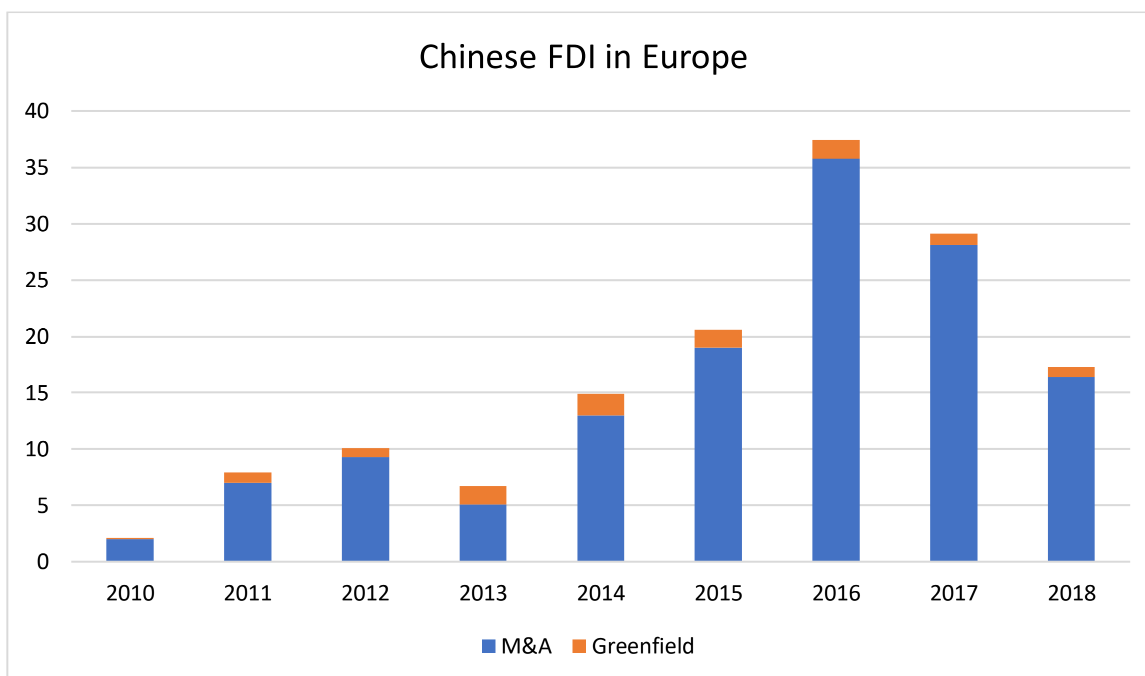


Table 11. Chinese FDI in Europe. Source: Rhodium Group.

The reasons behind this shrinking of investments are known and can be mainly found at "home". The first reason of declining investment is linked to the capital control imposed by Beijing, with the aim of stabilizing the yuan.

The second reason is related to the negative sentiment and backlash against Chinese business, developed in the recent years, especially after Trump's election at the White House. Many European countries have built and implemented more strict regulation for what concerns the screening of foreign investment. While small economies are revaluating the positive effect of Chinese initiatives, like the Road and Belt program, the European powers are more concerned by national security implication of a strong Chinese presence in their economies, due to the strong hand of Beijing government (hence military and security bureau) in Chinese companies' businesses.

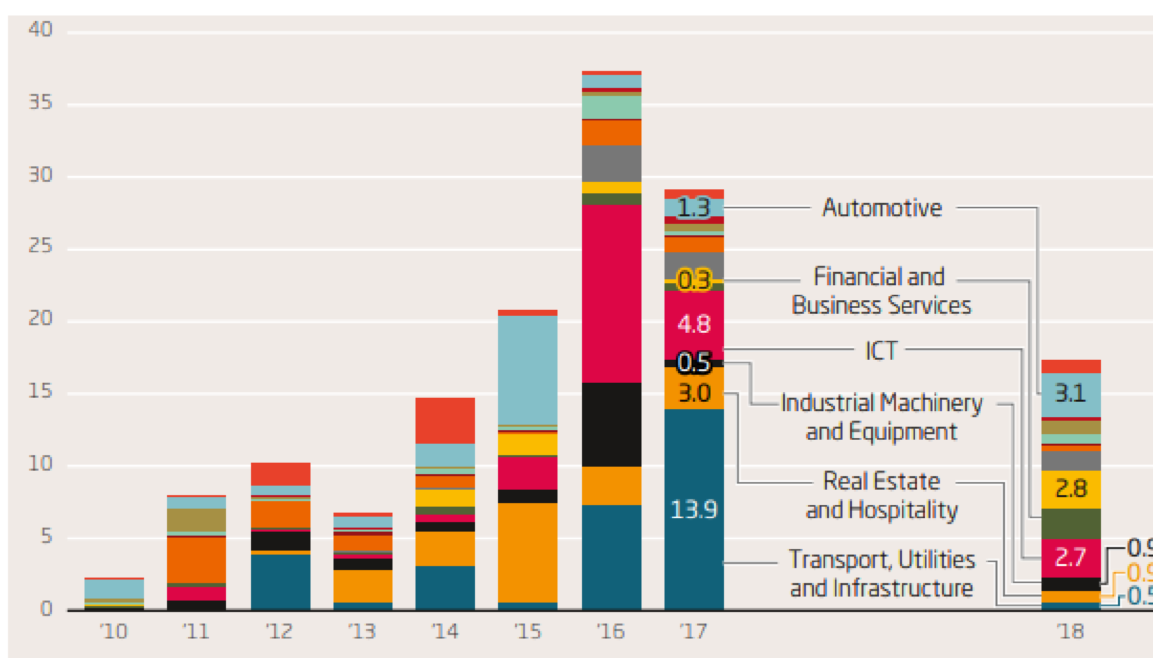
Target sectors and target countries.

Beside the above mentioned shrinking that characterized the FDI coming from Beijing, the Chinese portfolio is still rich and diversified.

The main target countries are still the "Big Three" economies: UK, Germany and France. Investments in those countries represents the 45% of total investments, but they have seen a deep decline compared to 2017 where the Big Three part consisted in 71% of the total.

On the other hand, a completely different pattern is concerning the Nordic countries, that passed from 4% of 2017 to 23% of 2018. Positive trend can be observed also in the Benelux and Southern Europe region.

Among the top sectors, one of the strongest one for growth is automotive, with the acquisition of Volvo by Geely for 3.1 billion euros. Also, financial and business services and health and biotech have seen an increase in investments. Totally different is the scenario for transport, utilities and infrastructure, with a drop of 96% compared to 2017



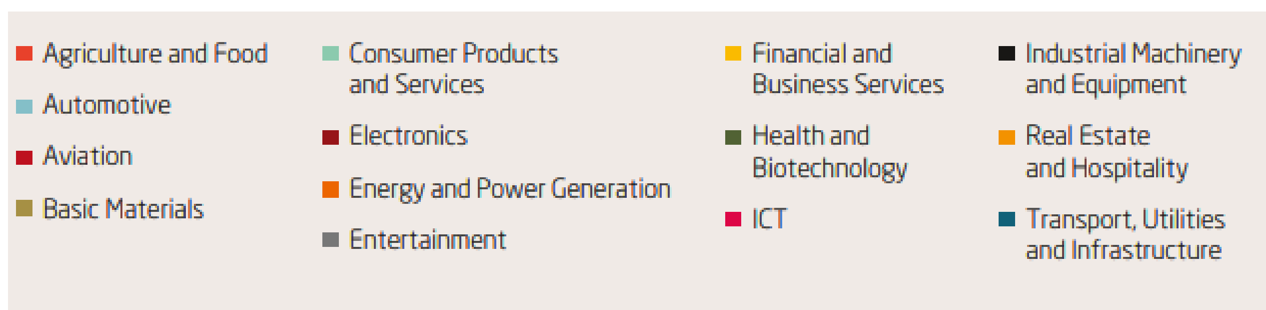


Table 12. Chinese FDI transactions in the EU by sector (EUR billion). Source: Rhodium Group.

European screening framework.

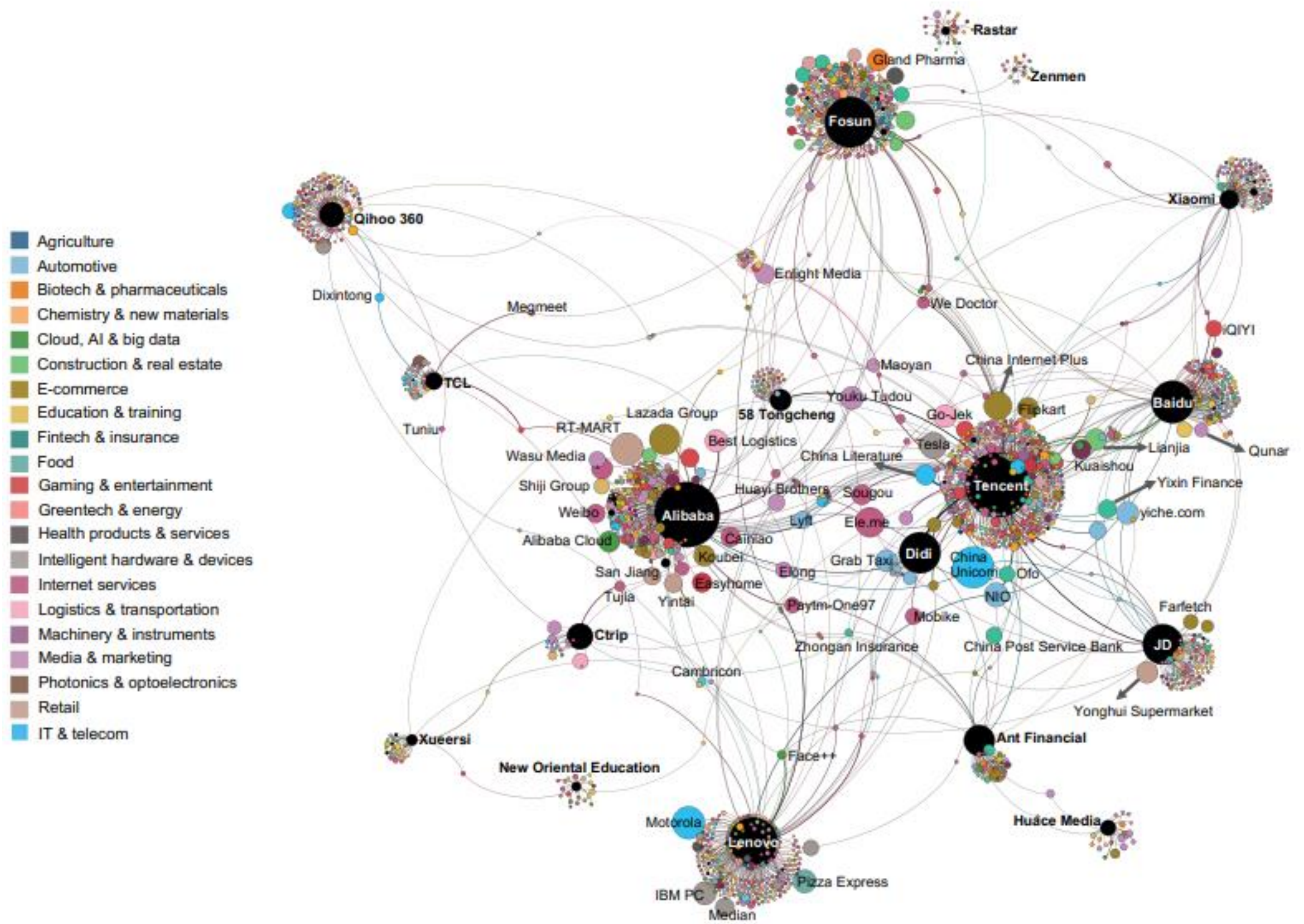
The screening tool for FDI proposed by the European Commission in September 2017 and approved by the European Parliament in November 2018 is part of this trend. This new framework deeply influences the treatment of inbound acquisitions. The framework allows the European Commission to issue non-binding opinions on acquisitions (venture capitals and greenfield investments are excluded) with the member state obliged to justify its decision when against the European Commission's opinion.

Even if the new framework should not be considered as a real stringent screening tool, but more like a loose coordination and cooperation framework, it represents a milestone in analysis of foreign acquisitions. Firstly, it takes into account different sectors for what is related to national security, with the possibility of expanding the range in the future. Secondly, the framework aims to prevent and identify acts of "circumvention" a national screening, inviting the member states to look beyond the mere investments coming from China, but also keeping track of intra-European investments of Chinese owned companies.

Startup in China.

The Chinese startup ecosystem is booming. Despite a decrease in investments made by venture capital firms, the startup ecosystem is the second largest in the world in terms of amounts raised, invested and exited.

The origins of such massive sector can be found in the born of tech giant Baidu, Tencent and Alibaba two decades ago. These companies concentrated knowhow and best practices around them, becoming magnet for the development of thousands of startups in the nearby areas.



Fundraisinig is considered difficult, especially compared to european and US ecosystem. A report carried out by Silicon Valley Bank, stated that 88% of Chinese startups struggle to raise capital. Even if, venture capital industry has strghten its position in China and it is considered as the main source of financing for Chinese startups, the last years have seen a substantial decrease of investments.

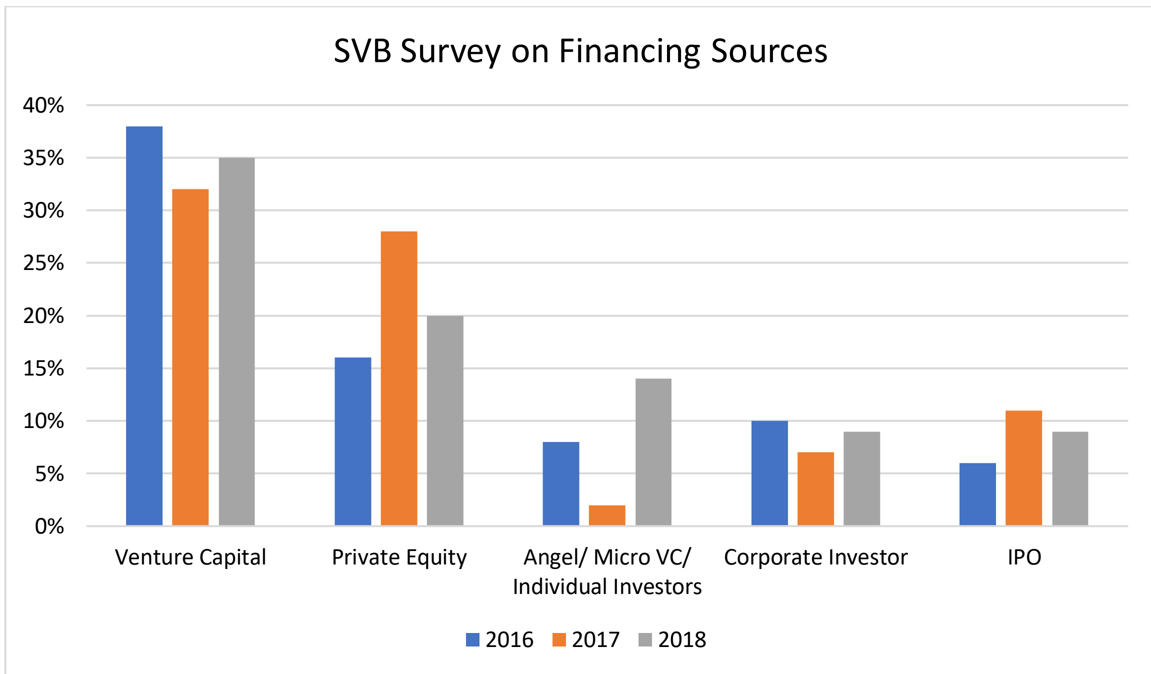


Table 13. SVB Survey on Financing Sources. Source: Silicon Valley Bank

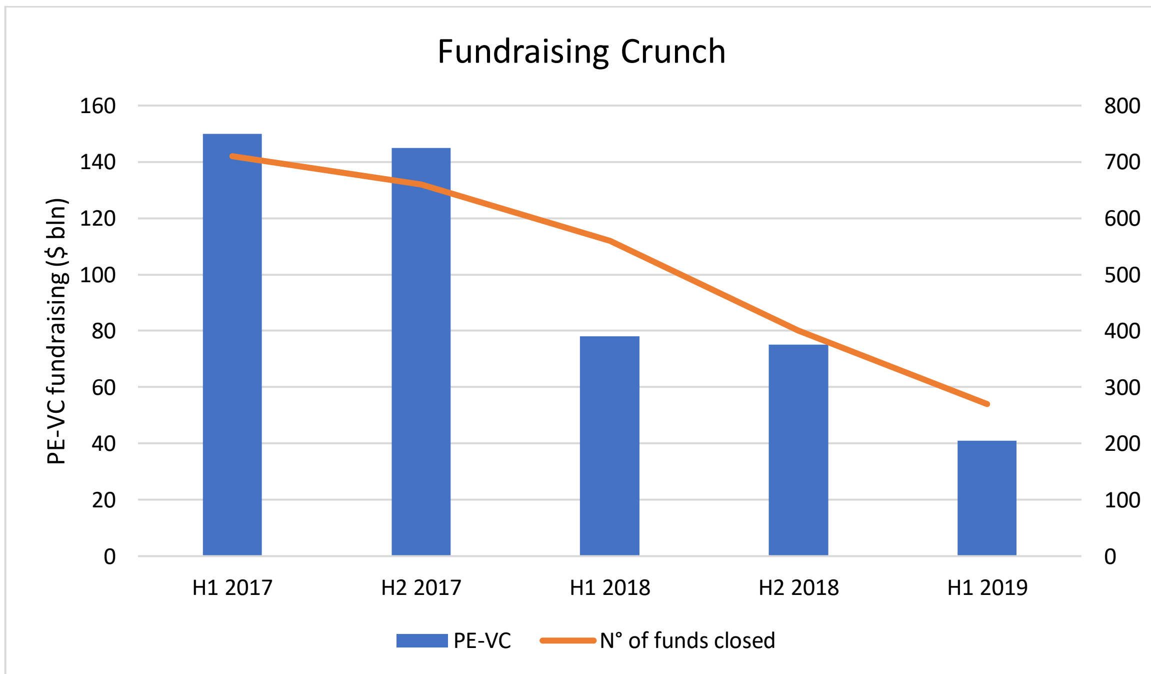


Table 14. Crash Crunch. Source: ChinaVenture/TechCrunch

As reported by ChinaVenture, data registered a decrease of about 50% in the amount of money raised by domestic startups. This down going trend should be read as the research for an equilibrium in the sector. The booming of investments of 2016, coming from domestic and foreign investors in Chinese startups acquired the typical connotations of the "*fomo*" bubble,

the investors' "fear of missing out" opportunities. Now, Chinese investors are gaining more knowledge and expertise in understanding real opportunities and they are specializing in determined sectors. One of these is surely artificial intelligence. SVB report states that AI and life science related startups are the most promising ones, they are thriving and getting funds more easily. In this context, an interesting new investors' attitude is getting attention in the ecosystem. Chinese venture capitalists are getting interested in backing foreign companies. Especially for what concerns artificial intelligence, Chinese investors understood the importance of "buying" what they cannot get at home. In what is considered a new "space race" against US, China wants to play a major role in this sector, even if this means resorting to foreign resources. After the "public slap" of Google DeepMind AI software who defeated the world champion Ke Jie in go, one of the most famous and ancient board game in China, the government has launched a plan to develop and increase AI industry, pushing big tech company of China in pouring millions in the sector.

Limitations imposed by Trump to Chinese investment in US, led the flow of investment mainly to Israel and Europe. Italy is not strong in AI, but is one of the main players, if not the leader, in pharmaceutical sector, that is the second blooming field in China. Biotech and pharma SMEs, who represent a big part of the Italian industry, may look east in the search for opportunities.

2.9 Cultural differences

One of the main challenges in doing business in a foreign country are the cultural differences between two players. This is particularly true in a country like China, that is very different, for geographical distance and political history, from western countries. As Hofstede (1993) said "there is something in all countries called 'management', but its meaning differs to a larger or smaller extent from one country to another". The study of culture in business attitude is rich and provides various model. One very explicative one is surely Hofstede model, built in 1980, which identified four factors who influence the way a country does business. Later, the model was revisited by Bond (1989) who inserted another factor. The five factors are: power distance, individualism/collectivism, masculinity/femininity, uncertainty avoidance and long-term/short-term orientation.

Power distance is the extent of hierarchical control on lower ranking individuals. A society with high power distance has lower ranking individuals more likely to accept an unequal distribution

of power. Individualism/collectivism is an index of the degree to which people are integrated into groups. Individualistic society are formed by relatively loose ties, in which people feel to belong only to a small group, i.e. a family. On the opposite, collectivistic society are formed by people who feel part of a larger group, usually loyal and supportive. Masculinity/femininity represent respectively the attitude to succeed, to obtain material reward and heroism, and the attitude to care for the weak, to cooperate and to be modest. Uncertainty avoidance is the degree of tolerance for ambiguity. Society with high degree of uncertainty avoidance prefer predefined laws and rules and predictable behaviors. On the other hand, low uncertainty avoidance characterizes countries who prefer free-flowing environment and acceptance of different thought and ideas. The last factor, the long-term/short-term orientation, is explicative of the extent to which past events are able to influence future events. This is particular clear, in honoring traditions. A country who is strongly attached to its past, has a short-term orientation, and usually does not look at distant goals in the future, but is more focused on the current state of things. On the other hand, a long-term orientation country puts pragmatism in reaching distant achievements before everything.

If we look at the following graph (table 13) we can appreciate the main cultural differences between China and Italy.

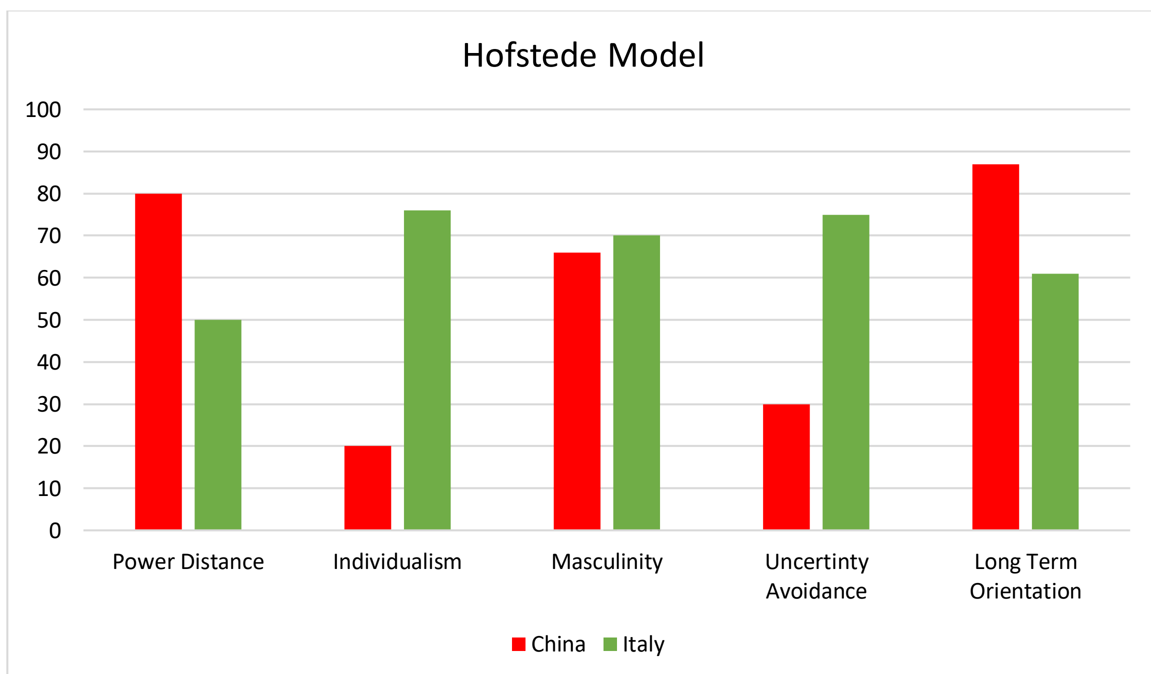


Table 15 Hofstede model comparison between Italy and China. Source: Hofstede Insights.

Italy is surely a more individualistic and risk-adverse country compared to China. These differences tend to emerge during the establishment of a partnership between a Chinese and Italian player. As we have said, the low level of individualism in China means that Chinese people tend to define themselves as “we” rather than “I”. This approach leads to a strong feeling of belonging to a group or a family. In business, this could imply that Chinese people will prefer to protect and favor people of their group or family, consequently excluding western businessmen.

On the contrary, China has a high-power distance index compared to Italy. This translates in a strong devotion to rules and work even if further from home or headquarters. Indeed, it is globally acknowledged that Chinese are good workers devoted to their job, even if the work conditions are not good or comfortable.

In the process of cooperation, Italian place greater importance on contractual safeguards than the Chinese, as we can deduct from the high level of uncertainty avoidance. They believe that contracts can ensure that their partners' tendencies to focus on individual goals and aspirations do not interfere with their own individual goals and aspirations. But the Chinese don't consider contracts as seriously as the Italian. They think there will always be changes and the contracts can be reasonably modified according to changes. Instead, they tend to pay more attention to relationships than contracts.

Big differences are also for what concerns the resolution of conflicts. Collectivistic cultures emphasize cooperation, interdependence, and group goals, and thus prefer plans that support group harmony. Chinese belief in collectivism, make them less prone to the direct confrontation. Whenever a problem or a conflict should emerge, they tend to suppress it with authority or they decide to solve it privately, without interfering with public and general harmony of the group. This attitude translates also in the will of Chinese party to look for the mediation, even for third parties for which they are not directly involved.

2.10 Guanxi

With the word guanxi we indicate the system of social relationships shared by the same collective of people. As we will see, the guanxi represents a fundamental “tool” for doing business in China, but at the same time can be perceived as a brake, an obstacle for the correct developing of activities.

The meaning of the word is expressed quite clearly by the two characters which compose the term. The first one is “guan” which means “door” or “closing, shutting”. The second one is “xi” that means “to bond, to link”. So, guanxi can be literally translated as “crossing the closed door to connect with others”, that is to overcome the obstacle a Chinese may find on the road thanks to the relationships he has. In the actual business definition of the expression guanxi, it is referred as the valuable. network It is a friendship that implies the continuous exchange of favors (Pye 1982). Once the favor is obtained, the one who benefit should be ready to pay it back in time, even years after the favor. Whenever this does not happen, the person will be considered unreliable, and he will “diu mianzi”, i.e. he will lose his face. This will imply not only the loss of that particular guanxi, but also all the guanxi connected to that will be considered lost, in a chain effect.

Guanxi are personal and should not considered as a corporate asset. They depend exclusively on the person who bring the favor in the company. This means that Guanxi cannot be between companies as abstract entities, but an intermediary should always be present.

Fa vs guanxi

According to a paper of Renzo Cavalieri, for foreign companies who operate in China is important to have in mind that coexist two kinds of law. There is the law, coming from the party, that is the official law, that is called “fa”, and then there is the guanxi, that is the common law. The do not have the same value, with the latter considered more important to Chinese. This is due to the fact that the rules coming from the national law are considered not objectives by the Chinese, but only a tool or an expression of the will of the party. The unification of the political powers without a form of control, delegitimizes, in a sense, the abovementioned rules and pushed Chinese to look for social rules able to mediate conflicts. So, the guanxi represents the valid way to maintain harmony and peace.

3. Challenges of doing Business in China.

The aim of this chapter is to investigate the common and known problems and opportunities a SME may encounter during its journey in the Chinese ecosystem. A well-documented literature that evolved with years exists for this topic, but how we will see in the next chapter, I will also "listen to" the experiences and the feedback of real players.

3.1 Barriers.

The approach to internationalization of SME is not always easy. The newness and smallness of those firm surely represent an important factor that make SME more prone to failure than larger established rivals (Lee et al. 2012). So, one important academic question that should be answered is "why do those firms, that are small and hence more subjected to external risk, seek out the additional risk of internationalize?" (McDougall, Oviatt, & Shrader, 2003). Multinational operations frequently proved to be associated with higher performance (Beamish and Delios, 1999). A SME will internationalize when the potential advantages exceed the disadvantages.

The disadvantages I will analyze in this paragraph are of two types and are provided by the OECD: internal and external. Internal, are due to elements which lack or are present inside the firm, that bring the company to "endanger" the business activity. On the other hand, the external ones, are typical of the business environment in which the SME internationalize, that in our case is Chinese ecosystem.

The internal barriers are:

- **Informational barriers**. The informational barriers are due to the lack of knowledge about foreign markets and international opportunities. Due to geographical distance and lack of resources, the SME does not gain any insights about overseas customers and market strategies.

- **Human resource barriers.** The human resource barriers are connected to the lack of the right managerial skills to manage and set a business outside the domestic borders. Often, the staff is not enough specialized and communication problems may arise between the foreign and the domestic staff.

- **Financial barriers.** This barrier manifests as a shortage in funding to finance the working capital in the foreign country or as the difficulty of insuring assets abroad.

- **Product and price barriers.** These barriers are due to the inability of SME of adapt its product to the design and style of the foreign market. They manifest also as the impossibility of reaching the legal standards for quality provided in that country. Also, the price, if not well set, is a barrier, because a too high price means the inability of the firm to match the competitor's price and consequently the loss of market shares.

- **Distribution, logistics and promotion barriers**. They consist in the difficulties of use or find the proper sale channels abroad. These barriers can also explicit in logistics related difficulties such as supplying inventory abroad, paying insurances or providing proper after sales.

The external barriers are:

- **Procedural barriers.** They are barriers associated with the operating aspects of transactions with foreign customers. They may be the difficulties of following the right legal procedures in terms of permissions and paperwork. Also, the difficulty of enforcing the contracts due to the poor quality of them or lack of knowledge of the foreign legal system can be considered as procedural barriers.

- **Governmental barriers.** These are barriers linked to the will of the government to prefer the domestic firms at the expense of the internationalized SMEs. This could result in funfair tax regimes or the need of special permissions for operating in certain sectors for the foreign SMEs

- **Customer and foreign competitor barriers.** The habits of the customers in the foreign country may be totally incompatible with the product the SME sells or it may be the

competition is particularly keen and focused and does not allow the entrance of external firm or the maintenance of a competitive position

- **Business environment barriers.** These are barriers linked to the political and socio-cultural environment of the foreign firm. The environment may be hostile because of currency exchange risk, but also because of totally different way conceiving relationships in the business context. The presence of an authoritarian regime who does not guarantee the property right, for example, is a quite strong barrier.

- **Tariffs and non-tariffs barrier.** These barriers are related to the presence of excessive duty for imported goods or other standards that have to be met. For example, technical or safety standards of the good. The presence of embargoes shall be also considered in this kind of barrier.

This thesis is centered on the activities of Italian SMEs in their approach to the Chinese market. For this reason, I will now match the theoretical framework provided by the OECDD with the real and actual barriers that our companies face when dealing with China.

OECD Framework Internal Barriers	**"Italian SMEs in China" scenario**
Informational barriers	• Lack of expertise (partly reduced by foreign investment in our country)
Human resource barriers	• Mainly family businesses managers who lack of language skills; • Coaching is the best way to learn;
Financial barriers	• Defensive strategy of Italian SMEs
Product and price barriers	• Made in Italy highly appreciated • Be aware of "sounding Italian"
Distribution, logistics and promotion barriers	• Lack of expertise

OECD Framework **External Barriers**	**"Italian SMEs in China" scenario**
Procedural barriers	• Bureaucracy is improving in terms of speed • Contracts still insidious for foreigners.
Governmental barriers	• Not really a problem. • Good Chinese taxation. • Italian financial aids.
Customer and foreign competitors' barrier	• Made in Italy appreciated. • Quality is not enough.
Business environment barriers	• Political interference. • Increasing censorship.
Tariffs and non-tariffs barrier	• IP protection: Chinese efforts are important, but many problems remains in terms of procedures and outcomes. • FTT.

3.2 The internal barriers.

As we have seen in the previous paragraph, the internal barriers to internationalization according to OECD are informational barriers, human resource barriers, financial barriers, product and price barriers and distribution, logistics and promotion barriers.

The lack of knowledge and resources that characterized these barriers will be analyzed in detail for the Italian SMEs scenario, with the aim of understating the status quo and the level of readiness of Italian firms.

Informational barriers.

The informational barrier in Italy is directly linked with the network model of internationalization. One of the most stressed problem of the abovementioned model is the possibility for some SMEs to rely exclusively on the network to expand its activities. If the company does not have the right network of other companies who internationalize and hence provide knowledge to the other members of the network, it could easily lead to dead ends (Uzzi, 1997) (Burt, 1992). Centro Studi A.P.I. (Associazione Piccole Medie Imprese) carried out a survey on mechanics and chemical companies (some of the most important sectors of action abroad for the Italian companies) in Lombardy. The results show that the lack of knowledge and information about the foreign markets is still one of the most important brakes for SMEs which want to go international. In Italy, according to this study from Prometeia, the presence of foreign FDI helps Italian companies to develop and international awareness and more modern way to conduct activities. This attitude inevitably is spread across sectors thanks to the network. Attracting foreign investment may eventually increase the awareness of our companies.

Human resources barriers.

Many studies have demonstrated the key role of the human resources in determining the success of internationalization (Leonidou, Katsikeas, & Piercy, 1998) and it seems there is a positive relation between the competences of the management and the propension to internationalize (Manolova, Brush, Edelman, & Greene, 2002). The presence of mainly family businesses in Italy created a situation of reluctance in assuming external managers and consequently making

difficult for the Italian SMEs to get the right competences to internationalize (Bannò & Sgobbi, 2005).

A study conducted by Pedrini and Dal Bianco (2007) on a group of 300 SMEs from Lombardy, found that the majority of the skills that are lacking and are requested by the firms are language competences and only secondly competences related to the foreign market. These are the two main gaps in terms of skills which lack at human resources. These firms use "coaching" as the main way to learn and teach. The choice of hiring a "coach" is not only due to the lack of resources, but also to the particular asset of the management that is familiar and that seek a direct and immediate knowledge. Furthermore, for the companies analyzed in the paper, the problem of learning, even though a coach, come from the difficulty of separating the operative moment with the learning ones.

Financial barriers.

The financial barriers intended as internal barriers are the monetary challenges the SMEs faces in the process of internationalization. The question I try to answer here is "do Italian SMEs have enough internal funds to carry out internationalization campaign?".

An important help in answering the question comes from the Cerved Report about the Italian SMEs status. The situation emerging from the scenario has as main element of analysis, a general deceleration of SMEs economic growth. Revenues grown of only 4,1%, a declining data compared to 4,4% of the previous year. Also, the value-added grown less than the cost of work (4,1% vs 5,6%) with bad results on productivity and margins.

Profitability indexes and level of failures measured alarming data. As we can see from the following two pictures, profitability indexes continued the robust decline. In addition, after the stability of 2018, failure rates begun to increase again in 2019.

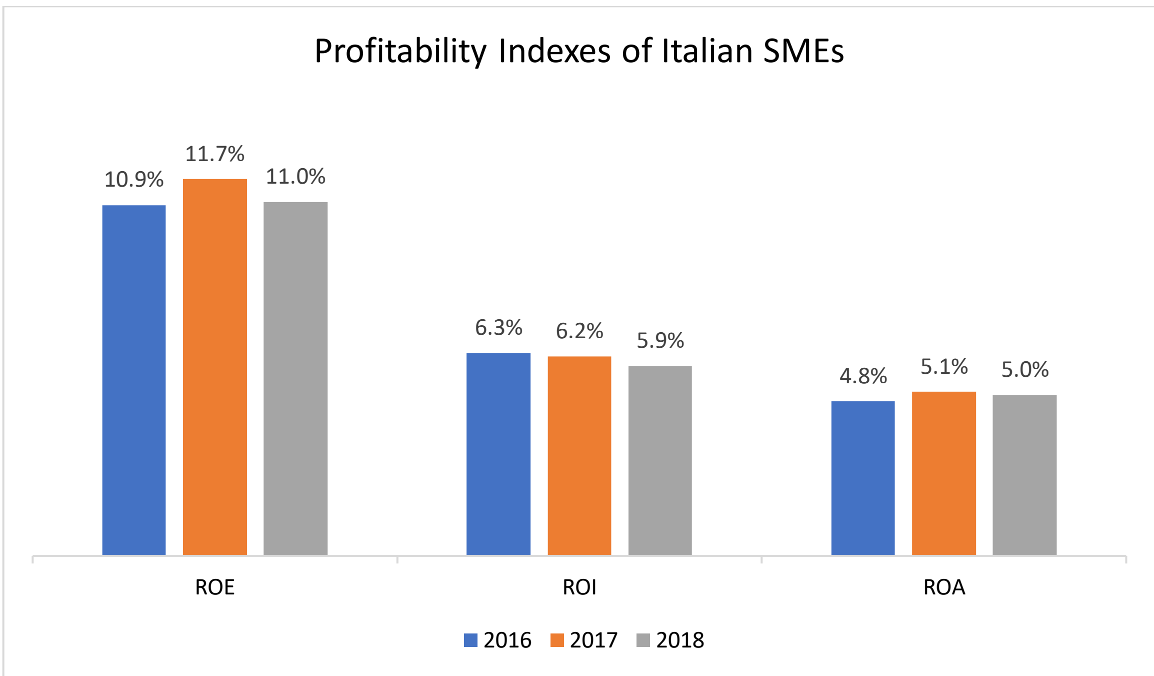


Table 16. Profitability Indexes of Italian SMEs. Source: CERVED

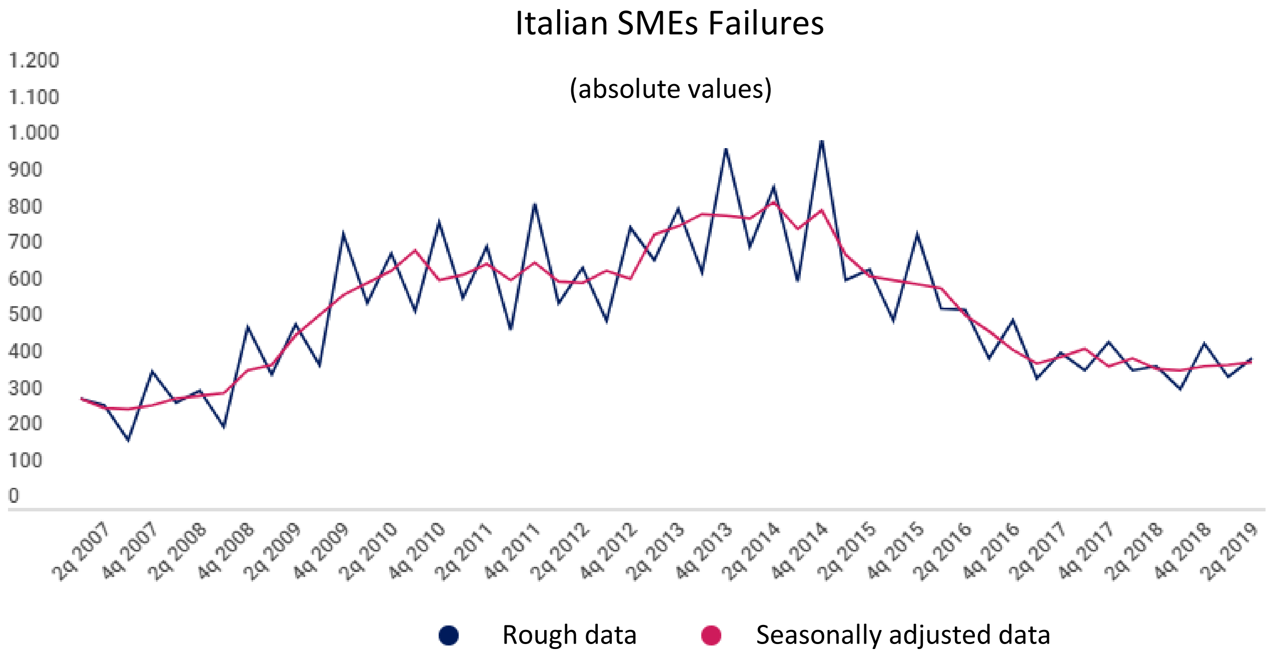


Table 17. Italian SMEs Failures. Source: CERVED.

However, in this alarming scenario, Cerved reported a healthy and mature level of financial stability of Italian SMEs. Financial debts increased with a rate of 2,2% in 2018 compared to 1,2% of 2017, but looking at the level of health of equity capital, SMEs improved it at an higher pace of 8%. The number of SMEs in the database with solid financial statements has reached its maximum since 2012, while the same positive trend happened for the company with the lowest ranking, which reached a minimum in 2017.

Interesting it is Cerved's comment on the investment situation. Investments, especially in manufacturing SMEs, increased, touching the 7,1% from 6,4% of the previous year. The absolute value of investment remains, unfortunately, under the level pre-crisis. It is curious to notice that this low level does not depend on the bad quality of SMEs' financial "backbone". On the contrary, the report shows that companies have a lot of investment potential unused. If they would increase the level of debt until the threshold of two times the EBITDA (that is considered a level of safety), they could benefit of investments for 133 billion of euros.

This defense strategy is the real barrier which prevents SMEs from internationalizing.

Price and product barriers.

History techs us that Italian product are well appreciated in China. However, the changes in the attitude, as I have already said, are not to be undervalued. As it will assessed in the chapter related to the opportunities of Italian firms in Chinese market, an important element that will drive consumption will be the ability of Italian firm to innovate and set themselves competitive ad a "digital" level. So, the barrier in this sense is not related to the lack of understanding of Chinese consumers 'will. It is more related to the wrong approach to communicate in the market.

It can be easily shown through the Italian fashion industry how the digital communication is fundamental. Explicate is the case of Versace. Despite many western fashion players, who are struggling to keep the pace with Chinese social media, Versace has a strong presence online in China with the social network Sina Weibo. Through this social, the company promotes products endorsed by Chinese and international celebrities. It was appreciated until it committed one single error. In August it promoted a shirt which reported Hong Kong as separated state, provoking resentment and hate toward the brand. One single error (although not small) is able to cost millions in sales for Italian brand. As everyone may remember, similar fate happened to

Dolce & Gabbana. Without getting into whether the racism of their spot was real (it showed a Chinese model struggling to eat pizza and spaghetti with chopsticks), the real negative consequences occurred later the accident on social media. The inability of the brand to admit their errors plus a late apologize video on the social Weibo (it is a twitter-like platform), costed a shrink of 2% of sales in Asia zone.

On a completely different path is Gucci. Gucci is also very active on Chinese socials. It is mainly present on a social called "Douban", which allows users to create and post film, music and other multimedia content. Thanks to Douban, Gucci promoted "Cut&Craft" contest, that push users to be express their creativity creating home-made bags with Gucci's tips.

Another good example of integration of Italian product inside the Chinese market is the food industry. Made in Italy food is recognized worldwide for its high competitiveness in quality and safety. The rapid changes in consumption are making the consumers more aware of quality and safety issues of the food, despite the price is still the most important driver in the choice of the product. In this view, the Italian food represents an appealing alternative for Chinese consumer. Italy has always been the second exporter of olive oil in China, with Spain as leading country, but analysts say thing may change in the next future. Italy is the only country which is seen its share in oil exportation rising. The rising Chinese middle class is pushing the consumption of oil, once considered a luxury product.

The same can be said about Italian pasta with 23 million of euro sold in 2018.

A symptom of appreciation of Italian products abroad, even if harmful for our economy, is the "Italian sounding" phenomena. With this expression, it is meant application of practices of imitation to food products It identifies a set of phenomena carried out through the use of ingredients of lower quality and value than the originals, a productive process directed to cost containment and avoiding of legal requirements; and also the counterfeiting of company identity, geographical origin, productive process and most important, the imitation of specific aspects of a product that suggest a misleading geographical origin, like the improper use of words, colors, names, places, images (Nomisma, 2003). The economic consequences for SMEs are huge. Coldiretti has estimated an economic damage of one hundred billion of lost revenues.

The phenomenon concerns many products of Italy, but in China the problem is mainly related to Italian cheese. The famous "parmesans" produced in America (which are not allowed in EU) are sold in China with Italian sounding labels (for example with Italian flag). Their presence is massive with 5 American cheese versus only one coming from EU. Although the problem is massive in China for the dimension of its market, the presence of fake Italian food is

unfortunately present worldwide and presents few things to do in order to solve it. Economic agreements and ad-hoc rules between China and Italy are not enough. It is needed the proper communication of Italian culture and food (an Italian version of Confucius Institute), with Italian SMEs investing on marketing created specifically for China.

Distribution, logistics and promotion barriers.

This specific barrier is associated to owning and correctly managing the ability to reach the foreign market. This topic can be easily addressed referring to the previous point in which I stated the lack of expertise of SME management. Italian SMEs managers do not have enough knowledge about foreign distribution channel, they do not know how to correctly prompt their activity on foreign land and often they decide to launch the internationalization process without any help. As we will see during the interview with the export manager, Mariano De Santo, a figure who knows how to move between bureaucracy and insidious partners is mandatory.

3.3 The external barriers.

Procedural Barriers.

During the research for this thesis I found on website specialized in Chinese law, a simple but effective advice about Chinese contracts: “make them enforceable or don’t bother”. Although it is a semi-serious statement, it is indeed true that enforcing contracts in china is not an easy job. In addition to the different culture, the language and a different way of conceiving the business and the job relationships sets even higher barriers. So, if a company wants to do business in China, it should have its back covered.

The first question a western company should ask itself is: am I contracting with the right party? To found itself prepared the company signing the contract should always be sure that the dealing party is holding company and not the contracting manufacturer. In addition, misunderstanding may arise also if the company is part of a group. These misunderstandings are in part due to the lack of western name from the majority of Chinese firm. So, it is fundamental to write the correct name in Chinese to avoid homonyms and names that may sound similar to a western ear.

In general, it is appropriate to select Chinese as the legal language of the contract. English is not so common and there would be the risk of double interpretation of the document.

If the company found itself in a situation of trading with a Chinese company, of course is important to state the national law applied to the contract. The Chinese civil law allows ta foreign law to be applied in the situation of an international contract where at least one of the parties is not Chinese. Also, in the choice of the judicial court the Chinese law allows "contractual autonomy". However, in "everyday life" we see a limited number of such situations. This is due to an extensive interpretation of article 282 of Chinese civil law, which denies the liberty of choosing the juridical court in presence of alleged violations of "law essential principles of People Republic of China" and of "state public and social interest".

Bureaucracy, remembered as sclerotic and corrupt, is improving, making easier for companies to operate in China. According to the World Bank Index about "easiness of doing business", China ranked at position 30, which is better than Italy at 58. If we consider that in 2014 it ranked at 90, we can appreciate the progress.

China is following the Singaporean way, aiming to digitalize many services and procedures that were typically dealt with documents. Due to this, the days to open a business now are nine compared to 22 days of previous years (for domestic investors). For foreign investors, the policy "one window, one form" led to the creation of an online platform where foreign investors can go through the majority of the procedures without paying any commission.

Governmental Barriers.

As we will see, no specific governmental barriers emerge. I will cover the tax regime and the financial aids coming from Italy, assessing a positive situation.

The Chinese taxation is system for foreign enterprises and foreign investment enterprises is the following:

Corporate Tax on Income (CIT): the standard tax rate is 25% but it could be lowered to 20% for "small profits" companies. If the company is high-tech, it can benefit of an additional discount for a rate of 15%. In the case of new companies, there is a fiscal exemption for the first two years, replaced with a rate of 12,5% for the subsequent three years at the end of which it is introduced the normal rate of 15%.

The definition of "small profits" company has been broadened on January 2019. The new definition consists in the following criteria:

Eligibility criteria for preferential CIT	**Previous threshold**	**New threshold**
Annual taxable income	≤ RMB 1M	≤ RMB 3M
N° of employees	≤ 80 (≤ 100 for industrial entreprise)	≤ 300
Total assets	≤ RMB 10M (≤ RMB 30M for industrial enterprises)	≤ RMB 50M

In the following cases, the company can benefit of the following discount rates:

- High-tech companies 15%
- Companies which produces IC 10%
- Qualified technology-advanced service enterprises 15%
- Companies established in Qianhai Shenzhen-Hong Kong Modern Services Industry Cooperation Zone 15%
- Companies established in Zhuhai's Hengqin New Area 15%
- Companies established in the Pingtan Comprehensive Experimental Zone 15%

- From 1 January 2019 to 31 December 2021, qualified small profit enterprises with an annual taxable income of 1-million-yuan renminbi (CNY) or less are applicable to the effective CIT rate of 5%. Where their annual taxable income exceeds CNY 1 million but does not exceed CNY 3 million (inclusive), the CNY 1 million portion will be subject to an effective CIT rate of 5%, whereas the excess portion will be subject to the effective CIT rate of 10%

Annual taxable income	Previous preferential CIT	New progressive pref. CIT
ATI ≤ RMB 1M	10%	5%
RMB 1M < ATI ≤ RMB 3M	Not applicable	10%

- From 1 January 2011 to 31 December 2020 companies established in the Western Area 15%

- From 1 January 2019 to 31 December 2021 companies involved in pollution reduction 15%

Withholding income tax to non-residents: on May 2019 Italy and China has signed a new agreement aimed to void double imposition for what concerns interest, dividends, royalties and capital gains. According to the new agreement:

- Dividends are taxed at a rate of 5% instead of 10%. This happens in the case the direct participation of the share capital is at least 25%, maintained at least for 365 days. For every other situation, the rate is 10%.

- The withholding on interest cannot exceed 10% the gross amount. It is envisaged a reduction to 8% for interest due to bank and financial institutions for investment projects. However, the agreement envisages the exemption of such rates for interest due to governmental institutions.

- Art. 12 provides the maximum roof of 10% rate for royalties on copyrights. It is also provided an effective rate of 5% (10% it is applied on the 50% of the nominal value) for the use of industrial, commercial and technological tools and equipment. It is important to notice that the rate stipulated with Italy are lower than the one stipulated with other European countries.

- For capital gains, the new agreement confirms the known rate of 10% when deriving from the sale of share capital exceeding 25%.

The Italian company which has interest in exporting goods in China must pay the following taxes:

- Value-added tax (VAT): from April 2019, goods imported in China are subjected to 9% or 13% VAT. The nine per cent applies to goods in the category of agriculture and utility items. The 13% tax is addressed to all the other goods. The input is:

  "Sales x VAT rates".

- Consumption tax (CT): it is levied on five categories of products: harmful products (tobacco, liquor, firework etc.); luxury goods and non-necessities; high-energy consumption and high-end products (such cars and motorcycles); non-renewable and non-replaceable petroleum products; financially significant products. It can be calculated ad valorem:

  Consumption tax payable = Taxable sales amount x Tax rate

  Or quantity-based:

  Consumption tax payable = Taxable sales quantity x Tax amount per unit

  For exports goods, the consumption tax should not be paid. If the product exported was previously imported in China, the CT paid on it is refundable. For good that are VAT exempt also CT is exempted, but in that case is not possible to obtain refund for the previously paid CT in importing.

- Custom duties: it consists in import and export duties on 8549 items taxed. The import duties depend on the country which is exporting the goods. In the case of Italy, China applies a favorable regime, because of its belonging to WTO. It is important to notice that China has gone through several rounds of duties reduction from 2018 to 2019 in order to give stimulus to a slowing down economy. These reductions have favored Italian products because they cover pharmaceutics, pasta, shoes and clothes.
  Import duties can be calculated as following:

Ad valorem basis:

Duty payable = DPV x Tariff rate

Quantity-based:

Duty payable = Quantity of imported goods x Amount of duty per unit

Compound formula:

Duty payable = DPV x Tariff rate + Quantity of imported goods x Amount of duty per unit

In order to some product to be imported, it is mandatory the presence of the CCC brand (China compulsory certification). The rationale behind it similar to the CE brand in Europe, although the standards required are different. The list of products is viewable on the website of China Quality Certification Centre.

On the Italian side, our government provides several financial aids for the company which want to internationalize. As it possible to read from the Ministero dello Sviluppo Economico (Mise) website, the internationalization is promoted through "voucher" that allow the company to hire an export manager.

Introduced in 2017, the voucher systems for internationalization is aimed to SME of any juridical form. Can benefit of the vouchers also network of companies with minimum revenues of 500.000 € in the last financial year.

There are two types of voucher:

- Voucher early stage. This voucher is for the companies which are applying for the first time. It consists of 10.000 € coming from the government plus 3.000 € coming from the enterprise itself. Whether the company already asked for this aid, it receives only 8.000 €.

- Voucher advanced stage. In this case the voucher consists in 15.000 € with 10.000 € of funding coming from the company. If the company is able to reach determined milestones, it can benefit of additional voucher.

The listed companies will provide service of "tutoring" the company which benefited of the voucher during six months with a Temporary Export Manager.

The service itself seems well structured and as we can see from different surveys (among which the abovementioned A.P.I one) we can see that the financial barrier is not a real issue for Italian SMEs.

Customer and foreign competitor barriers.

This type of barrier is associated mainly with the tastes and attitude of the Chinese consumer. As I said multiple time during this thesis, the attitude is changing toward more sophisticated and high-quality goods.

Without entering in the depth of the analysis, it is possible to assess that this attitude is positive for Italian SMEs that can leverage on the quality and the provenience of "made in Italy" brand. So Italian products are appreciated, not only with relation to food and fashion, but also in sectors that are typically B2B. Italian manufacturing and mechanic tools producers are appreciated in China for the high customization and quality of the products. In 2018, 10% of Italian manufacturing of such products have been exported to China, representing the third largest target country for Italy.

Italy, on the contrary, is the fifth supplier of mechanic tools for China. Unfortunately, such numbers are far from 2013 data and declining since then. The real challenges faced by Italian producers is their impossibility to overcome the concept that "producing quality products is enough". Mass production of competitors and their ability of providing advanced IoT manufacturing tools, mine seriously the future of Italian export for this sector.

Business Environment Barriers.

The Chinese business environments is promising but at the same time has some dark spots. Looking at the numbers provided previously in this thesis about the status of the economy, I

can conclude that it is not impossible to imagine China as world economy leader in the next years.

Of course, when we talk about business environment barriers we talk about multiple and complex variables that may or may not foster foreign economic activities in China. Culture and language barrier, for example, represents a non-indifferent obstacle for foreign entrepreneurs who find themselves in struggle trying to understand and to maneuver between guanxi and fa, as I have already said.

But the main obstacle related to business environment barriers is another. I deem it to be the political ecosystem.

"Globally, sources of turmoil and points of risk are multiplying", stated Xi Jinping in January 2019 at the Central Party School. He continued "the party is at risk from indolence, incompetence and of becoming divorced from the public". These declarations have been followed by summoning of the major representatives of PRC with one aim: be aware of politics, ideology, economy, science and technology, society, the external environment, and Party building, that are several risk areas rising.

Indeed, 2019 represented a delicate year for China, for what concern politics and economy.

First of all, there is diffused sense of ideology crisis. The party tightened control across the internet via the Cyberspace Administration of China, launching several campaigns aimed to clean up all the "negative and harmful" information. Many analysts noted that even censorship is changing in China. Due to its massive presence on world market, its way of interfering is "exceeding the borders", involving other countries and international brands. If twenty years ago the intrinsic closure of the country limited dangerous communication of western companies about the internal political situation, now many historical brands found themselves in the core of the clash for the Hong Kong crisis. For example, a pro-Hong Kong tweet of the captain from the general manager of the Houston Rockets, let to NBA games being pulled from the Chinese television.

The same situation applies to western universities, who have in China branches and campuses. They feel the pressure of potential censorship, because one wrong word may mean deleting one important source of income that is represented by Chinese student.

Basically, Chinese government is using both visas and market access as a censorship weapon to use against the enemies of the Party.

From a business point of view, at the moment the Party has reached dangerous level of interference, compared to the past. It is a return to nationalization of economy that should scare foreign companies. For sure is mining Chinese private companies, which have seen a steady reduction of credit in the last years, in favor of state-owned enterprise.

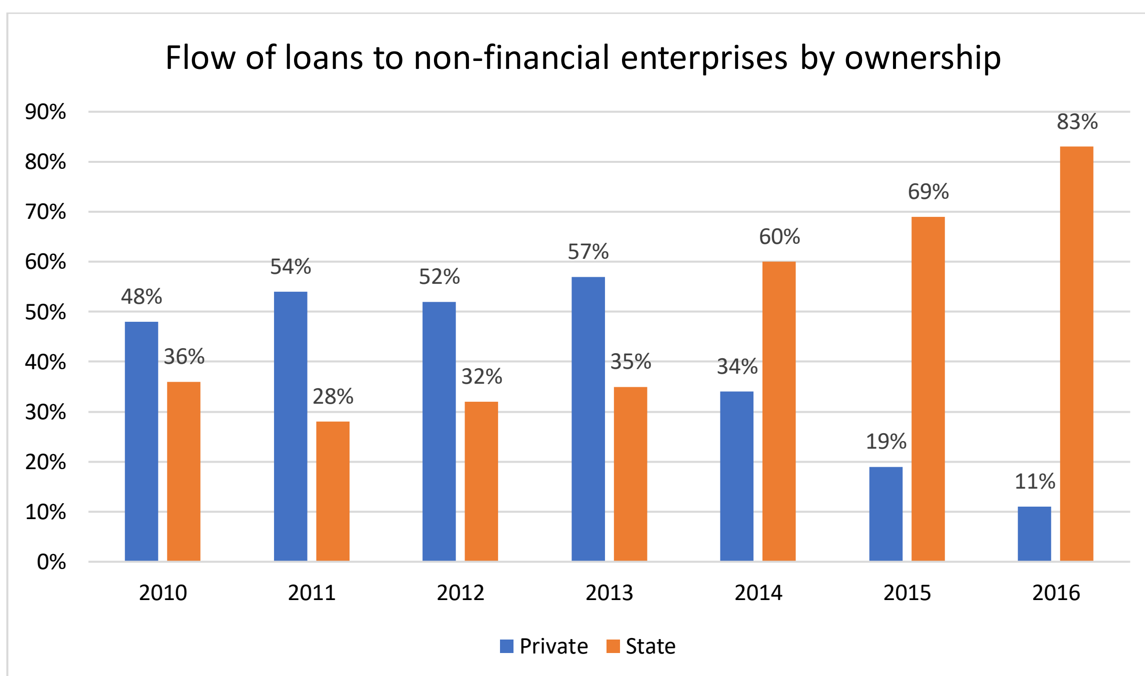


Table 18. Flow of loans to non-financial enterprises by ownership. Source: China Banking Society.

Tariff and Non-tariff Barriers

When we talk about intellectual property protection in China, we automatically associate it with the words "fake, copy and fraud". It is true that protecting own intellectual property in China is not easy, but in order to fully understand what the threats may be, we should analyze in detail in what consist IP protection in china.

We should begin saying that the IP protection law has changed drastically during the last years. China has made huge efforts to make its legislation modern and respectful of international standards. The SIPO, the former State Intellectual Property Office, now became the CNIPA, the Chinese Intellectual Properties Authority, with extended power of control, reporting directly to State Council through SAMR, State Regulation for Market Administration.

Special courts dedicated to IP protection have been established in Beijing, Shanghai and Guangzhou. In addition, in 2019 China created a special court dedicated to IP as part of Supreme People's Court.

Huge efforts have been made also with regards to patent, trademark and copyright laws, with an upgrade that is still going on.

Although the progress is clear, many problems remain. According to a recent report by EU Commission, the situation is still unfair for many European companies, who face a competition driven by unequal rules for local Chinese companies. While many western firms are owners of standard essential **patents** (SEP), that are crucial for the correct working of some technologies (for example 4G communications), many Chinese companies use such patents without paying adequate enough royalties, leaving the western companies with disproportionate fees to pay.

A recent amendment to the **trademark** law seems be promising for a better future, but also in this sector remains important loopholes in the procedures that keep Chinese companies to deposit trademark with bad faith.

FTT, or **forced technology transfer**, is still a spread phenomenon. It consists in the forcing for western companies, especially from governmental entities, to transfer their technology and knowledge to China, in exchange of market access. It is a systematic problem, carried out by many entities on multiple levels, that results in western companies licensing their know-how at very low rates or fees. It is to in the future how these problems will evolve with the new FIL law, which in theory should eliminate such practices.

Also **counterfeiting** represents still a huge problem for western companies. The Commission's Report on EU customs enforcement of intellectual property rights (2018) shows that 80% of fake products came from China, make it the main producer of counterfeit article in the world. Although it would be unfair to not mention the policies and actions of the Chinese government, the problem is far to be solved.

After having seen the main problematics, it is necessary to go in the details about patents and trademarks, showing the "technical aspects" of Chinese procedures.

Let's start from patent. China is part of the Patent Cooperation Treaty; it signed Paris Convention and has rules coherent with the international standards.

The Chinese Patent Law covers three distinct areas: invention patents, utility model patents and design patents.

The **invention patent** is related to technical solutions or improvement to a product or a process, provided that the technical solution has a practical applicability. Obviously, it should not have been disclosed previously through publications (newspaper, scientific journal, papers etc.) This means the novelty principle should be respected.

The **utility model** patent is similar to invention patent but protects new shape or physical structure of a new product. A common practice in China is to file both the UM patent and the innovation patent. In this way the company can benefit of the early protection provided by the UM and the longer extent provided by the invention patent. In order to benefit from this practice, is mandatory to file the applications on the same day, declaring the double filing. In the case one of the two is refused, automatically also the other one is refused.

The **design patent** covers the shape, the pattern, the shape and pattern, the shape and color, the shape, pattern and color of a product. In order to apply for it, the product should not have been used in China. It is common to describe accurately why the design should be considered new, how it can be used in industry, how it can be produced in batches. Highlighting these, will reduce the risk for the patent to being invalidated.

Invention Patent vs. Utility Model Patent

Common Features:

- Protection requirements:
    - There are specific disclosure requirements (on sufficiency, support, and clarity).
    - Novelty.
    - Industrial applicability.
- Scope of protection:
    - Interpretation of the protection scope of the patent.
    - Grounds of invalidation.
- Enforcement possibilities:
    - Compensation for infringement.
    - The right to forbid any other person from practicing the invention for operation or manufacturing purposes without the patentee's consent is granted.

Differences:

1) Subject matter – UMs only protect products with new shape/structural physical features. For example, methods of production or chemical compounds are not eligible as they do not have a shape or structure.
2) Inventiveness – although invention patents in literal terms require a higher 'inventiveness', in practice there is no difference.
3) Examination – UMs only require the 'formality examination' or 'preliminary examination', while invention patents require 'substantive examination', which takes longer and is much more detailed. Grounds for objections at preliminary examination are also different.
4) Term of protection – the maximum term of protection for a UM is 10 years from the filing date, while an invention patent lasts 20 years.
5) Cost – the official application fee for an invention patent is RMB 900 and for a UM it is RMB 500, although supplementary agent fees that may be required will vary. See the 'Related Links' section of this guide for more information about patent application fee rates.

In the following tables is possible to view the fees and terms related to the patent submission.

Patent	Application Fee (RMB)	Examination Fee (RMB)	Granted within (years):	Duration:
Invention	900	2500	3-5	20
UM	500	No	1	10
Design	500	no	1	10

Patent	Surcharge
Invention	Surcharge for claims in excess of 10 (per claim) 150 Surcharge for specification in excess of 30 pages (per page) 50 Surcharge for specification in excess of 300 pages (per page) 100
UM	Surcharge for claims in excess of 10 (per claim) 150 Surcharge for specification in excess of 30 pages (per page) 50 Surcharge for specification in excess of 300 pages (per page) 100
Design	Surcharge for claims in excess of 10 (per claim) 150 Surcharge for specification in excess of 30 pages (per page) 50 Surcharge for specification in excess of 300 pages (per page) 100

Patent	Annuity fees (years)					
	1-3	**4-6**	**7-9**	**10-12**	**13-15**	**16-20**
Invention	900	1200	2000	4000	6000	8000

Patent	Annuity fees (years)			
	1-3	**7-9**	**13-15**	**16-20**
UM	600	900	1200	2000
Design	600	900	1200	2000

Trademarks in China must respect the following requirements in order to be deposited:

- It must be legal; it must not be identical or similar to a state name or a flag; It must not be identical or similar to Chinese governmental entities names and logos; It must not be identical or similar to specific locations, landmarks, logo and theme song of Chinese Army. It must be legal - it must not be identical or similar to Red Cross or other international organization logos; it must not be discriminative, exaggerated and containing fraudulent advertising etc.

- It must be distinctive;

- non-functional (this apply to 3D shapes that cannot be registered if they generate from the product itself and so are a merely reproduction of the product, if they incorporate a technical aspects or element that keep the competitor away from reproducing it, if it enables the product to be valuable);

- It must be available for registration at the China Trademark Office (CTMO).

4. Opportunities of doing business in china.

As we have seen in the previous paragraph of this thesis, the great big question mark for the future development of Chinese economy are consumptions. The evolution of the buyer persona in China is still something that is under analysis by many analysts and eventually will determine the attributes that the economy demands. What I want to show in this thesis is the incredible opportunity Italian firms have to enter the Chinese market. If "made in Italy" does not mean much in our country, many buyers in different country still appreciate the quality and the provenience of the product made in Italy. Of course, this is not enough. Doing business in China is still "hell" for inexperienced sailors so Italian firms need to master other attributes in order to make it in China.

4.4 Italian presence and what we need.

Italian companies in China are about 2000, with a total revenue of about 5 billion of dollars. The sectors in which they operate are quite diversified with prevalent share in manufacturing and textile industry.

China represents a good importing country of Italian products. It is the ninth destination market for our country products and the number one considering only Asia. The rates of export growth are the fastest in terms of growth compared to the rest of the world. As we can see for the following table, the exports in Asia are growth of almost 6% from 2010.

Geographical Areas	Value (2018, € bln)	Cagr 2010 - 2018
Asia	39,3	5.9%
Advanced markets	341,3	4.4%
Latin America	14,1	3.3%
Sub-Saharan Africa	5,5	2.8%
CSI	16,3	1.7%
Middle east & North Africa	38,8	0.6%

Table 19. Growth of Italian export. Source SACE SIMEST on Istat data.

In the same period, the sale of Italian products toward China are growth, on average, of 5,5%, going from 8.6 billion of euro to 13 billion in 2018. Although, in 2018 the data shows a small decrease (-2,4%). However, this decrease can be reconducted to general negative performance of the automotive sector. Indeed, after the sale boom of cars in 2017 (+70,1 %), they decrease of 60,3 the last year.

The data shows a positive export year for what concern the sector of rubber and plastic (+ 6,2 %) and electrics (+ 4,6 %), although, for what concerns the export of mechanic tools (the main Italian sector for exports), it has been recorded a small decrease.

In general, the numbers show a quite positive future for Italian products in China. Analysts expect a continuous growth of Italian export in next years. The main opportunities will be in the electronics, chemical-pharmaceutical, mechanics and transportation mean sectors. In particular Italian manufacturers of mechanics tools will benefit an increase of demand of higher quality tools, in accordance to the general qualitative “upgrade” and to the “Made in China 2025” program.

Features that are appreciated.

Data about Chinese market are quite clear: the consumptions are changing and evolving, bringing a new way to define what Chinese want and what they don’t. The real question here is: what can Italian companies give in terms of value added and appreciated features?

Let’s start this analysis trying to understand in which way consumption are changing. As we have already said, Chinese consumers are not as they used to be. A study carried out by Accenture, shows the main characteristics the Chinese buyer persona seek in the customer journey.

First of all, they are looking for **liquid experiences**. This means that the customer experience (CX) shall evolve into more sophisticated funnel. This translates into the fall of the traditional separation between online purchase and offline purchase. Nowadays Chinese want to buy in a seamless experience. It is not enough important to stress the world “buying” because it is demonstrated that Chinese who buy online are more prone to buy online and vice versa. So, whoever wants to launch his products in China, should build a multiplatform/online2offline experience.

Another important aspect of the experience is **“setting the scene”**. Setting the scene means to allow the willing buyer to perceive how the product will be. Augmented reality and virtual reality are keys of success to let the consumer to “taste” the product before the actual sale.

Furthermore, the experience should be **“social”.** Socializing the sale means to collocate the sale inside a community ecosystem. The digital generation in China feel to be part of communities and want to buy what is sponsored and accepted by its “clan”. Comments and recommendations are crucial for Chinese in assessing the goodness of a product.

While these characteristics are quite general and may applied to different brand from all around the world, Made in Italy should be able to reinvent to adapt to those characteristic.

It is important to say that not everything is so bright as often Italian media say. A recent study from ”*Osservatorio Paesi terzi di Business Strategies*” on the perception and acceptance of the “Made in Italy” shows some ambiguous results about the knowledge of Chinese consumers toward Italian brands. In general, consumer seems very prone and receptive for Italian brands. They look for new and novelty coming from our country especially for what concerns food (51%), fashion (45%), wine (29%) and cars (17%). But answering the question “Tell me the first Italian name or brand”, many Chinese “fail”, reporting their ignorance especially in the food sector, where the 69% of the interviewed is not able to tell even one name. The most famous Italian brand is Ferrari, known by 18%, followed by Gucci with 9%. Barolo and Fiat follow with 5%. Illy, that has a strong presence in China, is known only by 1% of the interviewed. Silvana Ballotta, CEO of Business Strategies, commented the results stating that the main problem of the Italian firms is that they are not able to communicate their mission and vision.

On the other hand, we should not despair. As Ballotta also added, there is space for “us” in China. The recent history is full of good example of how the “italianity” of our product is accepted in China. For example, in fitness market.

The fitness market is booming in china. The Accenture study shows that 60 per cent of the consumers interviewed spend more than 3 hours a week in keeping fit and training. Currently valued USD 235 billion, the market is expected to value 735 billion of dollars in 2025.

As many things going on in China, in order to crowd out the market gym and fitness companies should think outside the box and try to merge the quality of the products with innovation. This is indeed the case of Technogym. The 2018 financial statements show an outstanding + 26% for sales on Chinese market. This numbers are result of years and years of analysis of trends.

The foundation of an academy to form the trainers, in addition to the creation of a digital ecosystem inside the gyms, let the brand to be a reference point in Chinese gyms.

4.5 Example of success.

To conclude this thesis, I have decided to talk about cases related to the Sino-Italian cooperation, that should be seen as references, for all the Italian companies which want to start their Chinese journey.

Thanks to the mediatic attention about the new Silk Road and the quite proactive role played by Italy, business cooperation between the two countries is getting stronger. Without talking about whether the political repercussion of this proactivity will be positive for the future of Italian centrality in the international scene, I focused on the immediate and favorable effects such relationship is creating.

Port of Trieste and CCCC.

The port of Trieste has signed a memorandum of understanding with the China Communication Construction Company (CCCC) to launch common project aimed to boost "Made in Italy" in China. The initiative will interest the Guangzhou, Jiangsu, Shanghai, Ningbo and Shenzhen area, with the intent to create a logistic corridor between Italy and China.

The port authority will not have direct participation in the projects that will be, but will coordinate and support the planning and the promotion of them.

Panda Bonds.

Panda bonds are bonds issued by Italian Cassa Depositi e Prestiti on the interbank Chinese market. The issuing of these bonds has a total value of one billion of RMB (130 million of euro) with a fixed interest rate of 4,5%. The bonds are the result of the Memorandum of Understanding signed between Italy and China for the Belt and Road Initiative, aimed to

increase the connection and the exchanges between the two countries. Italy is one of the few countries in Europe which have signed for the issue of the bonds together with Portugal, Poland, Hungary and Austria.

The bonds are issued with the aim of helping foreign companies, which operates on Chinese land, to obtain funds. Due to the difficulty in access to credit for foreign enterprises, the bonds represent a valid alternative.

Italy meets China: High Manufacturing.

Italy meets China: High Manufacturing is the name of the second edition of the "Forum Bilaterale Sino Italiano sulla macchina utensile". The event took place in November 2019 in Beijing and was promoted by the Ministry of economic development (MISE), UCIMU (that is the Italian association of mechanic tools manufacturer), Italian embassy in China and China Machinery Industry Federation. In the event more than one hundred of experts of the sector were presents, along with Italian companies' part of UCIMU. These companies presented best practices and innovation with real applications in various sectors coming from the Italian industry. The aim of the event, according Massimo Carboniero, UCIMU chairman, is to create a point of dialogue on the 4.0 manufacturing topic, joining the industrial plan of both countries.

Da Vinci Village.

In the next two year, a village and hub for Italian SMEs will be built in Ningbo. Born from the will of Italian CNA (La Confederazione Nazionale dell'Artigianato e della Piccola e Media impresa) and the province of Ningbo Fenghua, the hub will be called Da Vinci Village and will host 150 small and medium enterprises. The agreement has been signed in Napoli in May 2019 and represents a huge opportunity for Italian companies (especially in the handcrafted goods sector) because they will be able to access an area that has a GDP of 13 billion of euros.

The initiative, created on the path of the New Silk Road, will make the city of Napoli and the city of Ningbo closer, bringing a virtual connection between the two markets.

According to Giuseppe Oliviero, the national vice-president of CAN, the project will be articulated in various steps. First of all, it will be created an incubator and a showroom for

Italian SMEs in Shaoxing. Later, in two years from now, the Da Vinci Village will be built on 120.000 square meters, and it will be divided between residential areas and commercial places.

Cdp and Unicredit for SMEs in China.

Italian Cassa Depositi e Presititi, together with Unicredit bank, will launch a revolving credit line for Italian SMEs in China of 300 million of euro. Specifically, it will be destined to Italian SMEs working in China or Italian-owned Chinese companies, allowing the credit access also with RMB and co-financing tools.

The project will help Italian SMEs also with a desk in the Shanghai branch, for improving the expertise of Italian companies in dealing with foreign markets and bureaucracy.

China Italy Innovation Forum

In November 2019 has been held the tenth edition of China Italy Innovation Forum. One of the key words of the recent agreements between Italy and China has been “innovation”. The cooperation between researchers and university has never been so strong.

The forum, held in Beijing and Jinan and promoted on the Italian side by Città della Scienza, put together more than ten thousand experts in cooperation projects, more than five thousand entrepreneurial realities and favoring more than five thousand of technology transfer between the two countries.

Besides the many praises coming from the respective governments and the presence of CNR and the most relevant Italian universities, the forum was also a possibility for Italian excellences to be appreciated abroad. In fact, the “China-Italy Best Startup Showcase”, at its third edition, allowed Italian promising startups to deal with Chinese clients and investors. Italian MIUR and its Chinese respective, the MOST, have launched this program in 2016 with the aim of promoting innovation in smart manufacturing, environmental sustainability, artificial intelligence and big data. The top 9 startups (among 100) had the opportunity to be present while the top three received a monetary prize.

Interviews.

In this part of the thesis I have decided to collect some opinions from subjects who have touched with their hands what does it mean, for a small Italian business, to deal with China.

As I previously mentioned, this part should not be considered as "experimental". The data collected are mostly qualitative with the aim of providing to the reader a sentiment, more than a statistical truth.

The subjects interviewed are:

- Mariano De Santo, export manager.
- Tommaso Gecchelin, startup founder.

The question provided were all the same for all the interviewed with the exception of the questions for Tommaso Gecchelin. For him, I have decided to follow a different approach due to the diversity of the content of the interview. Indeed, I have talked with him about a specific episode happened to its startup, Next Future Transportation, which is, by the way, the startup where I am actually working in as business developer. The episode is about an aborted operation of funding coming from a Chinese investment group. For the specificity of his story, I have decided to let him talk, while I put myself in the place of the listener, interrupting him only to better channel the conversation.

For Mariano De Santo and the questions were related to the following topics:

- Brief description of the interviewed and its job.
- Comments on the barriers to internationalization provided by the OECD, with his opinions on the most impacting ones.
- Comments on the opportunities generating from dealing with Chinese market.
- One negative anecdote (where challenges for SMEs were many).
- One positive anecdote (where opportunities for SMEs were many).

Interview #1 with Mariano De Santo.

Mariano De Santo, is an "export expert" with forty years in the business working as export manager and now with its own company called AS International s.r.l.

I had the pleasure to meet him via my father's company, a transport and logistic company in Maddaloni near Caserta, who benefited of Mariano's service for a long period in the past. So, when I told him about my thesis, he was very happy to help me and share its knowledge.

The barriers.

As the interview started and I provided him the questions related to internationalization barriers, he immediately stops me from any further explanation. He had from the beginning clear in his mind which is the most important challenge Italian company faces when dealing with China: the lack of expertise. According to him, many clients have the presumption to believe that is easy to deal in China. But once they start to venture on their own, they waste money and time, addressing their efforts in the wrong direction. Eventually, they end up asking for help in companies like AS International. "In order to doing business in China, you must know and resort to the right person, otherwise you will end up crashed between procedures and an alien language".

For example, the bureaucracy, for what concerns the export is not a barrier per se. It may seem complex for an Italian company, but this is why export manager exists. Also, the culture, that for many aspects, seems very remote from Italian one, should be understood and considered as important when dealing with China. "They are great and strict workers, maybe even too much for our Italian standards. In fact, according to him, while we Italian tend to put friendship and extra work relationships first, they place work before everything. They are good and friendly people, but when it is time to do business, nothing comes first".

The opportunities.

For what concerns the opportunity, as "exporter" he has no doubts that Made in Italy is still a big opportunity for companies which are able to place themselves in the market. However, he admitted that Chinese people have a very limited awareness of Italian brands. They know all the big brands, but they are ignorant in relation to the smaller excellences of our country. This is an opportunity but at the same time a challenge. The Chinese market is huge with an

increasing part of willing to buy consumers. They are ready to "receive" new products as long as they are perceived as "qualitative superior and rich lifestyle associated". So, the objective of Italian SMEs should be to focus on communicating their value, leveraging on the Italian provenience.

Positive and negative episodes.

With his experience in the exporting business, Mariano has seen a clear increase in Chinese consumption of wine. He is positive that this trend will go on together with other "famous" food and brands of the made in Italy. As already said, the market is very dynamic and understanding the consumption trend is everything. He told me this anecdote that make me understood that China can still be a land of opportunity for few chosen products. He told me about an Italian exporter of fur and similar products, who when he started to perceive the decline of its business, he reinvented himself. In Shenzhen he opened a pizzeria (he had no past experience in the sector), which then led to the opening of various other pizzerias in the area. He invented his job from scratch, by observing what Chinese people wanted.

However, Mariano stressed a very important concept. The "*italianity*" works only until you do not step on Chinese domestic business". It is fundamental to not forget that China is a state driven country, very protectionist toward its affairs. Tax and duties on foreign product may always arise if the government decides to protect domestic production.

Interview #2 with Tommaso Gecchelin.

I met Tommaso in May 2019 and I immediately found his project very interesting. He is founder and CEO of a startup which has the objective of building a different mobility paradigm for our city. The idea at the center of the project is "car jumping", that means an easier and quicker substitute of the traditional bus connections. In this case, instead of waiting at the bus stop the right bus for you, you can take the bus while moving. Indeed, Next's buses are provided with opening doors that allow the bus to attach and detach from another one, allowing the passenger to change bus while moving. This idea has been acknowledged by the New York University as a game changer in the current mobility scenario, with an important reduction of traffic, stress and pollution.

After our first meeting I have decided to become part if this project and currently I am working as business developer for Next.

One of the first anecdotes Tommaso told me about Next's past, is related to a failed funding operation coming from China. So, during the redaction of this thesis I thought that interviewing him about the episode, could provide a brief but real taste of the instability sometimes related to doing business in China.

As already stated, I have decided to not aske questions directly to him, instead I let him talk, interrupting him when necessary.

This is his description of the facts:

In March 2018, after the Dubai presentation of our modules, Next came in contact with a Chinese vehicle producer, interested in financing the project and in acquiring the license for the Chinese market. The money involved were many, and the executives of the company went in China two/three times to meet and discuss about the deal. Everything was going in the proper way and we were obviously very happy about it. A curious episode is that during the first meeting, Next's executives were invited to a "gargantuan" dinner with every kind of cooked and raw fish. The representatives of the Chinese vehicle manufacturer got drunk and burped freely, a thing that left our guys quite surprised and amused (a strong evidence of the diversity of business culture).

After the meetings in China, was time of the due diligence in Italy. Two European representatives of the Chinese company went in our offices to asses our work. They were quite impressed with the operations and the engineering of the modules, so the there was no problem encountered. Four months after the first contact with them, the deal was done and was time for celebrations. More or less, we are talking about August 2018.

Everything was wonderful, except there was no sign of the money. The Chinese company started to say there were problems in sending the money due to the ongoing trade war with U.S. (Next is basically two companies, one in US and one in Italy. The founders are the same for both companies). After days of delays, Chinese company decided to send one eighth of the due money via a Dubai company affiliated to them. Now the thing gets fishy. The Dubai company sent the money but not as funding capital. Next was forced to issue invoice to get the money. Remember that at that moment only one eighth of the due investment was occurred.

Months passed and the money were used to finance operations in Next. When cash was finishing, was time to contact again the Chinese company. The idea in our head was "they gave us only part of the money, without having back promised company shares, so it is impossible they will stop sending us money". Those were last famous words. The Chinese company simply disappeared. No one ever replied to Next's messages. After a while resignation took the place of anger.

Months later, while interfacing with our partners, we found out that similar fate happened to other companies which were contacted by the same Chinese company. We started also to put together pieces and tried to understand what happened.

The reality was that in China many companies were born during a series of governmental incentives to produce electric vehicles and to invest in AI related technologies. Many of those, unfortunately existed only to get incentives to successively disappear. In a way to limit the phenomenon, the government reduced the incentives and the Chinese company found itself with reduced resources. Furthermore, a former employee of them told us that they were getting problems in obtaining some licenses to manufacture.

In retrospect, a mix of fate and our inexperience led us to ignore some aspects that could have avoided the situation. First of all, resorting to an expert with experience in dealing with Chinese, could lead us to make our own due diligence of the Chinese partner. The inexperience of the executives avoided the recognition of clear signals of lack of professionality coming from the

Chinese partners. Experts and advisors of the vehicles manufacturing sector could have advised about the risks and dynamism of the Chinese regulations.

Conclusion

During the redaction of this thesis I understood and learned many things about China, but also many things about Italy. Problems and opportunities are typical of every business in every part of the world, it does not matter if it is a small medium firm or a multinational. However, going through the problems and barriers which keep our companies away from becoming international in China, and assessing our abilities and the merits the world acknowledges, I felt a feeling of squandering. Now I know the big potential unexpressed of Italian SMEs, that sometimes comes out despite the difficulties and despite our "being Italian", that often self-sabotage us.

Looking at the main obstacles, we face when dealing with China, we have to mention our *lack of experience and know-how* about internationalization. How seen also in the interview with Mariano De Santo, without the right person and mindset is not possible to deal with China. Exporting in such a foreign environment on your own eventually lead to failure, fostering the misconception that China is a hostile environment. Surely China presents some intrinsic problematics. The *strong presence of the communist party*, which is running the state under strong protectionist policies, is an important source of instability for every business there. *Censorships and import duties* do not help.

Many cooperation policies and internationalization incentives may help Italy to be more present there. The signing of the memorandum of understanding for the *Belt and Road Initiatives* along with the cooperation events cited at the end of this thesis, are a strong sign that the will of improving the relationships and exporting the good we have is more present than ever. But what do we have that is considered good? *Fashion and food*, although may seem stereotypical, represent a good starting point for internationalization. The *"Made in Italy"* is still very appreciated and is driving Italian export in china. However, as I said before, this is not enough. Italian companies should start to do two things. Firstly, their approach to Chinese market should change. They should start to stress and properly communicate the values that make our product so unique. Chinese are wonderful people, but they are still "infant" buyers, who have seen their income increasing suddenly. Because of this, they want quality and reliable products, especially if foreign. Hence, this is the perfect time to *communicate* the "being Italian" of products. They will buy them. The second important thing Italian SMEs should understand, is that competition against competitors is not won only with quality. New markets and needs develop quickly in an infant market as Chinese one. While the communication of "Made in Italy" is important, it is important also to formulate *new business models*, able to adapt to the new digital and customized paradigm. On-line commerce and social trends play a crucial role in modern buying

behavior. Indeed, technology should not be seen as enemy of quality, but a way to enhance it, as Italian fashion brands demonstrate. This rule applies also to B2B business like mechanic tools manufacturing. China is running the race for *smart industry*, with IoT and advanced machine learning integrated in the machines. If Italian SMEs want to be part of the race, eventually they will have to adapt themselves.

I conclude this thesis with a message. Nowadays, misconception and misunderstanding of China and Chinese people is more detrimental for Italy than China, whether we like it or not. In a global changing scenario, it is becoming more and more evident that Asia will be center of the world. This does not mean we must be subjected to a different culture. Being Italian is something that Italian firms will never lose because it is synonym of talent and creativity, and those attributes are forever part of our DNA. Indeed, it means that new opportunities and frontiers, closed before, are now opening for whom is able to see further and undertake them.

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At the end of my academic journey, looking behind me, I do not see myself alone, having exams and bringing home results, I see my family with me. I see my mom and dad, who understood me when it was time to understand and clashed with me when it was time to clash. I see my brother and sister, Paolo and Francesca, who are also study companions of mine, with whom I have expressed my fears and with whom I laughed during many (maybe too many) study breaks. I see my lifelong friend Christian, standing by my side, who taught me how easy it can be when you have someone to rely on.

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