OPTIONS FOR RESISTANCE STRATEGIES OF
LOCAL CHINESE COMPANIES
AGAINST FOREIGN COMPETITION
IN THE CHINESE CONSUMER GOODS MARKET

Lin Zhang

China
CONTENTS

List of Figures ........................................................................................................................ VI
List of Tables ........................................................................................................................... VIII
List of Abbreviations .............................................................................................................. X

1 Introduction ........................................................................................................................... 1
  1.1 Prevalent Problems for Local Chinese Companies .......................................................... 1
  1.2 Research Aim ................................................................................................................... 4
  1.3 Structure of the Dissertation ........................................................................................... 7

2 Theoretical Framework ......................................................................................................... 9
  2.1 Strategy and Strategic Management ................................................................................. 9
    2.1.1 The Concept of Strategy ............................................................................................ 10
      2.1.1.1 Definition of Strategy ......................................................................................... 10
      2.1.1.2 Strategy Typologies ........................................................................................... 13
        2.1.1.2.1 Corporate Strategies ..................................................................................... 16
          2.1.1.2.1.1 Growth Strategy ....................................................................................... 17
          2.1.1.2.1.1.1 Product-Market-Strategies ................................................................. 17
          2.1.1.2.1.1.2 Local, National, International and Global Strategies ................................. 20
          2.1.1.2.1.1.3 Autonomy, Cooperation, and Integration Strategies ............................ 22
          2.1.1.2.1.2 Stabilization Strategy ................................................................................. 29
          2.1.1.2.1.3 Retrenchment Strategy .............................................................................. 29
        2.1.1.2.2 Business Strategies ......................................................................................... 31
        2.1.1.2.3 Functional Strategies ....................................................................................... 33
      2.1.2 Strategic Management ............................................................................................... 36
        2.1.2.1 Definitions of Strategic Management ................................................................. 36
        2.1.2.2 Strategic Management Process .......................................................................... 37
          2.1.2.2.1 Strategic Planning ......................................................................................... 38
          2.1.2.2.2 Strategy Implementation ................................................................................ 39
          2.1.2.2.3 Strategic Evaluation and Control .................................................................... 41
      2.1.3 The Significance of Strategic Environment Analysis in Strategy Planning ............... 43
        2.1.3.1 External Environment Analysis ........................................................................... 45
          2.1.3.1.1 Macroenvironment ....................................................................................... 45
            2.1.3.1.1.1 Political/Legal Environment ................................................................. 46
            2.1.3.1.1.2 Economic Environment ........................................................................... 46
            2.1.3.1.1.3 Sociocultural Environment ................................................................. 47
            2.1.3.1.1.4 Technological Environment ................................................................. 48
          2.1.3.1.2 Microenvironment ......................................................................................... 48
            2.1.3.1.2.1 Industry Analysis ...................................................................................... 48
2.1.3.2 Internal Environment Analysis ............................................................... 58

2.2 Resistance Strategies .................................................................................. 60
  2.2.1 Research Context ...................................................................................... 60
  2.2.2 Definition and Research Propositions ..................................................... 63
  2.2.3 Literature Review ...................................................................................... 66
    2.2.3.1 Miles and Snow’s Strategy Typology .................................................. 66
    2.2.3.2 Meffert’s Strategy Typology ............................................................... 70
    2.2.3.3 Kuester, Homburg, Robertson and Schaefer’s Strategy Typology ....... 76
    2.2.3.4 Raffée and Segler’s Strategy Typology ............................................... 80
    2.2.3.5 Gorynia and Wolniak’s Strategy Typology ......................................... 83
    2.2.3.6 Dawar and Frost’s Strategy Typology ................................................ 87
    2.2.3.7 Analysis of the Existing Approaches ................................................... 87
      2.2.3.7.1 Summary .................................................................................. 87
      2.2.3.7.2 A New Classification and its Analysis ......................................... 89
      2.2.3.7.3 Contribution ............................................................................ 93
  2.2.4 Alternative Resistance Strategies ............................................................. 93
    2.2.4.1 Two Required Parameters .................................................................. 94
    2.2.4.2 Options of Resistance Strategies without Strategic Alliances ............. 95
      2.2.4.2.1 Defender .................................................................................. 96
      2.2.4.2.2 Extender ................................................................................. 99
      2.2.4.2.3 Dodger ................................................................................... 100
      2.2.4.2.4 Contender ............................................................................. 103
    2.2.4.3 Options of Resistance Strategies with Strategic Alliances ................. 105
      2.2.4.3.1 Defender ................................................................................. 108
      2.2.4.3.2 Dodger ................................................................................... 110
      2.2.4.3.3 Extender ................................................................................. 110
      2.2.4.3.4 Contender ............................................................................. 111
    2.2.4.4 Summary .......................................................................................... 112

3 Analyzing the Marketing Environment of Domestic Actors in the Chinese Consumer Goods Market ................................................................. 116
  3.1 Chinese Consumer Goods Companies ......................................................... 116
    3.1.1 Consumer Goods and Consumer Goods Companies ................................ 116
      3.1.1.1 Definition and Typology of Consumer Goods ................................... 116
      3.1.1.2 Consumer Goods Companies in the Context of Globalization .......... 118
    3.1.2 Types of Chinese Consumer Goods Companies ...................................... 120
      3.1.2.1 Chinese State-Owned Enterprises ................................................... 121
      3.1.2.2 Chinese Township and Village Enterprises ....................................... 124
      3.1.2.3 Chinese Private-Owned Enterprises ............................................... 125
    3.1.3 Major Chinese Consumer Goods Companies ......................................... 127
  3.2 Major Macroenvironmental Forces .............................................................. 129
3.2.1 Political/Legal Environment ................................................................. 130
  3.2.1.1 Political Background and Current Situation ............................... 130
  3.2.1.2 Legal and Regulatory Environment .............................................. 133
3.2.2 Economic Environment ........................................................................ 136
  3.2.2.1 The History of Economic System .................................................... 137
  3.2.2.2 Present Economic Performances ..................................................... 143
    3.2.2.2.1 Foreign Trade .......................................................................... 143
    3.2.2.2.2 Foreign Direct Investment and Overseas Direct Investment ... 145
      3.2.2.2.2.1 Foreign Direct Investment ............................................ 145
    3.2.2.2.2.2 Overseas Direct Investment ............................................. 147
  3.2.2.2.3 Gross Domestic Product, Investment and Consumption .......... 149
3.2.2.3 Economic Challenges ....................................................................... 152
  3.2.2.3.1 Imbalance ............................................................................... 153
  3.2.2.3.2 Banking System ...................................................................... 154
  3.2.2.3.3 Currency Revaluation ................................................................ 155
3.2.2.4 Prospects .......................................................................................... 157
3.2.3 Sociocultural Environment ................................................................... 158
  3.2.3.1 Demographic Environment ............................................................ 158
  3.2.3.2 Physical Environment .................................................................... 159
  3.2.3.3 Cultural Environment .................................................................... 160
3.2.4 Technological Environment ................................................................... 161
3.3 Microenvironment Characteristics and Actors .......................................... 162
  3.3.1 The Chinese Consumer Goods Market ................................................. 162
    3.3.1.1 The Significance of the CCGM ....................................................... 162
    3.3.1.2 Current Situation of the CCGM ..................................................... 164
      3.3.1.2.1 Sales Analysis ........................................................................ 164
      3.3.1.2.2 Demand Analysis ................................................................... 165
    3.3.1.3 Future Trends of the CCGM ............................................................ 168
    3.3.1.4 Unique Characteristics of the CCGM ............................................. 170
      3.3.1.4.1 Geographic Hierarchy ............................................................. 171
      3.3.1.4.2 Consumer Goods Hierarchy ................................................... 173
  3.3.2 Chinese Consumers ........................................................................... 175
    3.3.2.1 Chinese Consumer Evolution ....................................................... 176
    3.3.2.2 Chinese Consumer Hierarchy ......................................................... 177
    3.3.2.3 Chinese Consumer Behavior ......................................................... 181
  3.3.3 Foreign Competitors .......................................................................... 184
    3.3.3.1 The Evolution of China’s Regulatory Environment toward Foreign Investment ........................................................................... 186
    3.3.3.2 Foreign MNCs’ Three Developing Stages in China ...................... 190
    3.3.3.3 The Evolution of Foreign MNCs’ China Strategies ....................... 191
    3.3.3.4 Major Foreign Consumer Goods Companies in China ................. 194
    3.3.3.5 Overall Evaluation of Foreign MNCs’ Strengths, Weaknesses, Opportunities, and Threats in China ......................................................... 197
  3.3.4 Distributors .......................................................................................... 199
### 3.4 Overall Evaluation of Chinese Consumer Goods Companies’ Strengths, Weaknesses, Opportunities, and Threats

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.4.1 Strengths</td>
<td>205</td>
</tr>
<tr>
<td>3.4.2 Weaknesses</td>
<td>208</td>
</tr>
<tr>
<td>3.4.3 Opportunities</td>
<td>210</td>
</tr>
<tr>
<td>3.4.4 Threats</td>
<td>212</td>
</tr>
</tbody>
</table>

### 4 Applied Options for Resistance Strategies of Local Chinese Companies against Foreign Competition in the CCGM — A Case Study Approach

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1 Research Methodology and Case Selection</td>
<td>214</td>
</tr>
<tr>
<td>4.1.1 Case Study as a Research Methodology</td>
<td>214</td>
</tr>
<tr>
<td>4.1.2 Case Selection</td>
<td>218</td>
</tr>
<tr>
<td>4.1.2.1 Selection in Chinese Consumer Goods Industries</td>
<td>218</td>
</tr>
<tr>
<td>4.1.2.2 Selection in Chinese Consumer Goods Companies</td>
<td>219</td>
</tr>
<tr>
<td>4.2 Case Studies</td>
<td>220</td>
</tr>
<tr>
<td>4.2.1 Case Study One: Hangzhou Wahaha Group Co., Ltd.</td>
<td>220</td>
</tr>
<tr>
<td>4.2.1.1 Chinese Beverage Industry Overview</td>
<td>220</td>
</tr>
<tr>
<td>4.2.1.2 Enterprise Background</td>
<td>222</td>
</tr>
<tr>
<td>4.2.1.3 Wahaha’s Defender Strategies</td>
<td>222</td>
</tr>
<tr>
<td>4.2.1.3.1 Defending with Strategic Alliances</td>
<td>223</td>
</tr>
<tr>
<td>4.2.1.3.2 Defending Autonomically</td>
<td>224</td>
</tr>
<tr>
<td>4.2.1.4 Summary</td>
<td>228</td>
</tr>
<tr>
<td>4.2.2 Case Study Two and Three: Shanghai Jahwa and Beijing DaBao</td>
<td>230</td>
</tr>
<tr>
<td>4.2.2.1 Chinese Cosmetics Industry Overview</td>
<td>230</td>
</tr>
<tr>
<td>4.2.2.1.1 Huge Market Potential</td>
<td>230</td>
</tr>
<tr>
<td>4.2.2.1.2 Intensive Competition</td>
<td>231</td>
</tr>
<tr>
<td>4.2.2.2 Case Study Two: Shanghai Jahwa and its Defender Strategies</td>
<td>233</td>
</tr>
<tr>
<td>4.2.2.2.1 Enterprise Background</td>
<td>233</td>
</tr>
<tr>
<td>4.2.2.2.2 Jahwa’s Defender Strategies</td>
<td>233</td>
</tr>
<tr>
<td>4.2.2.3 Case Study Three: Beijing DaBao and its Dodger Strategies</td>
<td>236</td>
</tr>
<tr>
<td>4.2.2.3.1 Enterprises Background</td>
<td>236</td>
</tr>
<tr>
<td>4.2.2.3.2 Dabao’s Dodger Strategies</td>
<td>237</td>
</tr>
<tr>
<td>4.2.2.4 Summary</td>
<td>238</td>
</tr>
<tr>
<td>4.2.3 Case Study Four: Lenovo Group Limited</td>
<td>240</td>
</tr>
<tr>
<td>4.2.3.1 The Globalization of the Personal Computer Industry</td>
<td>240</td>
</tr>
<tr>
<td>4.2.3.2 Chinese Personal Computer Industry Overview</td>
<td>241</td>
</tr>
<tr>
<td>4.2.3.2.1 Suppliers</td>
<td>241</td>
</tr>
<tr>
<td>4.2.3.2.2 Government Policies</td>
<td>242</td>
</tr>
<tr>
<td>4.2.3.3 Enterprise Background</td>
<td>243</td>
</tr>
<tr>
<td>4.2.3.4 Lenovo’s Three Growth Stages and its Contender Strategies</td>
<td>244</td>
</tr>
<tr>
<td>4.2.3.3.1 Stage One: Pioneering Era</td>
<td>245</td>
</tr>
<tr>
<td>4.2.3.3.2 Stage Two: PC Brand Era</td>
<td>246</td>
</tr>
</tbody>
</table>
4.2.3.3 Stage Three: Globalization Era ......................................................... 249
4.2.3.5 Summary ......................................................................................... 250
4.2.4 Case Study Five: Haier Group .............................................................. 251
4.2.4.1 Chinese Household Appliance Industry Overview ............................ 251
4.2.4.1.1 Industry Development Background ............................................. 251
4.2.4.1.2 Current Situations and Prospects ................................................. 253
4.2.4.2 Enterprise Background and Four Growth Stages ............................... 254
4.2.4.3 Haier’s Evolving Resistance Strategies in different Growth Stages .... 257
4.2.4.3.1 Stage One: Defender .................................................................... 257
4.2.4.3.2 Stage Two: Dodger ....................................................................... 258
4.2.4.3.3 Stage Three: Extender ................................................................. 260
4.2.4.3.4 Stage Four: Contender .................................................................. 263
4.2.4.4 Summary ......................................................................................... 265

4.3 Results and Synthesis of the Empirical Cases ............................................. 266
4.3.1 Defending with the Home Field Advantages ........................................... 267
4.3.2 Dodging the Onslaught ......................................................................... 270
4.3.3 Extending Local Advantages Abroad ..................................................... 272
4.3.4 Contending on a Global Level ............................................................... 274
4.3.5 Strategic Alliances with Foreign MNCs ................................................... 278

5 Strategic Implications, Conclusions, Limitations and Suggestions for Future Research .......................................................... 282
5.1 Strategic Implications for Chinese Consumer Goods Companies ............... 282
5.1.1 Go beyond Low-Cost Approach ............................................................ 282
5.1.2 Merger and Acquisition Control ............................................................. 284
5.1.2.1 Acquisitions of Chinese Companies by Foreign competitors ............ 284
5.1.2.2 Outbound Acquisitions by Chinese Players ....................................... 285
5.1.3 Branding .............................................................................................. 286
5.1.4 Learn to Live with Foreign Giants .......................................................... 288
5.1.5 Innovation ............................................................................................ 291
5.1.6 Qualified Human Resources ................................................................. 292

5.2 Conclusions ............................................................................................. 293
5.3 Limitations and Suggestions for Future Research ........................................ 297

References ................................................................................................. 300
List of Figures

Figure 1-1: Structure of the Dissertation ................................................................. 8
Figure 2-1: Three Hierarchical Levels of Strategy ................................................... 15
Figure 2-2: The Interrelationship of Different Types of Enterprise Strategies .......... 16
Figure 2-3: Product-Market-Combination ............................................................... 17
Figure 2-4: Classification of Diversification Strategies .......................................... 19
Figure 2-5: International Strategies ........................................................................ 22
Figure 2-6: Classification of Integration Strategies .................................................. 25
Figure 2-7: The Comparison among Merger, Acquisition and Alliance ................. 27
Figure 2-8: Strategic Management Process ............................................................ 38
Figure 2-9: Traditional Approach to Strategic Control ............................................ 42
Figure 2-10: Contemporary Approach to Strategic Control .................................... 43
Figure 2-11: Strategic Environment Analysis ........................................................ 44
Figure 2-12: Porter’s Five Competitive Forces Model .......................................... 49
Figure 2-13: A Framework for Competitor Analysis .............................................. 52
Figure 2-14: Consumer Marketing Channels ........................................................ 56
Figure 2-15: Dual Natures of Resistance Strategy .................................................. 65
Figure 2-16: Miles and Snow’s Strategic Typology .............................................. 68
Figure 2-17: Typologies of Competition-oriented Behavior .................................... 73
Figure 2-18: Classification of Reactions to Threats from New Competitor/Product .. 77
Figure 2-19: Alternative Competition-related Directions of Impact .................... 80
Figure 2-20: Strategic Alternatives of Local Companies in Emerging Markets
  (without Strategic Alliances) .............................................................................. 96
Figure 2-21: Strategic Alternatives of Local Companies in Emerging Markets
  (with Strategic Alliances) ................................................................................. 108
Figure 2-22: Samsung’s Alliances ......................................................................... 112
Figure 3-1: Typology of Goods ............................................................................. 117
Figure 3-2: Some Logos of Major Chinese Consumer Goods Companies .......... 128
List of Figures

Figure 3-3: The Framework of China Legal System ....................................................... 134
Figure 3-4: Development Stages and Historical Events .................................................. 137
Figure 3-5: Value of FDI in China (USD 100 Million) .................................................. 146
Figure 3-6: Stock of Chinese ODI (Billion US$) ......................................................... 148
Figure 3-7: Growth of Total Retail Sales of Consumer Goods (1979-2005) ............. 164
Figure 3-8: Per Capita Annual Net Income of Urban and Rural Households
   (1978-2005) (RMB Yuan) .......................................................................................... 167
Figure 3-9: Composition of Average Household Consumption (1995 and 2004) ...... 168
Figure 3-10: Map of China ............................................................................................ 171
Figure 3-11: Consumer Goods Hierarchy related to .................................................... 175
Figure 3-12: Strategic Shift from “Foreign Investors” to “Strategic Insiders” .......... 192
Figure 3-13: China Retail Sales Value and Growth Rate (2000—2010) ................. 200
Figure 4-1: Lenovo’s Three Growth Stages ................................................................. 244
Figure 4-2: Haier’s Four Growth Stages and Strategic Shifts .................................... 255
Figure 4-3: Haier’s Resistance Strategies in Various Growth Stages ....................... 257
Figure 4-4: Path of Haier’s International Expansion .................................................... 262
List of Tables

Table 2-1: The Comparison between Strategy and Tactics .................................................. 11
Table 2-2: Main Definitions of Strategy over Time .............................................................. 12
Table 2-3: Strategy Typologies .......................................................................................... 14
Table 2-4: Three Types of Strategic Alliances ................................................................. 24
Table 2-5: Three Generic Competitive Strategies ............................................................ 32
Table 2-6: Components of the External Environment Analysis ........................................ 45
Table 2-7: Variables for Segmenting Customers ............................................................... 54
Table 2-8: Retailing and Wholesaling .............................................................................. 57
Table 2-9: Gorynia, Jankowska and Owczarzak’s Strategy Typologies ......................... 82
Table 2-10: Summary of Strategy Typology ................................................................. 88
Table 2-11: Classification of LCs’ Reactions against MNCs ........................................... 89
Table 3-1: The Comparison between NDCG and DCG ............................................. 118
Table 3-2: Classifications of Enterprise Ownership in China .......................................... 121
Table 3-3: The Process of State-Owned Enterprises Reform ........................................ 123
Table 3-4: Differences in Market Reforms between China and Former Soviet Union 140
Table 3-5: Total Value of Imports and Exports (USD 100 Million) ............................ 144
Table 3-6: Foreign Direct Investment by Vehicle Type (2004 and 2005) .................... 147
Table 3-7: Gross Domestic Product Growth (1978-2005) ......................................... 150
Table 3-8: Gross Domestic Product by Expenditure Approach ............................... 151
Table 3-9: Fixed Assets Investment (100 Million Yuan) ........................................... 151
Table 3-10: Final Consumption Expenditure (100 Million Yuan) ................................. 151
Table 3-11: Income Comparison of Rural and Urban Households ............................. 154
Table 3-12: China’s Population Growth ........................................................................ 166
Table 3-13: Geographic Diversification in the CCGM ................................................. 172
Table 3-14: Classification of Chinese Consumers’ Wealth Level ................................ 178
Table 3-15: China’s Institutional Changes to Foreign Investment ............................. 187
Table 3-16: The Geographic Expansion toward Foreign Investors ........................... 188
List of Tables

Table 3-17: The Forms of Foreign Invested Enterprises in China.............................. 189
Table 3-18: Three Developing Stages of Foreign MNCs in China............................... 190
Table 3-19: Foreign Consumer Goods Suppliers in China........................................... 195
Table 3-20: Strengths, Weaknesses, Opportunities, and Threats of............................ 198
Table 3-21: Major Foreign and Chinese Retailers in the CCGM ............................... 201
Table 4-1: Major Domestic and Foreign Cosmetics Makers in China......................... 232
Table 4-2: Examples of Emerging Chinese MNCs.................................................... 277
## List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADRs:</td>
<td>American Depository Receipts</td>
</tr>
<tr>
<td>CAS:</td>
<td>Chinese Academy of Sciences</td>
</tr>
<tr>
<td>CCA:</td>
<td>China Consumers Association</td>
</tr>
<tr>
<td>CCGC:</td>
<td>Chinese Consumer Goods Company</td>
</tr>
<tr>
<td>CCGM:</td>
<td>Chinese Consumer Goods Market</td>
</tr>
<tr>
<td>CCP:</td>
<td>Chinese Communist Party</td>
</tr>
<tr>
<td>CEO:</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CGM:</td>
<td>Consumer Goods Market</td>
</tr>
<tr>
<td>CIT:</td>
<td>Chinese Institute of Technology</td>
</tr>
<tr>
<td>CJV:</td>
<td>Contractual (or Cooperative) Joint Venture</td>
</tr>
<tr>
<td>CMC:</td>
<td>Central Military Commission</td>
</tr>
<tr>
<td>COE:</td>
<td>Collectively Owned Enterprise</td>
</tr>
<tr>
<td>DCG:</td>
<td>Durable Consumer Goods</td>
</tr>
<tr>
<td>e.g.:</td>
<td>Exempli gratia, for example</td>
</tr>
<tr>
<td>EJVs:</td>
<td>Equity Joint Ventures</td>
</tr>
<tr>
<td>et al.:</td>
<td>et alii, and others</td>
</tr>
<tr>
<td>etc.:</td>
<td>et cetra, and so on</td>
</tr>
<tr>
<td>FDI:</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FFIs:</td>
<td>Foreign-Funded Enterprises</td>
</tr>
<tr>
<td>FIEs:</td>
<td>Foreign Investment Enterprises</td>
</tr>
<tr>
<td>FMCG:</td>
<td>Fast Moving Consumer Goods</td>
</tr>
<tr>
<td>FMM:</td>
<td>Fast Moving Manufacturing</td>
</tr>
<tr>
<td>GDP:</td>
<td>Gross Domestic Production</td>
</tr>
<tr>
<td>HRM:</td>
<td>Human Resource Management</td>
</tr>
<tr>
<td>i.e.:</td>
<td>id est, that is</td>
</tr>
<tr>
<td>Ibid.:</td>
<td>ibidem, at the same place</td>
</tr>
<tr>
<td>IBM:</td>
<td>International Business Machines (Corporation)</td>
</tr>
<tr>
<td>IOC:</td>
<td>International Olympic Committee</td>
</tr>
<tr>
<td>IPR:</td>
<td>Intellectual Property Rights</td>
</tr>
<tr>
<td>IT:</td>
<td>Information Technology</td>
</tr>
<tr>
<td>J&amp;J:</td>
<td>Johnson and Johnson</td>
</tr>
<tr>
<td>JVs:</td>
<td>Joint Ventures</td>
</tr>
<tr>
<td>KFC:</td>
<td>Kentucky Fried Chicken</td>
</tr>
<tr>
<td>LC:</td>
<td>Local Corporation</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>Merger and Acquisition</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
</tr>
<tr>
<td>N/A</td>
<td>Not Available</td>
</tr>
<tr>
<td>NBA</td>
<td>National Basketball Association</td>
</tr>
<tr>
<td>NDCG</td>
<td>Non-Durable Consumer Goods</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress</td>
</tr>
<tr>
<td>NRDC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>OBM</td>
<td>Own/Original Brand Manufacturing</td>
</tr>
<tr>
<td>ODI</td>
<td>Overseas Direct Investment</td>
</tr>
<tr>
<td>ODM</td>
<td>Original Design Manufacturing</td>
</tr>
<tr>
<td>OEM</td>
<td>Original Equipment Manufacturing</td>
</tr>
<tr>
<td>P&amp;G</td>
<td>Procter &amp; Gamble</td>
</tr>
<tr>
<td>p.</td>
<td>page</td>
</tr>
<tr>
<td>PC</td>
<td>Personal Computer</td>
</tr>
<tr>
<td>PLA</td>
<td>People’s Liberation Army</td>
</tr>
<tr>
<td>PMCG</td>
<td>Packaged Mass Consumption Goods</td>
</tr>
<tr>
<td>POE</td>
<td>Private-Owned Enterprise</td>
</tr>
<tr>
<td>pp.</td>
<td>pages</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>RMB</td>
<td>Renminbi</td>
</tr>
<tr>
<td>S&amp;T</td>
<td>Science and Technology</td>
</tr>
<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
</tr>
<tr>
<td>SEZs</td>
<td>Special Economic Zones</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SOEs</td>
<td>State-Owned Enterprises</td>
</tr>
<tr>
<td>TVEs</td>
<td>Town and Village Enterprises</td>
</tr>
<tr>
<td>UPOEs</td>
<td>Urban Privately Owned Enterprises</td>
</tr>
<tr>
<td>WFOEs</td>
<td>Wholly Foreign-Owned Enterprises</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
<tr>
<td>yoy</td>
<td>Year of Year</td>
</tr>
</tbody>
</table>
Introduction

1 Introduction

1.1 Prevalent Problems for Local Chinese Companies

With the fast-paced globalization and technological revolution, today’s world has become an arena that is characterized by rapid economic development and hypercompetitive business environment. In order to fully and effectively participate in the world economy, most countries have to make enormous changes. Accordingly, for the sake of following this mainstream and meeting the requirement of development, China, as an ancient civilization with a history of more than five thousand years, has also undergone tremendous changes in terms of politics, economy, culture and social life. With the help of an ambitious economic reform and Open Door Policy since 1978, China has experienced a stable, fast-growing economic expansion, worked miracle with 9% annual economic growth rate, and finally become the world’s second-largest economy only after the United States.

Firstly, accompanied by its political stabilization and economic prosperity, China has become the world’s largest and fastest-growing market for consumer goods thanks to expansive geographical area, huge population, increasing disposable incomes and impressive purchasing power. Moreover, the Chinese Consumer Goods Market (CCGM) will keep on booming at a rapid speed as a result of that “Chinese government keeps on focusing efforts on stimulating domestic consumption regarded as the key driving force for its sustained economic growth.”

Secondly, similar to other emerging markets such as Latin America, Eastern Europe etc., the CCGM has become “an ideal training ground for the rest of the world” in the context of global economic integration. This can be illuminated by a stable growth of inward Foreign Direct Investment (FDI) in China, from nearly zero in 1978 to around 61 billion US$ in 2004. Noteworthily, since China’s accession to the World Trade Organization (WTO) in 2001 and gradual performance of the WTO’s commitments up to 2007, more and more Multinational Corporations (MNCs) from Europe, America, or South Asia have

1 Sullivan, J. D. (2000), p. 5
3 Boetzel, S. et al. (2005), p. 7
Introduction

been attracted to this booming market, competing intensively against a great deal of local Chinese companies.

The influx of numerous, aggressive, and well-heeled MNCs into the CCGM has inevitably yielded a hypercompetitive business environment to the established local Chinese companies. On the one hand, greater competition can enhance choices, quality and value for consumers and it drives productivity and competitiveness for the economy as a whole. On the other hand, many local Chinese companies have to confront the fight to survive. The hypercompetitive environment is characterized by competition is very intense and changes very quickly, accordingly resulting in a highly uncertain, fast-moving and complex business environment. In this case, firms have to take instant action to fortify their competitive advantages and meanwhile to weaken counterworkers’, which further accelerates strategic reaction against one another. Moreover, in such hypercompetitive environment, no firm can hold its sustained competitive advantages over time. Any firm which wants to survive and prosper has to climb up to a higher step, start a new circle, or move to a new territory much faster than its counterparts.

In addition to launching a stiff business environment in the CCGM, these full-fledged foreign MNCs have brought along not only superior products, advanced equipment, updated technologies and know-how but also rich, practicable management skills and marketing experience. In such a way they are running a profitable business in the CCGM, competing against domestic Chinese companies effectively and efficiently.

Compared with those foreign MNCs, both Chinese state-owned enterprises and private companies have made great progress after experiencing a series of reforms. Nonetheless, they still have obvious disadvantages and potential weaknesses. Generally speaking, in contemporary China local Chinese companies are allowed to compete independently through determining an appropriate corporate strategy according to their external environment and internal resources. In the meantime, local Chinese firms have to consider their surviving and developing issues in a hypercompetitive environment, as they have gradually lost government protection. Specially speaking, facing increasing competition from the entry of MNCs, local Chinese companies are generally encountering four possibilities: disappeared, surviving hardly, not only surviving but also expanding, and turning itself into emerging MNCs. The reality testifies that after tough competition, some

4 The Competition Authority (2005)
Chinese companies have fortunately grown up and become the powerful counterparts against foreign players. They are actively participating in the frontal competition with foreign MNCs at home and abroad, such as Haier and Lenovo; on the contrary, some others have fallen into the battle passively, suffered greatly from the brute competition and finally lost their market share.

The existing Chinese companies can be regarded as survivals of the fittest after brutal competition. Nonetheless, they still remain high wariness to deal with the increasing pressures from the invasion and expansion of well-endowed foreign MNCs into their home markets. Two reasons for that stand out. Firstly, some Chinese enterprises still remain traditional management and marketing system. In this case, corporate strategies are formulated and implemented according to feelings instead of adequate market research and environment analysis, business activities are oriented by products instead of consumers’ needs, competitive means and models are simple instead of diverse, and companies are generally lack of consciousness of positioning. Secondly, with the change of competitive environment and industry structure, some potential weaknesses of Chinese enterprises have been exposed gradually. In other words, more and more comparatively competitive advantages previously possessed by Chinese manufacturers are gradually being eroded by the actions of foreign competitors, and may finally have been lost. For instance, the advantage in understanding local consumers does not turn to the competitive advantage of consumer resources, good location does not result in a good chance to catch consumers, the advantage in occupying resources is fading away, some special industries protected and monopolized by government before are gradually being opened to foreign competitors, and national and enterprise cultures haven’t been fully explored, just to name a few.

How can local Chinese companies resist existing foreign competitors and new foreign entrants on their home turf? In addition to asking for support and protection from government, imitating foreign competitors’ business model, or becoming subcontractors of foreign MNCs or selling out and quitting completely, there must be some other strategic options available to local Chinese companies, which enable them to compete against foreign rivals more efficiently and effectively.

To sum up, firstly, operating in the present open and hypercompetitive CCGM, local Chinese companies are clearly concerned about how to compete against foreign MNCs in their domestic marketplace and how to compete on a level playing field with foreign giants
in global markets. *Secondly*, local Chinese companies should be equipped with the capabilities of taking fast, flexible and resistant reaction, since none of them can forecast its situation in the future. *Thirdly*, the most important thing is local Chinese companies have to adopt and develop a series of appropriate resistance strategies on the basis of analyzing external environment, reconfiguring their resource bases, re-thinking their competitive relationships with foreign MNCs and re-designing their corporate strategies. Only under the guidance of active and impactful resistance strategies, can local Chinese firms fend off foreign competitors so as to survive, develop and remain their competitive position in the established CCGM, and thereby step into a new and profitable territory much faster than foreign rivals. We never want to see that those existing local Chinese companies will confront the fate of failure finally and those growing ones are excluded from the competition game among foreign giants. In a word, a more innovative, critical, and proactive strategic approach than what most local Chinese companies have typically adopted is now more necessary and important than ever before to their survival and prosperity,\(^5\) that is, resistance strategies.

**1.2 Research Aim**

In a hypercompetitive environment, “every firm is vulnerable to attack by competitors”\(^6\). Regardless of new entrants or established firms trying to reposition themselves, any of their actions might bring vital impacts on existing firms. To protect their competitive positions, these existing firms have to adopt a series of resistant measures in order to deter or at least bate those negative impacts. Besides, market competition, in a sense, equals to the competition of enterprises’ strategies. From a long-term perspective, whether an enterprise can establish and maintain its sustainable competitive advantages depends pivotally on whether it can formulate and implement a suitable strategy effectively.

Although a mass of Western and Chinese literatures, monographs, journals and information in website contain the relevant topic, there are still some insufficiencies which can be summarized as follows:

- From a theoretical perspective, market defence has attracted much less attention than

---

\(^5\) Ger, G. (1999), p. 65

market attack both in academe and business circles. A lot of research has been addressed on how to launch new product or expand market; however, little was conducted for analyzing how to fend off and fight against attack. “This is a serious weakness in strategy and marketing. Defence against competitive attack poses an important problem and the issues facing the defender are different to those facing the attacker.”

Furthermore, in the context of globalization, numerous research has been focused primarily on advising MNCs how to formulate and implement their entry strategies and expansion strategies in emerging markets in order to overcome current barriers and shortcomings and enhance their competitive positions, but much less on advising the survival and development issues of host-country companies in face of foreign MNCs’ invasion and expansion in their home market.

- From a long-term and practical perspective, the research on strategic options and competitive response of local Chinese companies to foreign competition are overlooked and underestimated. The manner and attitude with which local Chinese companies and foreign companies treat with each other are seriously unequal. In other words, foreign companies pay much more attention to the resistant reaction launched by local Chinese companies. They realize that it makes much sense to analyze Chinese companies’ strategic decisions and reactive behaviour against their attack and challenge because these resistance strategies reflect to some extent whether foreign companies’ strategies are appropriate in their target Chinese market. On the contrary, Chinese companies pay much less attention to foreign companies. Most of them still view large State-Owned Enterprises as their main competitors instead of foreign companies. Thus, a systemic and holistic research on the strategic options and responsive patterns of Chinese homegrown enterprises in the face of foreign competition can not be found so far.

- The theories of corporate strategies, competitive response and marketing management generated for foreign companies can not be applied to Chinese domestic companies

---

8 Ibid.
Introduction

directly. Due to big differences in terms of firm’s background, management style, organizational structure, financial resources and so on, local Chinese companies need urgently to find out their specific corporate strategies which are expected to be harmonized with their external and internal environment.

Therefore, an overall, strategic purpose of this dissertation is to **identify the alternatives of resistance strategies at the corporate strategy level available to Local Corporations (LCs) confronting Multinational Corporations’ (MNCs) competition in the Chinese consumer goods market**, by systematically presenting Western theories about enterprise strategy and strategic management and empirically studying representative local Chinese companies’ cases. In order to fulfil the goal and address above-mentioned insufficiencies, the following two specific sub-goals are expected to achieve.

1) **Identifying and Analyzing Resistance Strategies of Local Chinese Companies against Foreign Competition in the CCGM**

From both theoretical and practical perspectives, I intend to identify and analyze the resistance strategies adopted by local Chinese companies against foreign competition in the CCGM by focusing on the methodology of typical case study in representative Chinese consumer goods industries. Moreover, I will put forward my suggestions on choosing an appropriate resistance strategy for local manufacturers, which are expected to have more Chinese indigenous characteristics and to explore Chinese thinking model and practical operative methods.

2) **Abridging the Gap between Western Theories and China’s Practical Operations**

The theories about strategy and strategic management that emerged in Western countries have been gradually applied by Chinese companies in the face of increasing foreign competition. However, as it’s still at the primary stage together with China’s unique situation, there will be some gaps between Western modern theories and Chinese companies’ practical operations. In this research, I intend to find out the gaps and narrow them as much as possible.
1.3 Structure of the Dissertation

Considering the theoretical and practical situation to fulfill research objectives, the remainder of this dissertation is composed of 4 major sections. Following this introduction, chapter 2 constructs a theoretical framework of resistance strategies. Firstly it begins with a literature background in terms of strategy and strategic management, in which strategic situation analysis concerning macroenvironment, microenvironment and the company’s internal environment will be given special attention. Subsequently, resistance strategies in terms of research context, definition and research propositions will be identified, as well as literature review which can underpin resistance strategies. The most important concern will be focused on those four generic strategic alternatives, which can be achieved either internally or externally, accordingly forming eight major options for resistance strategies. Chapter 3 provides a systematical and holistic analysis on the marketing environment of domestic actors in the Chinese Consumer Goods Market (CCGM), in terms of the Chinese Consumer Goods Companies (CCGCs), major macroenvironmental forces, microenvironment characteristics and actors. In this chapter, special attention is given to an overall evaluation of Chinese consumer goods companies’ strengths, weaknesses, opportunities and threats. Chapter 4, a major part of the dissertation, approaches the applied options for resistance strategies of local Chinese companies against foreign competition in the CCGM by selecting and analyzing five representative cases, encompassing both successful and unsuccessful situations. Finally, this chapter concludes with an in-depth analysis of results and synthesis of the empirical cases. Chapter 5 ends the dissertation with a series of strategic implications for CCGCs, conclusions, as well as limitations and suggestions for future research. Figure 1-1 outlines the structure of the dissertation.
### Figure 1-1: Structure of the Dissertation

<table>
<thead>
<tr>
<th>Chapter 1: Introduction</th>
<th>Prevalent Problems for Local Chinese Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Research Aim</td>
</tr>
<tr>
<td></td>
<td>Structure of the Dissertation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 2: Theoretical Framework</th>
<th>Strategy and Strategic Management</th>
<th>The Concept of Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strategy and Strategic Management</td>
<td>Strategic Management</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Significance of Strategic Environment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Analysis in Strategy Planning</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 2: Theoretical Framework</th>
<th>Resistance Strategies</th>
<th>Research Context</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Definition and Research Propositions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Literature Review</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Alternative Resistance Strategies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Types of Chinese Consumer Goods Companies</td>
<td>Major Chinese Consumer Goods Companies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 3: Analyzing the Marketing Environment of Domestic Actors in the Chinese Consumer Goods Market</th>
<th>Major Macroenvironmental Forces</th>
<th>Political/Legal Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Economic Environment</td>
<td>Sociocultural Environment</td>
</tr>
<tr>
<td></td>
<td>Technological Environment</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Chinese Consumers</td>
<td>Foreign Competitors</td>
</tr>
<tr>
<td></td>
<td>Distributors</td>
<td></td>
</tr>
</tbody>
</table>

|----------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|

<table>
<thead>
<tr>
<th>Chapter 4: Applied Options for Resistance Strategies of Local Chinese Companies Against Foreign Competition in the CCGM --- A Case Study Approach</th>
<th>Research Methodology and Case Selection</th>
<th>Case Study as a Research Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Case Selection</td>
<td>Case Selection</td>
</tr>
<tr>
<td></td>
<td>Case Studies</td>
<td>Case 1: Wahaha</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Case 2: Jahwa</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Case 3: Dabao</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Case 4: Lenovo</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Case 5: Haier</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 5: Strategic Implications, Conclusions, Limitations and Suggestions for Future Research</th>
<th>Strategic Implications for Chinese Consumer Goods Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conclusions</td>
</tr>
<tr>
<td></td>
<td>Limitations and Suggestions for Future Research</td>
</tr>
</tbody>
</table>

Source: self-summarized on the basis of the dissertation
2 Theoretical Framework

This chapter, mainly divided into two sectors, seeks to construct a theoretical framework for the analysis of resistance strategy.

The first sector is concerned with strategy and strategic management. Firstly, the field of strategy will be introduced by defining the concept of strategy and identifying various strategy typologies. Subsequently, a conceptional background of strategic management and its process concerning planning, implementation and control will be presented briefly. Finally, special attention will be paid to strategic environment analysis regarding macroenvironment, microenvironment and firms’ internal environment, in view of its significant role in the course of formulating and implementing enterprise strategies.

The second sector focuses on identifying resistance strategy. It begins with a brief introduction of actual circumstances in which resistance strategy emerges and becomes indispensable to emerging market companies, as well as a proposed definition of resistance strategy and research propositions. Subsequently, some strategy typologies are presented in order to facilitate the analysis of resistance strategy, along with a conclusion of the existing approaches. By choosing a dominant typology as the research framework, the end of this chapter will examine the most important content — four core strategic alternatives, by which local companies attempt to survive and prosper in face of the intensified foreign competition on their home turf. As these four generic strategic options can be achieved either internally or externally, strategic options for resistance strategies can be finally extended into eight alternatives.

2.1 Strategy and Strategic Management

There are a lot of different terminologies and theories available in strategy and strategic management literature. It is necessary to examine some relevant fundamentals which will be applied in this dissertation.
2.1.1 The Concept of Strategy

2.1.1.1 Definition of Strategy

The term strategy comes from the Greek word “strategia” that refers to “generalship”.\(^9\) CAMBRIDGE Dictionary Online (2006) defines strategy as a long-term and detailed plan for achieving particular objectives in different situations.\(^10\)

Originally, strategy is a term that is derived from military use (Hart 1967; Chandler 1977; Schendel and Hoffer Schendel 1979; Bracker 1980; Fahey and Christensen 1986; Huff and Reger 1987; Miller and Cardinal 1994; Mintzberg 1994; Prahalad and Hamel 1994; McKiernan 1997; McCraw 1998). Military strategy plays an important role in wars, as it guides the army to defeat the enemy by dealing with the planning and conduct of campaigns, the movement and disposition of forces, and the deception of the enemy. Hart (1967) contributed a short definition of military strategy: “the art of distributing and applying military means to fulfil the ends of policy.”\(^11\)

In the course of time, strategists in business world have realized that there were vast knowledge bases from military strategies, which could be applicable for the business. Hence, those strategists turned to military strategies for guidance. Some famous military strategies have been applied in business world directly, for instance, Sun Tzu’s “The Art of War” (about B.C. 500), Carl von Clausewitz’s “On War” (1832), and Mao Tse Tung’s “The Red Book” (1966). Afterward, due to the increasing variability and uncertainty of the business environment, strategy which originates form the military has been greatly developed and widely applied in business world to adjust and balance the relationship

\(^10\) Cambridge Dictionary Online (2006)
between firms’ activities and environment changes. Nonetheless, the essence of strategy remains the same --- to compete (with the enemy) and to win (the war).

It is important to point out that although the terms of strategy and tactics both originate from military world and involve the relationships between ends and means, there exists a basic distinction between strategy and tactics. In principle, “strategy is concerned with deploying the resources at your disposal whereas tactics is concerned with employing them”.

Concretely, strategy and tactics differ in the following aspects shown in table 2-1.

<table>
<thead>
<tr>
<th></th>
<th>Strategy</th>
<th>Tactics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scale of the Objective</td>
<td>Grand</td>
<td>Limited</td>
</tr>
<tr>
<td>Scope of the Action</td>
<td>Broad &amp; General</td>
<td>Narrowly focused</td>
</tr>
<tr>
<td>Guidance Provided</td>
<td>General &amp; Ongoing</td>
<td>Specific &amp; Situational</td>
</tr>
<tr>
<td>Degree of Flexibility</td>
<td>Adaptable but not hastily</td>
<td>Fluid, quick to adjust and</td>
</tr>
<tr>
<td></td>
<td>changed</td>
<td>adapt in minor or major ways</td>
</tr>
<tr>
<td>Timing</td>
<td>Before Action</td>
<td>During Action</td>
</tr>
<tr>
<td>Resource Focus</td>
<td>Deployment</td>
<td>Employment</td>
</tr>
</tbody>
</table>

Source: Nickols, F. (2003), p. 3

Over the last half century, strategy has been a major focus of management concern. In general, strategy in the business world refers to a series of measures for achieving and sustaining an organization’s long-term success. Since strategy was introduced into business and management in the 1960s, its definition has greatly evolved according to various dimensions and contexts. Of hundreds of definitions of strategy in the business literature, accordingly, it is difficult to find a universally accepted answer. In table 2-2 below, some definitions of strategy are summarized chronologically.

---

12 Nickols, F. (2003), p. 2
Table 2-2: Main Definitions of Strategy over Time

<table>
<thead>
<tr>
<th>YEAR</th>
<th>AUTHOR</th>
<th>CONTENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>Chandler</td>
<td>Strategy is the determination of the basic long-term goals and the objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.</td>
</tr>
<tr>
<td>1965</td>
<td>Andrews</td>
<td>Corporate strategy is the pattern of major objectives, purposes, or goals and essential policies or plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.</td>
</tr>
<tr>
<td>1965</td>
<td>Ansoff</td>
<td>---Strategy in terms of strategic decisions which “...are primarily concerned with external, rather than internal, problems of the firm an specifically with selection of the product mix which the firm will produce and markets to which it will sell.” ---strategy as the ‘common thread’ that gives “...a relationship between present and future product-markets which would enable outsiders to perceive where the firm is heading, and the inside management to give it guidance”.</td>
</tr>
<tr>
<td>1976</td>
<td>Glueck</td>
<td>Strategy is a unified, comprehensive, and integrative plan designed to assure that the basic objectives of the enterprise are achieved.</td>
</tr>
<tr>
<td>1979</td>
<td>Schendel and Hofer</td>
<td>Strategy is the centerpiece of strategic management.</td>
</tr>
<tr>
<td>1980</td>
<td>Tregoe and Zimmerman</td>
<td>The framework which guides those choices that determine the nature and direction of an organization.</td>
</tr>
<tr>
<td>1980</td>
<td>Porter</td>
<td>Competitive Strategy: positioning a business to maximize the value of capabilities to distinguish it from its competitors.</td>
</tr>
<tr>
<td>1980</td>
<td>Quinn</td>
<td>The pattern or plan that integrates an organization’s major goals, policies, and action sequences into a cohesive whole. A well-formulated strategy helps to marshal and allocate an organization’s resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents.</td>
</tr>
<tr>
<td>1983</td>
<td>Ohmae</td>
<td>What business strategy is all about is, in a word, competitive advantage. The sole purpose of strategic planning is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy thus implies an attempt to alter a company’s strength relative to that of its competitors in the most efficient way.</td>
</tr>
<tr>
<td>1990</td>
<td>Hax</td>
<td>Pattern of decisions that an organization makes.</td>
</tr>
<tr>
<td>1994</td>
<td>Mintzberg</td>
<td>Five conceptual equivalents of strategy: plan, ploy, perspective, and pattern.</td>
</tr>
<tr>
<td>1994</td>
<td>Treacy and Wiersema</td>
<td>Three “value-disciplines” that can serve as the basis for strategy: operational excellence, customer intimacy, and product leadership.</td>
</tr>
<tr>
<td>2002</td>
<td>Johnson and Scholes</td>
<td>The direction and scope of an organization over the long-term, which ensure the organization’s achievement, maintenance and development of competitive advantages.</td>
</tr>
</tbody>
</table>

Among these definitions, Quinn’s (1980) contribution is in a dominant position in this dissertation, as he indicated that strategy integrated an organization’s major goals, policies and action sequences into a cohesive whole and provided a holistic framework from the viewpoints of market positioning, resource-oriented base and reactions of competitors.

Finally, in today’s dynamic and turbulent marketplaces, strategy plays an obviously important role in achieving and sustaining a company’s long-term success. The purposes of conducting strategy for a company are not only to ensure the achievement of competitive advantage by defining the direction and scope of this company, but also to fulfill stakeholders’ expectations and objectives by matching the resources and competencies of this company within a rapidly changing environment.14

Especially in these marketplaces, it is impossible to predict which competences or strategies will be successful and for how long.15 Any company has to keep flexible in choosing enterprise strategies that are consistent with its external and internal environment.

2.1.1.2 Strategy Typologies

Identifying strategy typologies aims at obtaining a clear understanding of how many ways a company can choose to achieve its objectives. According to diverse perspectives and criteria, there are a wide variety of strategic alternatives available to the company, as summarized in table 2-3. Which strategy typology a company will choose depends on its external and internal circumstances; meanwhile, different strategic options will bring different impacts to companies in turn.

15 Sekulic, V. (2002), p. 68
### Table 2-3: Strategy Typologies

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Strategy Typology</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organizational Scope</strong></td>
<td>Corporate Strategy</td>
</tr>
<tr>
<td></td>
<td>Business Strategy</td>
</tr>
<tr>
<td></td>
<td>Functional Strategy</td>
</tr>
<tr>
<td><strong>Development Direction</strong></td>
<td>Growth Strategy</td>
</tr>
<tr>
<td></td>
<td>Stability Strategy</td>
</tr>
<tr>
<td></td>
<td>Retrenchment Strategy</td>
</tr>
<tr>
<td><strong>Competitive Advantage/Market Coverage</strong></td>
<td>Cost Leadership Strategy</td>
</tr>
<tr>
<td></td>
<td>Differentiation Strategy</td>
</tr>
<tr>
<td></td>
<td>Focus (Cost/Differentiation) Strategy</td>
</tr>
<tr>
<td><strong>Functional Scope</strong></td>
<td>Marketing Strategy</td>
</tr>
<tr>
<td></td>
<td>Production Strategy</td>
</tr>
<tr>
<td></td>
<td>Financial Strategy</td>
</tr>
<tr>
<td></td>
<td>Research and Development Strategy</td>
</tr>
<tr>
<td></td>
<td>Human Resource Strategy</td>
</tr>
<tr>
<td></td>
<td>Supply Chain Management Strategy</td>
</tr>
<tr>
<td></td>
<td>Technology System Strategy</td>
</tr>
<tr>
<td><strong>Product/Market</strong></td>
<td>Market Penetration Strategy</td>
</tr>
<tr>
<td></td>
<td>Market Development Strategy</td>
</tr>
<tr>
<td></td>
<td>Product Development Strategy</td>
</tr>
<tr>
<td></td>
<td>Diversification</td>
</tr>
<tr>
<td><strong>Geographical Scope</strong></td>
<td>Local Strategy</td>
</tr>
<tr>
<td></td>
<td>National Strategy</td>
</tr>
<tr>
<td></td>
<td>International Strategy</td>
</tr>
<tr>
<td></td>
<td>Global Strategy</td>
</tr>
<tr>
<td><strong>Degree of Independence</strong></td>
<td>Autonomy Strategy (Internal Development Strategy)</td>
</tr>
<tr>
<td></td>
<td>Cooperation Strategy</td>
</tr>
<tr>
<td></td>
<td>Integration Strategy</td>
</tr>
</tbody>
</table>

First and foremost, strategy differs from tactics from a military perspective, as previously examined; from an enterprise strategy perspective, strategy in diversified companies can be generally formulated and implemented at three different levels: the corporate level, the business level, and the functional level (Hofer & Schendel, 1978; Andrews, 1980; Johnson & Scholes, 1997, and Thompson & Strickland, 2001), as shown in figure 2-1 below. Whether a company is successful depends primarily on whether these three level strategies fit with each other and work efficiently and effectively as a whole.

**Figure 2-1: Three Hierarchical Levels of Strategy**

![Diagram of Three Hierarchical Levels of Strategy]

Source: self-designed according to research

Looking closer by combining table 2-3 and figure 2-1 together, all strategic options listed in table 2-3 can be accordingly ranged into those three strategy levels illustrated in figure 2-1, which generates an integrated framework (figure 2-2 below) for the interrelationship of different types of enterprise strategies accordingly. Each strategy level and relevant strategy typologies will be examined respectively.
### Figure 2-2: The Interrelationship of Different Types of Enterprise Strategies

<table>
<thead>
<tr>
<th>Strategy Level</th>
<th>Strategy Typologies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Level</strong></td>
<td>Corporate Strategy</td>
</tr>
<tr>
<td></td>
<td>Growth Strategy   Stability Strategy   Retrenchment Strategy</td>
</tr>
<tr>
<td></td>
<td>Product/Market Strategies</td>
</tr>
<tr>
<td></td>
<td>Local, National, International, and Global Strategies</td>
</tr>
<tr>
<td></td>
<td>Autonomy, Cooperation, and Integration Strategies</td>
</tr>
<tr>
<td><strong>Business Level</strong></td>
<td>Business Strategy</td>
</tr>
<tr>
<td></td>
<td>Cost Leadership Strategy   Differentiation Strategy   Focus Strategy</td>
</tr>
<tr>
<td><strong>Functional Level</strong></td>
<td>Functional Strategy</td>
</tr>
<tr>
<td></td>
<td>Marketing Production Financial Human Resource R &amp; D Supply etc.</td>
</tr>
</tbody>
</table>


2.1.1.2.1 Corporate Strategies

Corporate level strategy is the highest, broadest and the most important, as it takes considerable impact on guiding all strategic decision-making throughout the business activities. “The role of corporate strategy is to look for solutions that are best for the corporation as a whole.”\(^{16}\) Therefore, what should be identified within a corporate level strategy covers not only an organization’s overall purpose but also its product scope, geographical scope, and vertical scope.\(^{17}\) In other words, a series of selections encompassing the range of products, the geographic spread of markets in which a company will compete, and the range of vertically linked activities will be considered in corporate strategy. Generally, there are three various classifications of corporate strategy in the

---


\(^{17}\) Anonymous (2001a), pp. 1-2
strategic management according to different strategic directions a company takes. They are growth strategy, stabilization strategy, and retrenchment strategy, which will be examined in the following sections respectively.

2.1.1.2.1.1 Growth Strategy

As for any business company, growth is a key precondition for its long-term survival in the face of a rapidly changing business environment and the increasing competition. Growth strategy, an offensive corporate strategy, refers to the attainment of an organization’s specific growth objectives beyond its past performances by fully capitalizing on external opportunities and deeply exploiting internal competences. The primary purposes of implementing growth strategy are to enable the company to realize a long-run survival, obtain the economies of scale in production, purchasing, marketing, finance and management, expand market share, raise sales revenues and profits, and so forth. In detail, business firms seek to achieve growth through several alternative routes as illustrated in figure 2-2, and each alternative growth strategy will be examined in subsequent sections.

2.1.1.2.1.1.1 Product-Market-Strategies

Product-Market-Strategies, an effective marketing tool for enterprises which seek for growth, were firstly put forward by Ansoff (1957) in his article “Strategy for Diversification” in Harvard Business Review. By virtue of combining two dimensions: new/existing products and new/existing markets, Ansoff put forward the Product-Market-Matrix to offer four basic corporate growth strategy models that set the direction for the business expansion. (Figure 2-3) And each model in this figure will be examined in subsequent sections, respectively.

**Figure 2-3: Product-Market-Combination**

<table>
<thead>
<tr>
<th>Markets</th>
<th>Products</th>
<th>Existing</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing</td>
<td>Market Penetration</td>
<td>Product Development</td>
<td></td>
</tr>
<tr>
<td>New</td>
<td>Market Development</td>
<td>Diversification</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ansoff, H. I. (1957), pp. 113-124

---

18 Ansoff, H. I. (1957), pp. 113-124
Market Penetration Strategy (existing products and existing markets) indicates a growth strategy by which a company aims at increasing the market share control in its existing market with the help of existing products. In this instance, the company neither changes the product nor tries to look for new customers. Rather, the objective can be achieved through attracting customers of competitors’ products; buying out competitors; or converting non-users into current users. Usually, this strategy as the lowest-risk option is best applied to markets featured with the high growth and relatively few competitors.

Market Development Strategy (existing products and new markets) refers to that a firm introduces the established products to the marketplace where it had no presence before. In this instance, products remain unchanged, however, firms aim at attracting new customers; exploiting new usages of existing products; expanding into new geographical areas; or entering new market segments, for instance, opening up more and more overseas markets. Firms realizing growth through geographic expansion will be further examined in the following section 2.1.1.2.1.2.

Product Development Strategy (new products and existing markets) is a very crucial strategy for a company to gain competitive advantages by developing new products which can appeal to the existing markets. In order to achieve this strategy, companies can improve products in terms of features, quality, reliability and durability; enhance their aesthetics or styling; add more technological value into their products; or exploit totally new products. In doing so, companies intend to attract more users into the current marketplace on the one hand, and on the other hand, to match the requirements of those customers who want to replace and update the existing products.

Diversification Strategy (new products and new markets) is the riskiest one of these four strategies for growth, and it is applicable for a company desiring to expand its operations by exploiting and offering new products or services to new markets. Three reasons for adopting diversification strategies stand out: 1) a decline of the attractiveness of the traditional business unit may force the business to diversify; 2) it is an opportunity for companies to enter new markets; and 3) it leads to the more efficient use of existing resources and capacities. The aims of pursuing diversification

---

strategies are to achieve the profit maximization, reduce risks, realize an enterprise’s growth, and so on.\textsuperscript{20}

According to Ansoff (1965)\textsuperscript{21}, diversification can be achieved mainly through four basic growth strategies: \textit{horizontal integration}, \textit{vertical integration}, \textit{concentric diversification}, and \textit{conglomerate diversification}, as illuminated in figure 2-4 below:

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{diversification.png}
\caption{Classification of Diversification Strategies}
\end{figure}

The above figure indicates a traditional classification of diversification. However, this classification is, to some extent, disadvantageous in distinguishing between diversification and integration. Therefore, in order to present a clear explanation of diversification, only concentric diversification and conglomerate diversification will be examined here as two categories of diversification strategies. And horizontal integration and vertical integration will be addressed in subsequent section 2.1.1.2.1.1.3 as two sorts of integration strategies.

Concentric diversification and conglomerate diversification are growth strategies aiming at relative or completely new product-market-combination beyond the inherent industries a company presently acting.\textsuperscript{22}

\begin{itemize}
\item \textbf{Concentric/Related Diversification} refers to the development beyond the present product and market but still within the broad confines of the industry within which the company currently operates.\textsuperscript{23} In other words, it is a corporate-level growth strategy in which a company seeks to develop by adding new but strategically related products to
\end{itemize}

\begin{itemize}
\item \textsuperscript{20} Johnson, G. and Scholes, K. (1984), pp. 179-180
\item \textsuperscript{21} Ansoff, H. I. (1965), p. 132
\item \textsuperscript{22} Ibid., p. 441
\item \textsuperscript{23} Johnson, G. and Scholes, K. (1984), p. 182
\end{itemize}
its existing product lines so as to attract new customers. Concentric diversification is expected to bring the company synergy effects by “combining companies with complementary marketing, financial, operating, or management”24.

- **Conglomerate/Unrelated/Lateral Diversification** refers to options that lie beyond the boundaries of the industry within which the company presently operates.25 In other words, with little relationship with a firm’s current business line, conglomerate diversification is a corporate-level growth strategy in which the firm seeks to develop by adding totally new and unrelated products, services or markets to its existing business. Therefore, this kind of growth strategy is very risky. However, if successful it will provide firms with the growth and the improved profitability.

To sum up, diversification is a form of corporate-level strategies, whereby a firm intends to achieve growth by diversifying itself into other products and industries; and generally, diversification can be realized either internally by internal ventures or externally by mergers, acquisitions or strategic alliances.26

### 2.1.1.2.1.1.2 Local, National, International and Global Strategies

As previously examined, one of the vehicles for market development strategy is geographical expansion. Therefore, according to different geographic scope in which a firm operates, corporate growth strategy can be realized through the following strategic options: expanding the scope of business into new geographies such as from local to national, from national to international, and from international to global. Geographical expansion is regarded as one of the fastest and the most powerful options to accelerate the profitable growth but also the most difficult one.

Applying the local strategy refers to that a company concentrates on operating in different places or regions within the boundaries of domestic markets. To achieve a long-run survival and prosperity as well as new development opportunities, these companies often introduce their most successful product lines into other regions or countries after they have

---

26 Hunger, J. D. and Wheelen, T. L. (2003), p. 11
fully developed their existing markets.\textsuperscript{27} This accordingly requires a series of geographic expansion strategies, that is, \textit{national strategy}, \textit{international strategy}, and \textit{global strategy}.

Applying the national strategy refers to that a company enters new geographies in a national scope rather than in previously local one but still within the domestic boundary. This strategy will make much sense if the size of domestic markets is tremendous. In this instance, however, companies also confront certain risks due to unfamiliar geographic segmentation, diverse regulatory environment, fragmented distribution channels, different economic development level, prospective consumption power, and so on.

International and global strategies involve those companies which decide to expand outside their domestic markets in order to gain new customers, reduce costs, enhance firms’ competitiveness, capitalize on their core competencies and spread their business risk across a wider market base.\textsuperscript{28} Generally, these two strategies may occur when firms encounter the limited domestic growth or the intense domestic rivalry. Precisely, an international strategy is based on the diffusion and adaptation of the parent company’s knowledge and experience to foreign markets; and a global strategy concentrates on economies of scale by offering standardized products and services.

However, international strategy and global strategy are further distinguishing in the following two respects: on the one hand, the former stresses that a company operates in a select few foreign countries, and the latter indicates that a company operates in most continents and world’s major countries and still continues to expand its business into additional country markets stably; on the other hand, a company competing as a real global player firstly needs stable establishments in several foreign markets.\textsuperscript{29} “A global strategy should not be equated with any one element such as standardized products or worldwide market coverage or a global manufacturing network, instead be a flexible combination of many elements”\textsuperscript{30}. In essence, companies seeking for growth through geographic expansion often deploy first international strategy before they go global.

In a word, achieving growth through international and global strategies offers companies not only significant opportunities but also high risks, as there are much more diversifications regarding political climate, regulatory environment, economic

\textsuperscript{27} Anonymous (2005a), p. 1  
\textsuperscript{28} Thompson, A. A. and Strickland J. A. J. (2003), p. 200  
\textsuperscript{29} Ibid.  
\textsuperscript{30} Iman, N. (2006), p. 3
development, cultural background and so on beyond domestic boundary than those within a national scope.

With a view to the importance of different business scope, Ansoff’s Product-Market-Matrix can be further extended on the basis of not only existing and new but also domestic and foreign sectors, as illustrated in figure 2-5.

**Figure 2-5: International Strategies**

<table>
<thead>
<tr>
<th>Market</th>
<th>Product</th>
<th>Present</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present</td>
<td>Domestic</td>
<td>Market Penetration 1</td>
<td>Product Development 1</td>
</tr>
<tr>
<td></td>
<td>Foreign</td>
<td>Market Penetration 2</td>
<td>Product Development 2</td>
</tr>
<tr>
<td>New</td>
<td>Domestic</td>
<td>Market Development 1</td>
<td>Diversification 1</td>
</tr>
<tr>
<td></td>
<td>Foreign</td>
<td>Market Development 2</td>
<td>Diversification 2</td>
</tr>
</tbody>
</table>


- **Market Penetration 2** strategy is a strategy that may contribute to capacity operation by means of increasing sales volume. It may also contribute to the economy of scale and being closer to target customers’ preferences.
- **Market Development 2** strategy is concerned with transferring the existing experiences with a product to new foreign markets. However, the prerequisites are that customers’ preferences of different foreign markets are homogeneous and accordingly the products are standardized.
- **Product Development 2** strategy enables firms to capitalize on the same advantages in foreign markets, and such advantages can be obtained so far in the domestic markets by the product development strategy.
- **Diversification 2** strategy helps firms reduce risks, which can be realized usually through the acquisition of foreign companies.

**2.1.1.2.1.3 Autonomy, Cooperation, and Integration Strategies**

According to various degrees of independence ranking from high to low levels, there are three primary means for firms to achieve the corporate growth: autonomy strategy, cooperation strategy, and integration strategy, whereby firms realize their growth, develop value-creating competitive advantages, and create differences between competitors and
Theoretical Framework

themselfs.\textsuperscript{31}

\begin{itemize}
  \item **Autonomy Strategy**
  
  Autonomy strategy, namely internal development, refers to that a company pursues the growth by means of activating its own potentials and capabilities. In today’s economy, the internal development is an important means, as it brings firms potential advantages. Compared with mergers and acquisitions, firms seeking internal development can capture the value created by their own innovative activities without having to share the achievements with partners or facing the difficulties concerning the combination of different activities of several companies and different cultural backgrounds.\textsuperscript{32} Firms can also benefit from relatively low costs for developing new products or services, as they rely on their own resources instead of external funding.\textsuperscript{33} However, the autonomy strategy is not applicable if a company has not enough potentials and capabilities to ensure its own growth. In this instance, companies pursuing survival and development through internal development may suffer from the disadvantages of time and cost consuming. In this regard, cooperation strategy or integration strategy enables the company to acquire resources and achieve strategic objectives more effectively and efficiently than autonomy strategy.

  \item **Cooperation Strategy**

  Cooperation strategy refers to a strategy by which “firms work together to achieve a shared objective”\textsuperscript{34} and in such a way the concerned partner firms can achieve the synergy effect. Cooperation strategy has become “a key source of competitive advantage for firms and has allowed them to cope with increasing organizational and technological complexities that have emerged in the global market.”\textsuperscript{35} Generally, cooperative relationships can be classified into two categories: horizontal and vertical cooperations.

    \begin{itemize}
      \item **Horizontal Cooperation** namely strategic alliance refers to collaborating with competitors. Generally speaking, “the formation of a strategic alliance occurs when two or more firms enter to an agreement that combines competition and cooperation
    \end{itemize}
\end{itemize}

\textsuperscript{31} Hitt, M. A. et al. (2005), p. 270
\textsuperscript{32} Dess, G. G. et al. (2006), p. 207
\textsuperscript{33} Ibid.
\textsuperscript{34} Hitt, M. A. et al. (2005), p. 270
\textsuperscript{35} Vivio, N. (2004), p. 3
Theoretical Framework

into a single strategy.” Specially speaking, strategic alliance is defined as two or more firms reach a cooperative agreement to pursue mutual interests and goals while they are still independent organizations. In essence, strategic alliance “fills the middle ground between transactional arrangements and acquisitions.” In a word, strategic alliance can be summarized as follows: in order to breach their own insufficiencies in resource and competence, to fully exploit external resource and competence, to expand market, to develop new product and to improve new knowledge, firms seek for appropriate partners, whereby both of them can complement competitive advantages, partake risks and share benefits.

Generally, the scope of strategic alliances involves raw materials, supply logistics, marketing and sales, technology development, distribution channels and human resource management. And strategic alliances can be structured in various ways according to diverse cooperative purposes, as listed in table 2-4 below:

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Application</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint Venture</td>
<td>A strategic alliance in which two or more firms create a legally independent company to share some of their resources and capabilities to develop a competitive advantage.</td>
<td>Are effective in establishing long-term relationships and in transferring R&amp;D knowledge.</td>
</tr>
<tr>
<td>Equity Strategic Alliance</td>
<td>An alliance in which two or more firms own different percentages of the company they have formed by combining some of their resources and capabilities to create a competitive advantage.</td>
<td>Many foreign direct investments are completed through this type.</td>
</tr>
<tr>
<td>Non-equity Strategic Alliance</td>
<td>An alliance in which two or more firms develop a contractual relationship to share some of their unique resources and capabilities to create a competitive advantage.</td>
<td>Less formal and demand fewer partner commitments than do joint ventures and equity strategic alliances. It can be used in different forms: licensing agreements, distribution agreements, and supply contracts.</td>
</tr>
</tbody>
</table>

Source: Hitt, M. A. et al. (2005), pp. 271-272

In face of challenges from global competition, more and more companies are applying strategic alliances to achieve the rapid growth by virtue of improving their core

---

36 Vivio, N. (2004), p. 4
37 Anonymous (2007a)
competencies and competitiveness. Strategic alliances bring many potential advantages to either large or small firms, for instance, “entering new markets, reducing manufacturing costs in the value chain, and developing and diffusing new technologies”. The establishment of strategic alliances is expected to be reciprocal for all involved parties, as it aims to fortify partners’ competitive advantages by achieving the synergy effect which results from optimally allocating and complementing resources and competences. However, strategic alliance also brings partners risks, such as the unequal benefit for both sides, management or communication problems, troubles with governments and other regulatory bodies, and so on. Hence, strategic alliance should comply with the following rules: “strategic fit, a focus on the long term and flexibility”.

- **Vertical Cooperation** is concerned with “firms share their resources and capabilities from different stages of the value chain to create a competitive advantage”. An overall objective of pursuing vertical cooperations is to obtain a larger profit for the participants in this cooperation, such as wholesalers, processors and retailers. It involves a series of contracts and agreements between consumers and suppliers.

Integration Strategy

Integration strategy can be classified into vertical integration and horizontal integration, as shown in figure 2-6.

![Figure 2-6: Classification of Integration Strategies](image)

Source: adapted from Johnson, G. and Scholes, K. (1984), p. 172

---

38 Dadashian, F. et al. (2007), pp. 98-99
41 Hitt, M. A. et al. (2005), p. 276
Vertical Integration refers to the diversification in forward or backward production stage within the industries the company presently acting. Alternatively, it is an approach for increasing or decreasing the level of control which a firm has over its inputs and distribution of outputs. “The greater the firm’s ownership and control over successive stages of the value chain for its products, the greater its degree of vertical integration”. The vertical scope of the firm is an important consideration in corporate strategy, as it takes a significant impact on a business unit’s position in its industry relevant to cost, differentiation, and other strategic issues.

According to the degree of vertical integration between the value chain of a firm and the value chains of its suppliers and distributors, vertical integration can be further sorted into two possible directions: backward (upstream) integration and forward (downstream) integration as illustrated in the previous figure 2-6. The former refers to the development into activities which are concerned with the inputs such as raw materials, machinery, or labor into the company’s present business; and the latter refers to the development into activities which are concerned with a company’s outputs such as transport, distribution, or servicing. Conducting vertical integration potentially brings a firm a series of advantages, for instance, reducing transportation costs, improving supply chain coordination, capturing upstream or downstream profit margins, leading to the expansion of core competencies through a higher control degree over the entire value chain, and so on.

Horizontal Integration refers to the offering of new products “at the same stage of production as a company’s current operations” which are competitive with or directly complementary to its present business lines. The objectives of conducting horizontal integration are to expand a firm’s products into other geographic locations, to reduce the production cost, to enlarge the range of products and service offered to current customers, to enhance the market position and to increase competitive advantage.

---

44 Anonymous (2001a), p. 5
45 Anonymous (2006a)
47 Anonymous (2006a)
advantages.

- **Horizontal Diversification** refers to extending into other industries at the same stage of the industry chain. In essence, it is one form of concentric diversification which has been addressed in the previous part 2.1.1.2.1.1.1.

Generally speaking, integration strategy can be achieved through mergers and acquisitions (M&As) among firms. Although merger is one of the business forms of acquisition, there is an important difference between them. A merger is a combination of two companies in order to form a completely new and larger company; whereas an acquisition is that a company is purchased by another without new company coming into being. Figure 2-7 below illustrates the differences among merger, acquisition and alliance.

**Figure 2-7: The Comparison among Merger, Acquisition and Alliance**

![Diagram of Merger, Acquisition, and Alliance](image)

In detail, acquisitions can be achieved through three forms: horizontal acquisition, vertical

---

49 The following contents are based on Bea, F. X. and Haas, J. (2005), pp. 172-173; Quélin, B. (2007), pp. 1-4
acquisition, or conglomerate acquisition. A horizontal acquisition occurs between two firms in the same business line; on the contrary, a vertical acquisition contains expanding forward or backward in the value chain, toward the source of raw materials or toward the ultimate consumers; lastly, a conglomerate acquisition is formed through the combination of unrelated businesses. Similarly, mergers also have three types according to the competitive relationship between the merging parties. In a horizontal merger, a firm acquires another firm that produces and sells identical or similar products in the same geographic area in order to eliminate the competition between them. In a vertical merger, a firm acquires either a customer or a supplier. Conglomerate mergers encompass all other acquisitions.

In face of the hypercompetitive and uncertain environment, many companies view M&A as a dominant strategy to increase revenues, reduce costs and obtain competitive advantages in the marketplace. In detail, acquisitions enable a firm to obtain the market penetration by consolidating itself within an industry; to achieve the market development by entering new market segments; to expand its product offerings by rapidly obtaining valuable resources; and to make diversifications by the access to diversiform high-technologies and experiences.

In a word, acquisitions bring a firm many potential advantages; in this regard it is similar to cooperation strategy. The rationale, behind the M&A which is a part of the organization’s horizontal and vertical integration strategies, is that the synergy can be achieved through the rationalization of the production, distribution, marketing and financial systems of the organization. A firm’s growth through M&As will benefit from the combination of complementary resources, tax advantages, and the elimination of inefficiencies as well as accordingly economies of scale and economies of scope.

However, compared with the alliance strategy, acquisitions also bring a firm the following

---

50 IBM Corporation (2005), p. 2
51 Tsosa, P. J. (2003), p. 156
disadvantages: expensive premiums that are frequently paid to acquire a business; difficulties in integrating the activities and resources of the acquired firm into firm’s operations; synergies that may be quickly imitated by the competitors; and cultural issues that may do harm to the desired benefits of all involved parties.52

2.1.1.2.1.2 Stabilization Strategy

Besides growth strategies, there are another two types of corporate-level strategies available to an organization, namely stabilization strategy and retrenchment strategy.

Stabilization strategy, a defensive corporate strategy, is applied either when a company is restricted to its external environment and internal capability or when a company is satisfied with its past performances and intends to pursue the same or similar objectives by maintaining its current markets, products or service.53 Pursuing stabilization strategy aims primarily at stabilizing the organization in a turbulent and rapidly changing environment, at least temporarily. In essence, there are two main characteristics of the stabilization strategy: first, it is not a passive approach, as it is difficult for a company to maintain a stable position in a fast-moving market, and some active strategies like investment and quality improvement might be required; second, the stabilization strategy might involve some aggressive actions, for instance, fending off competitors, lobbying for funds, and advocating for clients.54

2.1.1.2.1.3 Retrenchment Strategy

When a company faces poor economic conditions and the increased competition, and in the meantime, growth strategy and stabilization strategy can not work effectively, the company has no option but to apply retrenchment strategy. This strategy is a corporate-level strategy

52 Dess, G. G. et al. (2006), p. 203
53 Byars, L.L. (1984), p. 79
54 Anonymous (2006b), p. 17
that seeks to reduce the scale or scope of an organization’s business and expenditures in order to become financially stable. Retrenchment strategy can be further divided into turnaround strategy, divestment strategy, and liquidation strategy.

- A turnaround strategy is “an attempt to improve efficiency of operations during a decline in an organization’s financial situation.” ⁵⁵

- Divestment/Disinvestment involves “selling off a major part of the business, which can be a SBU, a product line, or a division.” ⁵⁶

- In the face of an inevitable failure and the invalidation of all other strategic options, liquidation is the only alternative for a company. “Liquidation involves terminating the organization’s existence either by selling off its assets or by shutting down the entire operation.” ⁵⁷

In short, corporate strategy and business strategy, as two basic levels of strategy within a multi-business enterprise, are distinguishing in many aspects. Firstly, corporate strategy is concerned with where a firm competes; while business strategy is concerned with how a firm competes within a particular market.⁵⁸ Further, Bourgeois (1980) summarized that corporate strategy was involved in the domain selection and business strategy dealt with the domain navigation.⁵⁹ Secondly, corporate strategy is formulated by the top management team and implemented by the corporate strategy staff, whereas business strategy is formulated and implemented mainly by the individual businesses. However, these two dimensions of strategy are closely interactional. In other words, “the scope of a firm’s business has implications for the sources of competitive strategy, whereas the nature of a firm’s competitive advantage is relevant to the range of businesses and markets within which a firm can be successful”.⁶⁰ Additionally, there is no distinction between these two

⁵⁶ Ibid., p. 98
⁵⁷ Ibid., p. 99
⁵⁸ Anonymous (2001a), p. 2
levels in a single-business company. What follows is an introduction of business strategies.

2.1.1.2.2 Business Strategies

Business-level strategy also known as business-unit strategy or competitive strategy is concerned with how the company competes within a particular industry or market.⁶¹ For an organization, the purposes of conducting business-level strategy are to build and maintain competitive advantages over its rivals and to adapt to changes in the industry where the organization is located.

Among many classifications of business strategies, Porter’s framework of generic competitive strategies is undoubtedly the one “most frequently discussed in the academic literature”⁶² and widely applied in practice.

According to Porter (1980), a company’s strategy should be unique in response to its particular external environment and internal competences; however, from a broad perspective, generic strategies are useful and necessary for providing the basis of strategic options.⁶³ With the help of analyzing five competitive forces, “three internally consistently generic strategies for creating such a defendable position in the long run and outperforming competitors in an industry”⁶⁴ were further put forward by Porter. In other words, through effectively applying one or more of these strategic approaches: overall cost leadership, differentiation and focus, a company intends to defend its position against those five competitive forces which will erode profitability, and to attain competitive advantages which lead the firm to outperform its competitors in an industry. Detailed descriptions of these three generic strategies are enumerated in table 2-5 below:

---

⁶⁴ Ibid., p. 34
### Table 2-5: Three Generic Competitive Strategies

<table>
<thead>
<tr>
<th>Goal</th>
<th>Overall Cost Leadership</th>
<th>Differentiation</th>
<th>Focus Cost/Differentiation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Target</strong></td>
<td>Broad mass market</td>
<td>Broad mass market</td>
<td>Particular buyer group, product segment or geographic market</td>
</tr>
<tr>
<td><strong>Approach</strong></td>
<td>Cost reduction through a body of vigorous, overhead control and managerial attention.</td>
<td>Providing unique product or service industrywide through various dimensions: quality, features, designed or brand image, technology, customer service and distribution, etc.</td>
<td>Seek differentiation in targeted market segment or serve special needs of narrow target market by using either low cost or high differentiation position, or both.</td>
</tr>
<tr>
<td><strong>Conditions / Assumptions</strong></td>
<td>✓ Price-sensitive customers &lt;br&gt; ✓ Few opportunities to differentiate &lt;br&gt; ✓ Ease of product manufacture and service &lt;br&gt; ✓ High market share &lt;br&gt; ✓ Favorable access to raw materials &lt;br&gt; ✓ Low-cost labor and distribution &lt;br&gt; ✓ Innovation and technology</td>
<td>✓ Strong research &lt;br&gt; ✓ Engineering &lt;br&gt; ✓ Marketing &lt;br&gt; ✓ Creative capability</td>
<td>✓ Customers have unusual needs &lt;br&gt; ✓ Production and delivery system for the segment can be improved</td>
</tr>
<tr>
<td><strong>Advantages</strong></td>
<td>Highly contestable, defensible, strong position and good protection against all competitive forces</td>
<td>Highly contestable, defensible, strong position and good protection against all competitive forces</td>
<td>Launching pad for bold competitive position</td>
</tr>
<tr>
<td><strong>Risks</strong></td>
<td>✓ Failing to attain or sustain the strategy; &lt;br&gt; ✓ For the value of the strategic advantage provided by the strategy to erode with industry evolution</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


To sum up, one of these three generic competitive strategies is essential to an enterprise’s strategy. However, effectively and efficiently implementing these strategies requires a sustained commitment in response to a company’s different resources, skills and operating system. That is, the selection of three generic strategies “rests on picking the strategy best
suited to the firm’s strengths and one least replicable by competitors”\textsuperscript{65}. Moreover, applying these generic competitive strategies singly or jointly will bring the company different competitive advantages. If a firm fails to develop its strategy in one of these three directions, it will be regarded as being “stuck in the middle” and accordingly having low profitability.\textsuperscript{66}

2.1.1.2.3 Functional Strategies

The more localized and shorter-term activities belong to the functional/operational level strategies which deal with how each functional area and each business unit are organized to match the directions established in long-term corporate-level and business-level strategies through effectively allocating resources. Three basic characteristics distinguish functional strategies from corporate-level and business-level strategies: first, functional strategies generally cover a much shorter time period; second, they are more specific and action-oriented; third, they are implemented primarily by functional departments which are at the lower levels of management.\textsuperscript{67} Conducting functional-level strategies aims at “improving the effectiveness of a company’s operations and thus its ability to attain superior efficiency, quality, innovation and customer responsiveness”\textsuperscript{68} and “to support the company’s overall business strategy and competitive approach”\textsuperscript{69} accordingly.

All organizations involve at least three basic functional strategies: marketing, production/operations, financial/accounting. In addition, functional areas can be further expanded into human resource management strategies, research and development strategies, supply chain strategies, purchasing strategies, information system strategies etc.,\textsuperscript{70} and all of them should accord with business-level strategies which in turn should be consistent with the broader corporate-level strategies. Several important functional strategies are outlined briefly as follows:

\textsuperscript{65} Porter, M. (1980), p. 44
\textsuperscript{66} Ibid., pp. 41-44
\textsuperscript{67} Byars, L.L. (1984), pp. 197-198
\textsuperscript{68} Hill, C. W. L. and Jones, G. R. (2004), p. 110
\textsuperscript{69} Thompson, A. A. et al. (2005), p. 36
\textsuperscript{70} Prentice Hall (2002), p. 3
Theoretical Framework

✓ Marketing Strategies

“Marketing strategy is concerned with matching existing or potential products or services with the needs of customers, informing customers that the products or services exist, having the products or services at the right time and place to facilitate exchange, and assigning a price to the products or services.”71 Actually, it is a consideration of the appropriate marketing mixes which consist of price, product, promotion, and distribution.

✓ Production Strategies

Production strategy is to address the following issues: determining the desirable level of production capacity from three options: demand matching, operation smoothing, or subcontracting; locating plants; choosing the timing of the investment in plants; making decisions on changing the existing plants or building new plants in the context of changes in production process; identifying whether the production resource is flexible enough, and so on.72

✓ Financial Strategies

Financial management is significantly crucial for an organization as it affects all other operational areas within the organization. It is mainly concerned with two functions: one is recording, monitoring, and controlling the financial results of an organization’s operations; the other is acquiring funds to meet the current and future needs of an organization.73

✓ Human Resource Management Strategies

The performance of an organization’s strategies finally depends heavily on its human resource applied through the whole process, because strategies are formulated and implemented by people instead of companies. Human Resource Management (HRM)

Theoretical Framework

involves many topics, mainly focusing on the maximization of the productivity and profitability of an organization through attracting, assessing, motivating, training and retaining the quantity and quality of its employees. Simultaneously, it also plays an important role in securing work environment and improving the work life of employees. In its broadest sense, HRM refers to the management of all decisions within an organization that are related to people. In practice, however, HRM is a tool applied to make optimum use of human resources as valuable resources, to foster individual development, and to comply with government mandates.

✔ Research and Development Strategies

Research and development (R&D) strategy is to answer the following questions: “what are the R&D skills required to put into effect the desired strategy? Is the identified required R&D resource available? What should be the R&D focus? Is the R&D capability compatible with the other operations areas of the organization? And is there sufficient support from other areas of the operation?”

Generally, the R&D activities can be divided into three basic segments in terms of basic research, applied research and development research.

✔ Supply Chain Strategies

A supply chain strategy is an iterative process that evaluates the cost-benefit trade-offs of operational components, which should be always consistent with intentions of the business strategy. While business strategy determines the overall direction where an organization intends to go, the supply chain strategy determines the actual operations of that organization and the extended supply chain in order to realize a specific supply chain objective. Precisely, the supply chain combines demand planning, sourcing, manufacturing, provisioning, and distribution logistics together. Sound supply chain strategies not only operationalize and support an organization’s business strategy, but also make contribution on driving down operational costs and maximizing efficiencies.

---

75 Ibid., pp. 205-206
76 Happek, S. (2005), pp. 1-4
77 Ibid., p. 1
78 Ibid.
2.1.2 Strategic Management

2.1.2.1 Definitions of Strategic Management

In the context of rapidly changing globalization, fast technological development, and increasing competition, any company in the business world encounters both challenges and opportunities. In this instance, a company’s success or failure depends primarily on its performance of strategy, as the essence of strategy is to capitalize on and leverage changes between the company’s external environment and internal competences. Consequently, in order to achieve anticipative effectiveness and profitability, and accordingly to meet organizational and stakeholders’ expectations, strategies of business firms need to be managed, which refers to strategic management.

Undoubtedly, strategic management plays a significantly important role in determining a company’s direction and growth; meanwhile, it is also regarded as the most complex and challenging facet of management.

First and foremost, the definitions of strategic management have been evolving since strategic management emerged in 1970s. Several predominant contributions made by various scholars are introduced in brief as follows.

Thompson and Strickland (2001) proposed that strategic management was made up of five components. Precisely, they contributed that the strategy-making/strategy-implementing process consists of five interrelated managerial tasks: forming a strategic vision; setting objectives; crafting a strategy to achieve the desired outcomes; implementing the chosen strategy; and evaluating performance.\footnote{Thompson, A. A. and Strickland, A.J. (2001), p. 6}
Hill and Jones (2004) defined strategic management as “the process by which managers choose a set of strategies for a company that will allow it to achieve superior performance”\(^{80}\).

Wheelen and Hunger (2004) defined strategic management as “a set of managerial decisions and actions that determine the long-run performance of the organization”\(^{81}\).

Pearce and Robinson (2005) contributed that “strategic management is defined as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company’s objectives”\(^{82}\).

Drawing from the above definitions, actually, the essential elements of strategic management which distinguish it from functional management and a long-term plan involve the following aspects: firstly, strategic management is oriented toward the future; secondly, it has an external emphasis; thirdly, it concentrates on assuring a good fit between the environment and the organization’s missions, objectives, strategies, structures, and resources; last but not least, it is an ongoing process, consisting of a series of sequential steps: strategic planning, strategy implementation, and strategic evaluation and control\(^{83}\). Accordingly, strategic management process will be examined in the following part.

2.1.2.2 Strategic Management Process

In practice, a thorough strategic management is an iterative and continuous process rather one time event, comprising three highly interdependent components: strategic planning, strategy implementation, and strategic evaluation and control, as shown in figure 2-8:

\(^{83}\) Crosby, B. L. (1991), pp. 5-7
Theoretical Framework

Figure 2-8: Strategic Management Process

Strategic Planning

- Identifying Vision, Mission, and Long-term Objectives
- Analyzing the External Environment for Threats and Opportunities
- Analyzing the Internal Environment for Strengths and Weaknesses
- Design/Analysis Strategic Alternatives
- Crafting the Best Strategy

Strategy Implementation

- Developing an Organization Structure and Action Plan
- Managing Organizational Activities
- Monitoring and Assessing the Performance of the Strategy in Achieving the Organization’s Objectives

Strategic Control

Sources: adapted from Byars, L. L. (1984), p. 10

2.1.2.2.1 Strategic Planning

The essence of strategic planning is to deal with three basic questions of where a company is now, where a company wants to go, and how to get there. Addressing the above questions is the forethought for a company to formulate an appropriate strategy.

Strategic planning process is concerned primarily with the following five steps:

1. Identifying and clarifying the organization’s vision, mission, long-term objectives and current strategies. The organization’s strategic vision is expected to address a future-oriented question “where we are going”\(^{84}\). Differing from the strategic vision portraying a company’s specific future business plans, the mission statement tends to determine the company’s present business scope by addressing the question “who we are and what we do”\(^{85}\). By setting strategic objectives and goals a company’s strategic vision and business mission can be converted into more specific performance targets.

---

\(^{84}\) Laensiluoto, A. (2004), p. 42

\(^{85}\) Thompson, A. A. and Strickland J. A. J. (2003), pp. 6-7
for the company to achieve. The objectives not only should be financial and strategic but also be long-term and short-term.

- Analyzing the external environment including macroenvironment and microenvironment. Generally, macroenvironment involves four general forces: political/legal forces, economic forces, sociocultural forces and technological forces, which do not directly influence the short-run activities of an organization but its long-term decisions. Analyzing microenvironment, namely task environment, includes the analyses of industry, competitor, customer and distribution channels. External environment analysis will be examined in detail in part 2.1.3.1 that follows.

- Analyzing the organization’s internal strengths and weaknesses, which will be also addressed further in part 2.1.3.2.

- Designing or analyzing strategic alternatives. Generally, there is more than one strategic option available to an organization in relation to its outside environment and inside competences, and all strategic options must be examined for their comparative viability, feasibility, and desirability.

- Finally selecting a specific strategy or strategies which enable the organization to achieve its objectives by coordinating the relationships between internal organization and external environment.

### 2.1.2.2 Strategy Implementation

Strategy implementation refers to a sum total of the activities and choices by which an organization puts its chosen strategies and policies into action, as well as a process of continuously reassessing and reformatting the plan. Strategy implementation plays an obviously key role in strategic management, and moreover, strategy planning and strategy implementation are regarded as the two sides of the same coin.

In practice, strategy implementation primarily involves two aspects: developing an

---

86 Laensiluoto, A. (2004), p. 43  
87 Crosby, B. L. (1991), p. 5  
appropriate organizational structure; and managing the organization’s mid- or short-term activities.89

✓ Developing an Appropriate Organizational Structure

The relationship between an organization’s strategy and its structure is complex as they are highly interactional. Strategic choices shape the organizational structure, while organizational structure constrains strategy.90 In other words, to implement a chosen strategy effectively and to achieve the organization’s objectives accordingly, there must be a compatible organizational structure. Furthermore, the structure should be constantly adjusted in tandem with the evolvement of the strategy. A sound organizational structure helps firms establish lines of authority, achieve synergy and facilitate the communication among the various organizational units.91

There are different organizational structure options available to a particular company. They cover not only some traditional structures such as functional structure, product or service structure, geographic structure, and customer structure, but also some new forms such as matrix organization, project management structure, committee organization, and hybrid structures.92 In these alternatives, nobody can conclude which one is the best for a specific company, because a sound organizational structure should be always compatible with the company’s actual external and internal situations.

✓ Managing Organizational Activities

Firstly, resources must be allocated appropriately and effectively to the various organizational units through budget. There are following budget types available to organizations: sales budget, production budget, direct materials budget, direct labor budget, overhead budget, selling and administrative expense budget, cash budget, budgeted income statement, and a budgeted balance sheet.93

Secondly, the development of functional strategies is another crucial element of organizational activities to achieve the corporate strategy.

90 Ibid., p. 163
91 Ibid., pp. 163-164
92 Ibid., pp. 165-175
93 Garrison, R. H. (1976), pp. 252-253
Lastly, a very important component of implementing corporate strategy is the capability of an organization’s leaders and staff. “The success with which the key tasks are actually performed is determined by the way in which the people within and around an organization are managed and controlled.”\(^{94}\) Meanwhile, motivational considerations including organizational reward system and discipline system must be designed to motivate employees’ performance or to standardize their daily behaviors.

2.1.2.2.3 Strategic Evaluation and Control

Strategic evaluation and control refer to the process of monitoring corporate activities and performance results compared with the desired performance, as well as modifying plans and actions constantly in the light of current achievements and environment alterations. Strategic evaluation and control are similar to strategic planning process, as they address the same questions “where the company is now, where does it want to be, and how can it get there”\(^{95}\). However, strategic evaluation and control occur after the fact; whereas strategic planning occurs before the fact.\(^{96}\)

The process of strategic evaluation and control involves three essential elements which ensure that control process works effectively and efficiently. These three elements include developing criteria for evaluation; evaluating performance; and feedback.\(^{97}\) Firstly, the criteria for evaluation include qualitative criteria and quantitative criteria. The former measure checks whether the chosen strategy is internally consistent; is consistent with the environment; is appropriate in view of available resources; involve the acceptable degree of risk; or has an appropriate time framework early in the strategy-implementation stage; whereas, the later measure helps an organization compare the performance with its historical performance or compete against its adversaries by collecting the information

\(^{95}\) Byars, L.L. (1984), p. 222
\(^{96}\) Ibid.
\(^{97}\) Ibid., p. 224
about growth in sales, market share, net profit, return on investment and so on.\textsuperscript{98} Secondly, the actual performance an organization has done needs to be evaluated by comparing it with the evaluating criteria, whereby corrective actions can be determined and implemented. \textit{Finally}, feedback plays an important role in the whole strategic management process, as a firm’s strategies may be readjusted or reformulated based on the feedback.

In addition, control methods and systems can be categorized into information control and behavior control.\textsuperscript{99} Behavior control puts emphasis on a balanced and consistent net consisting of culture, rewards, and boundaries. Besides, towards conducting information control, two approaches are available: traditional approach and contemporary approach.

\textit{Traditional control system}\textsuperscript{100} is a sequential process which is characterized by replying largely on the feedback approach and little or no action taken to revise strategies, goals and objectives until the end of the time period, as illustrated in figure 2-9:

\begin{figure}[h]
\centering
\includegraphics[width=0.6\textwidth]{figure2-9.png}
\caption{Traditional Approach to Strategic Control}
\end{figure}


However, in the \textit{contemporary approach}\textsuperscript{101} to strategic control, relationships among strategic planning, strategy implementation and strategic control are highly interactive. Organizational leaders make decisions on when the strategy needs to be altered based on continually monitoring the organization’s external and internal environment. This approach is shown in figure 2-10 below:

\begin{figure}[h]
\centering
\includegraphics[width=0.6\textwidth]{figure2-10.png}
\caption{Contemporary Approach to Strategic Control}
\end{figure}


\textsuperscript{98} Byars, L.L. (1984), p. 224-226
\textsuperscript{99} Dess, G. G. et al. (2006), p. 289
\textsuperscript{100} The following contents come from Dess, G. G. et al. (2006), p. 292
\textsuperscript{101} Ibid., p. 293
Today, the contemporary approach is more suitable due to the rapidly changing conditions in virtually all industries.\textsuperscript{102}

### 2.1.3 The Significance of Strategic Environment Analysis in Strategy Planning

In the context of strategy and strategic management, strategic environment analysis plays an obviously crucial role in the strategy planning, as the essence of enterprise strategy is concerned with the fit between the company’s internal capabilities and external environment. In other words, the chances of strategic success will obviously improve if the chosen strategic options are consistent with changes in the environment.\textsuperscript{103}

In general, environment analysis is the monitoring, evaluating and disseminating of information from the external and internal environment.\textsuperscript{104} Concretely, three levels of environment analysis --- macroenvironment, microenvironment and a firm’s specific environment take impact on a company’s operations. Macroenvironment analysis belongs to the broadest level, mainly encompassing political/legal, economic, sociocultural, and technological analyses, in which different opportunities and threats come into being. Microenvironment analysis involves the identification of industries, competitors, consumers, and distributions. A firm’s internal environment refers to its own strengths and weaknesses. After identifying external and internal strategic situations, market opportunities emerge on the one hand; on the other hand, a company can outline its

---

\textsuperscript{102} Dess, G. G. et al. (2006), p. 289
\textsuperscript{103} Fahey, L. and Narayanan, V. K. (1986), p. 203
\textsuperscript{104} Hunger, J. D. and Wheelen, T. L. (2001), p. 7
distinctive competences and comparably competitive advantages as well as weaknesses; subsequently, the company can accordingly make an appropriate strategic decision in a dynamic and turbulent environment.

The aforementioned points can be illuminated in figure 2-11 below which provides an overall research structure for this part and for formulating and implementing enterprise strategy as one step of strategic management processes. Besides, each aspect will be researched further in the following sections.

**Figure 2-11: Strategic Environment Analysis**

Source: self-designed according to the content of strategic environment analysis
2.1.3.1 External Environment Analysis

The situation of external environment closely and greatly affects firms’ activities and profitability. In order to identify a fast-moving and complex external environment and accordingly formulate an appropriate strategy, firms are involved in a process called the external environment analysis. “The continuous process includes four activities: scanning, monitoring, forecasting, and assessing.”\(^{105}\) Table 2-6 lists a short introduction for each step.

Table 2-6: Components of the External Environment Analysis

<table>
<thead>
<tr>
<th>Scanning</th>
<th>Identifying early signals of environmental changes and trends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monitoring</td>
<td>Detecting meaning through ongoing observations of environmental changes and trends</td>
</tr>
<tr>
<td>Forecasting</td>
<td>Developing projections of anticipated outcomes based on monitored changes and trends</td>
</tr>
<tr>
<td>Assessing</td>
<td>Determining the timing and importance of environmental changes and trends for firms’ strategies and their management</td>
</tr>
</tbody>
</table>

Source: Hitt, M. A. et al. (2005), p. 41

Additionally, studying external environment is the foundation to identifying a firm’s opportunities and threats.

2.1.3.1.1 Macroenvironment

Macroenvironment analysis, namely PEST analysis, is conducted to examine trends and events outside an organization that might affect strategy in both direct and indirect way.\(^ {106}\) The content of macroenvironment analysis can be mainly partitioned into four interactional segments: Political/legal, Economic, Sociocultural, and Technological (PEST) environment. Facing uncertainties of these forces, firms have little ability to predict these events and even less ability to control them.\(^ {107}\) What firms can do is analyzing how these forces affect industries, companies, and the company’s activities; what opportunities and threats these forces bring to firms; and which kind of strategy firms should deploy in this instance in order to catch opportunities and avoid threats.

\(^{105}\) Hitt, M. A. et al. (2005), p. 41
\(^{106}\) Aaker, D. A. (2005), p. 97
\(^{107}\) Dess, G. G. et al. (2006), p. 45
2.1.3.1.1 Political/Legal Environment

Political/legal environment is intimately connected with companies’ decisions, actions and profitability. A foremost consideration of analyzing political/legal environment is to evaluate the political stability of the target market, because any fatal activity and incident that happen in host country or region will directly or indirectly affect companies’ businesses, such as long-range wars, frequent strikes, and threats of terrorism. Under the circumstances, it is impossible for firms to do any normal business. Besides, another element that companies should scan and monitor is the government’s business legislation in the target market, including competition policy, taxation policy, privatization, employment law, multinational agreements, some regional trading blocks and so forth. Thereinto, multinational agreements play an important role; therefore, more and more countries are entering into the WTO, the International Monetary Fund, the United Nations, etc. In brief, the purposes of business legislation are “to protect companies from unfair competition, to protect consumers from unfair business practices, and to protect the interests of society from unbridled business behavior” 108. Any change in business legislation will bring new opportunities or potential restrictions to the manufacturing and selling of products.

2.1.3.1.2 Economic Environment

Compared with other environmental factors, the economic environment influences firms’ business activities in the most direct and tight way. Economic factors mainly include GDP, GDP per capita, income distribution, expenditure level, purchasing power, interest rates, exchange rates, inflation rates, unemployment rates, balance of payments, saving rate, labor cost and productivity, and so on. Thereinto, close attention should be paid to the income distribution and expenditure patterns. Income distribution patterns are often divided into five different groups: very low incomes; mostly low incomes; very low, very high incomes; low, medium, high incomes; and mostly medium incomes. 109 An awareness of such classification facilitates companies to find out opportunities and potentials of the target market and position their products appropriately. Besides, consumer expenditures are

---

109 Ibid., p. 168
affected by saving, debt, and credit availability.\textsuperscript{110} In a word, these economic variables have to be treated holistically by both analyzing their historical records and forecasting their trends in a dynamic and turbulent environment.

2.1.3.1.3 Sociocultural Environment

Sociocultural environment concerning demographic, social and cultural developments, natural conditions, and the effects of those developments and conditions on an organization, should be also considered within the PEST analysis.

\textit{Demographics} are the most basic elements of the macroenvironment, as any change in demographics is the root of changes in market. Demographic analysis provides companies with the predictable information in terms of the size and growth rate of population in cities, regions, and nations; composition of age, sex, and ethnic; educational situation; household patterns and structures; disparities in income level; and regional characteristics and movements.\textsuperscript{111}

\textit{Social forces} involve people’s basic values, personal value, beliefs, and attitudes that affect a society’s preferred life styles, women’s demand for coequal opportunity and social recognition, the changing patterns of work and leisure, the effects of urbanization, the rise of crime, the decline of conventional morality and so on.

\textit{Cultural aspects} are mainly concerned with people’s beliefs and their “relationships to themselves, to others, to organizations, to society, to nature, and to the universe”.\textsuperscript{112} “Cultures differ from one another on many bases, such as language, religion, values and attitudes, education, social organization, technical and material culture, politics, law and aesthetics.”\textsuperscript{113}

Besides, \textit{natural factors} involve “the shortage of raw material, especially water; the increased cost of energy; increased pollution levels; and the changing role of governments.”\textsuperscript{114}

\textsuperscript{110} Kotler, P. (2003), p. 169
\textsuperscript{112} Kotler, P. (2003), pp. 175-177
\textsuperscript{113} Fitzroy, P. and Hulbert J. M. (2005), p. 65
\textsuperscript{114} Kotler, P. (2003), p. 169
2.1.3.1.4 Technological Environment

Technological factors, encompassing information technology, R&D spending, new products, new technology, global technology transfer, technological advantages of a country, the internet, incremental and disruptive technologies, and biotechnology, shape not only business activities but also people’s daily life. Especially in the context of the shortage of raw materials and energy, technology is the dramatic point determining people’s fortunes and the society development. Thus, any company which wants a long-term survival and prosperity needs to pay great attention to the latest technological developments. Meanwhile, great attention should be also paid to the support associated with R&D budgets, innovation and skill personnel in different levels of a company’s strategies.

2.1.3.1.2 Microenvironment

The essence of formulating enterprise strategy is relating a company to its external environment, encompassing not only the macroenvironment but the microenvironment as well. As previously examined, the former is concerned with great changes that drive the society and affect all firms in a long-term and broader way; whereas the latter is concerned with specific factors that are associated with competitive environment and affect the firms within a particular industry in a direct way. Microenvironment analysis, namely competition analysis, is composed of an overall examination of industry, competitor, customer, and distribution, which will be addressed in the following sections, respectively.

2.1.3.1.2.1 Industry Analysis

One of significant microenvironment factors is the industry environment in which a firm operates. Industry analysis provides an underlying framework for determining competitive intensity and thereby examining the attractiveness and profitability of a market or a market segment by introducing the five competitive forces model. According to a contribution of Porter (1980), these five primary forces include the threat of new entrants, the bargaining power of buyers, the bargaining power of suppliers, the threat of substitute products, and
the intensity of rivalry among existing firms, as illustrated in figure 2-12 below:

Figure 2-12: Porter’s Five Competitive Forces Model

- **The threat of new entrants** refers to that the profitability of existing companies may suffer from the entrance of new competitors. The intensity of threat depends on “existing barriers to entry and the combined reactions from existing competitors.”

  There are six major resources of entry barriers: economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scale, and government policy.

- **The barging power of buyers** is concerned with that an industry may suffer from the increasing power of buyers in the form of forcing down prices, bargaining for higher quality, or playing competitors against each other.

- **The barging power of suppliers** is concerned with that an industry may suffer from the increasing power of suppliers in the form of raising prices or reducing the quality of

---

115 Porter, M. (1980), pp. 3-29
117 Porter, M. (1980), pp. 3-29
118 Ibid., p. 24
Theoretical Framework

purchased goods.\textsuperscript{119}

\begin{itemize}
  \item \textbf{The threat of substitute products:} all firms within an industry are competing with industries producing substitute products.\textsuperscript{120} The identification of substitute products refers to searching for other products that can perform the same function as the industry’s offerings.
  
  \item \textbf{The intensity of rivalry among competitors in an industry:} competition among existing adversaries is reflected in seeking a better position by applying tactics such as price competition, advertising battles, product introductions, and increased customer service or warranties.\textsuperscript{121}
\end{itemize}

“Based on the information derived from the five forces analysis, management can decide how to influence or to exploit particular characteristics of their industry”\textsuperscript{122}. The relationship between these five competitive forces and a firm’s strategy is interactional. On the one hand, according to the information of competitive intensity and the power of current competitive forces, a firm can search for options to influence these forces based on its interest and specific situation. This can result in a new strategic direction. On the other hand, new strategy can in turn change the impact of competitive forces on the firm. In doing so, the firm aims at defending itself against power of competitive forces. Furthermore, analyzing five competitive forces is a key in shaping strategy; meanwhile, the process of implementing strategy makes an impact on these driving forces in turn.

Although some authors argue that the five competitive forces model has gradually exposed some limitations in present fast-moving circumstance, it is still meaningful for this model as an essential point to further analyze competition and strategy. In a word, industry structure analysis “described competitive strategy as taking offensive or defensive actions to create a defendable position in an industry, to cope successfully with the five competitive forces and thereby yield a superior return on investment of the firm”\textsuperscript{123}.

\begin{flushleft}
\textsuperscript{119} Porter, M. (1980), p. 27  
\textsuperscript{120} Ibid., p. 23  
\textsuperscript{121} Dess, G. G. et al. (2006), p. 59  
\textsuperscript{122} Recklies, D. (2001)  
\textsuperscript{123} Porter, M. (1980), p. 34
\end{flushleft}
2.1.3.1.2.2 Competitor Analysis

Competitor refers to any firm that provides the same customers with the same or similar products and services at present or in the future.

Competitor analysis, a central element of microenvironment forces, plays a key role in the process of strategy formulation, as what Sun Tzu, the ancient Chinese strategist and the author of The Art of War (ca. 500 B.C.), said, if you know the enemy and know yourself, your victory will not stand in doubt.\(^{124}\)

In general, competitor analysis is concerned with a process of identifying the “strategies, objectives, strengths and weaknesses, and reaction patterns”\(^{125}\) of both existing and potential competitors. Concretely, competitor analysis includes two primary operations: \textit{firstly}, finding out the existing and potential competitors. Thereinto, identifying potential competitors is not an easy task, but potential competitors can often be identified by the following groups: “firms not in the industry but who could overcome entry barriers particularly cheaply; firms for who there is obvious synergy from being in the industry; firms for whom competing in the industry is an obvious extension of the corporate strategy; and customers or suppliers who may integrate backward or forward”\(^ {126}\). \textit{Secondly}, identifying target competitors’ objectives, strategies, comparatively competitive advantages, resources and significant competences, and forecasting their possible competitive responses by analyzing and evaluating collected information and data.

Although conducting competitor analysis seems to be very sophisticated because of the tremendous data required and the invisible causal relation hidden behind, there are four fundamentally diagnostic components underpinning the analysis, namely competitors’ “future goals, current strategy, assumptions, and capabilities”\(^{127}\), as illustrated in figure

\(^{124}\) Cantrell, R. (2003), p. 1  
\(^{125}\) Kotler, P. (2003), p. 248  
\(^{127}\) Ibid., p. 48
Most companies are equipped with good awareness of target competitors’ current strategies, strengths and weaknesses illustrated at the right side of figure 2-13; however, they pay much less attention to those two components at the left side, that is, competitors’ future goals and assumptions, which fundamentally determine how a competitor will behave in the future.128

Based on the analysis of these four components, a competitor’s response profile can be therefore concluded. Generally, competitors’ possible reactive patterns in face of attacks are closely connected with the incumbent’s enterprise strategies. Some competitors might respond slowly but some quickly; some might react only to certain types of assaults, but some might take an overall counterattack.129 Accordingly, a company should keep strategic flexibility in response to primary competitors’ reactions in terms of intensity, scope, speed and means.

Finally, in order to ensure that the framework for competitor analysis works efficiently and

---

effectively, a competitor intelligence system which involves “four main steps: setting up the system, collecting the data, evaluating and analyzing the data, and disseminating information and responding to queries”\textsuperscript{130} is required.

2.1.3.1.2.3 Customer Analysis

“In today’s world of fragmented loyalties and fierce competition, the customer’s point of view has increased in importance to become the overriding, driving concern for every organizational activity.”\textsuperscript{131} Customer at the heart of any marketplace is the end-user of products firms offer, and is regarded as the unique target firms serve as well as the only source of the profitability firms strive for. Hence, the customer-oriented conception always occupies the dominant position in modern framework of market orientation. In this instance, a firm’s strategy should be guided by the customer-oriented principle. Generally, the purposes of a company are to offer products whose value can meet maximally or even exceed customer’s perceived value, to deliver total customer satisfaction, and to attract new customers on the basis of keeping current ones.

Customer analysis, as the starting point and end-result of marketing, plays a prominent role in developing an appropriate corporate strategy and achieving organizational long-term objectives. Customer analysis involves detailed identifications of who the customer is and what the customer wants.

- **Who the customer is**

  _Firstly_, a company should identify who the customer is. “Customers include those who can influence the decision to purchase the firm’s products and services, not just those who pay.”\textsuperscript{132} The first and foremost step in analyzing customer is to define and describe customers through segmenting, so as to meet diverse needs of different target customer segment.

  “In a strategic context, segmentation means the identification of customer groups that respond differently from other groups to competitive offerings.” However, it is not easy to identify customer segments, as there are a mass of involved variables which

\textsuperscript{130} Kotler, P. (2003), p. 251
\textsuperscript{131} Johnson, M. (2005), p. 2
\textsuperscript{132} Fitzroy, P. and Hulbert, J. M. (2005), p. 80
need to be considered for segmentation. In general, some critical variables which are frequently used can be partitioned into two aspects: customer own characteristics and approaches related to product, as listed in the table below:133

Table 2-7: Variables for Segmenting Customers

<table>
<thead>
<tr>
<th>Unrelated to Product</th>
<th>Related to Product</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geographic</td>
<td>User type</td>
</tr>
<tr>
<td>Size and type of family</td>
<td>Usage</td>
</tr>
<tr>
<td>Age</td>
<td>Benefits sought</td>
</tr>
<tr>
<td>Sex</td>
<td>Price sensitivity</td>
</tr>
<tr>
<td>Occupation</td>
<td>Competitor</td>
</tr>
<tr>
<td>Income</td>
<td>Application</td>
</tr>
<tr>
<td>Lifestyle</td>
<td>Brand loyalty</td>
</tr>
</tbody>
</table>

Sources: Aaker, D. A. (2005), pp. 45-48

By segmenting, customers are partitioned into distinct groups with diverse purchasing needs, characteristics, and attitudes. On the basis of these partitions, firms can make decisions on applying a corresponding strategy focusing on a single segment or multiple segments.

➢ What the customer wants

After identifying target customers a firm has chosen to serve, the firm proceeds to identify what target customers want from the firm by defining customer value and evaluating their satisfaction.

"From a strategic perspective, a basic need of all customers is to buy products that create value for them."134 The value is called customer perceived value, referring to the difference between total customer value consisting of product, services, personnel and image value, and total customer cost including monetary, time, energy and psychic cost.135 Buyers will buy from the firm that they perceive to offer the highest customer perceived value.136 In this instance, a firm is required to identify, create, deliver, capture, and sustain customer value.137

Besides, evaluating customers’ satisfaction with existing products and identifying customers’ unmet needs are strategically important as they reveal opportunities and

133 Aaker, D. A. (2005), pp. 45-48
134 Hitt, M. A. et al. (2005), p. 110
135 Kotler, P. (2003), p. 60
136 Ibid., p. 85
137 Ibid., p. 70
threats the existing firms are facing. “A buyer’s satisfaction is a function of the product’s perceived performance and the buyer’s expectations”\textsuperscript{138}. If the performance reaches or even exceeds the buyer’s expectations, customers will be satisfied or highly satisfied; on the contrary, customers will be dissatisfied. “An unmet need is a customer need that is not being met by the existing product offerings.”\textsuperscript{139} Although it may be difficult to identify customers’ dissatisfaction and unmet needs, generally they could be identified by applying new technologies, conducting customers’ survey, or exploiting creative thinking.

In a word, customer analysis is concerned with the detailed examinations of who the customer is and what the customer wants. With the help of the awareness, firms are able to implement value-creating strategies and satisfy customers’ needs based on their core competencies. Equally important, high satisfaction often results in high customer loyalty; hence, many firms today are seeking for the total customer satisfaction.\textsuperscript{140}

### 2.1.3.1.2.4 Distribution Analysis

In most business, there are always intermediaries required between manufacturers and consumers, as not every manufacturer can hold sufficient financial strength to employ direct marketing or obtain sound return by strongly investing in establishing its own sales channels. A marketing channel, as one of significant external resources, consists of those intermediaries who act as bridges built between producers and ultimate users in order to promote the physical flow of products timely and swimmingly, accordingly firms can reach and occupy market efficiently.

Concretely, “marketing channels are sets of interdependent organizations involved in the process of making a product or service available for use or consumption”\textsuperscript{141}. They consist of retailing, wholesaling, and market logistics.\textsuperscript{142} The main functions of marketing channels are transferring products or service to consumers, and closing the gaps in place, time and ownerships between manufacturers and consumers.

\textsuperscript{138} Kotler, P. (2003), p. 85  
\textsuperscript{139} Aaker, D. A. (2005), p. 53  
\textsuperscript{140} Kotler, P. (2003), p. 85  
\textsuperscript{141} Stern, L. W. and El-Ansary, A. I. (1996), p. 4  
\textsuperscript{142} Kotler, P. (2003), pp. 534-560
In terms of the selection of a company’s marketing channel, there are four issues involved: 

*firstly*, the channel length has to be decided according to the involved level of intermediaries. Generally, marketing channel is divided into the direct and the indirect shown in figure below:

![Figure 2-14: Consumer Marketing Channels](image)

<table>
<thead>
<tr>
<th>Marketing Channels</th>
<th>Direct</th>
<th>Indirect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Channel Levels</td>
<td>0-level</td>
<td>1-level</td>
</tr>
<tr>
<td>Involved Intermediaries</td>
<td>Manufacturer</td>
<td>Manufacturer</td>
</tr>
<tr>
<td></td>
<td>Consumer</td>
<td>Retailer</td>
</tr>
<tr>
<td></td>
<td>Manufacturer</td>
<td>Wholesaler</td>
</tr>
<tr>
<td></td>
<td>Consumer</td>
<td>Retailer</td>
</tr>
</tbody>
</table>

Source: Kotler, P. (2003), p. 508

*Secondly*, the channel width should be then addressed according to the number of intermediaries to use at each channel level, and there are three strategies available: intensive distribution, selective distribution, and exclusive distribution, as illuminated as follows:  

- **Intensive distribution** aims to increase coverage of the market and sales, and it consists of manufacturers who place the goods or services in as many outlets as possible;
- **Selective distribution** refers to the use of a limited number of intermediaries in a geographical area to sell products;
- **Exclusive distribution** means seriously limiting the number of intermediaries.

*Thirdly*, the type of intermediaries, mainly including wholesaler, agent, retailer, or internet, should be chosen. Thereinto, retailing and wholesaling as two major types will be studied further below in table 2-8:

---

143 The content of these three strategies comes from Kotler, P. (2003), pp. 513-514
### Table 2-8: Retailing and Wholesaling

<table>
<thead>
<tr>
<th>Definition</th>
<th>Retailing/Retailer</th>
<th>Wholesaling/Wholesaler</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Retailing/Retailer</strong></td>
<td>Retailing includes all the activities involved in selling goods or services directly to final consumers for personal or nonbusiness use. Retailer refers to the enterprise whose sales volume comes mainly from retailing.</td>
<td>“Wholesaling includes all the activities involved in selling goods or services to those who buy for resale or business use.”</td>
</tr>
<tr>
<td><strong>Classification</strong></td>
<td><strong>Store retailers</strong>: specialty stores; department stores; supermarkets; convenience stores; discount stores; off-price retailers; superstores; and catalog showrooms.</td>
<td><strong>Merchant wholesalers</strong>: full-service wholesalers (wholesale merchants and industrial distributors), and limited-service wholesalers (cash-and-carry wholesaler, truck wholesalers, drop shippers, rack jobbers, producers’ cooperatives, and mail-order wholesalers)</td>
</tr>
<tr>
<td></td>
<td><strong>Nonstore retailers</strong>: direct selling; direct marketing; automatic vending; and buying services.</td>
<td><strong>Brokers and agents</strong>: manufacturers’ agents, selling agents, purchasing agents, and commission merchants.</td>
</tr>
<tr>
<td></td>
<td><strong>Retailer organizations</strong>: corporate chain stores; voluntary chains; retailer cooperatives; consumer cooperatives; franchise organizations, and merchandising conglomerates.</td>
<td><strong>Manufacturers’ and retailers’ sales branches, sales offices, and purchasing offices</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Miscellaneous wholesalers</strong></td>
</tr>
<tr>
<td><strong>Marketing decisions</strong></td>
<td></td>
<td><strong>Target Market</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Product assortment and procurement</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Services and store atmosphere</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Price</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Promotion</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Place</strong></td>
</tr>
</tbody>
</table>

Source: self-summarized according to Kotler, P. (2003), pp. 534-560

Lastly, an important task of establishing the successful marketing channel for firms is to choose a right distributor. That is, the qualified and competent intermediary must be found out and a close relationship between firms and intermediaries should be established and maintained.

In brief, a firm’s marketing channel management needs to be flexible. In other words, by communicating with involved members, harmonizing their internal relations, evaluating their achievements, motivating their dynamics, and solving intra-channel conflicts and competitions, a firm’s marketing channel should be continuously modified and developed to match the changes of market environment and the product life cycle.
To sum up, opportunities and threats come forth continuously in tandem with the changes of external macroenvironment and microenvironment. Analyzing opportunities and threats not only influences the competitiveness of a company, but also underpins the company’s crucial determination of strategic and competitive response. Opportunities mean that the evolutive directions of external environment changes are attractive, positive and profitable to a company’s survival and development, for instance, “expanding the company’s product line to meet a broader range of customer needs; integrating forward or backward”\(^\text{144}\), and the like. Yet, threats refer to a series of adverse factors of external environment, which directly or indirectly affect a company’s business, such as “increasing competition among industry rivals; showdowns in market growth; costly new regulation requirement”\(^\text{145}\), and so on. All in all, a company’s strategies should be tailored in response to its external strategic environment, whereby the company can pursue market opportunities well suited to its resource capabilities and take actions to defend against external threats to its business.\(^\text{146}\)

### 2.1.3.2 Internal Environment Analysis

After looking outward to a series of forces in the external environment concerning both macro- and micro-environment, a company can proceed to look inward to its internal environment.

Internal environment involves the availability of tangible and intangible resources within a company. The essence of analyzing internal environment is to underpin an identification of the company’s strengths and weaknesses; and accordingly this identification yields the company’s unique resources, capabilities and core competencies. The purpose of internal environment analysis or corporate analysis is to enable a firm to identify how it capitalizes on these unique resources, capabilities and core competencies to gain sustainable competitive advantages.

*Strengths* refer to not only a company’s competences in some areas but also the diversity

\(^\text{144}\) Thompson, A. A. and Strickland, J.A.J. (2003), p. 121  
\(^\text{145}\) Ibid.  
\(^\text{146}\) Ibid., p. 127
and uniqueness that a company is occupying in marketplace, and these strengths enhance a company’s competitive position. It is the competence suitable for current market that makes competitors difficult to imitate and exceed. For most business, strengths can be reflected in the fields of “management, organization, financial, marketing, production and service, technology, and personnel skill”\(^{147}\), for instance, a clear strategic direction and an effective strategy; a flexible organization and a group of capable leadership and skilled employees; a strong financial resource; good reputations for brand, product quality, and customer service, and so on. Any of these competences can be regarded as effective weapons to enhance a company’s market position and also a key determining factor of how well the company will be able to outperform its competitors.

By comparison, *weaknesses* refer to a company’s deficiencies in some aspects compared with its competitors, or “a condition that puts it at a disadvantage”\(^{148}\). A company’s internal weaknesses can be reflected by a weak brand image, shortage of financial resource, unresponsive organization structure, narrow product varieties, laggard technological innovation, lack of talented human resources, and so on.

In conclusion, the main objective of analyzing a firm’s external strategic environment and internal strategic capabilities is to achieve an overall evaluation of external opportunities and threats as well as internal strengths and weaknesses for the specific company. Analyzing external and internal environment is a considerably important step for a company to outperform its competitors in today’s ever-changing environment, as an accurate and objective evaluation of strengths, weaknesses, opportunities, and threats helps a company discern the actual external environment and internal competences, and provides the company with a platform to formulate a series of appropriate corporate strategies and be able to take rapid strategic reaction.

\(^{147}\) Li, N. (2000), p. 289
2.2 Resistance Strategies

2.2.1 Research Context

Before an official definition is proposed and alternative resistance strategies are offered, it is necessary to first examine the real context, in which the resistance strategy emerges and regarded as a basic and key element for a company to survive and prosper.

In contemporary world, globalization has become a predominant theme and an inevitable trend. The term globalization can be primarily interpreted as: “an integration of capital markets, trade, production processes and political and social interactions that results in the export and import of best practices.”[149] The impact of globalization on the whole world and global economy is impressively profound. On the one hand, globalization offers numerous opportunities for both large and small firms; on the other hand, it also generates new threats for these companies, which intensifies the need for adoption of appropriate corporate strategies.[150]

One of the most impressive results from globalization has been the rapid development of emerging markets. In the process of globalization, developing countries in Africa, Asia, Central and Eastern Europe, and Latin America have impressively integrated themselves into the world economy by readjusting institutional systems, reforming economies, and opening up tremendous and untapped markets. As a result, these emerging markets like China, India, Russia, and Brazil have become intriguing markets for many consumer products thanks to the rapid economic development and considerable population base.

Generally, an emerging market is defined as “a nation having an economy with a very low current gross domestic product per capita (GDP) with an above-average economic growth potential”.[151] There are some common characteristics of emerging markets, which distinguish them from those developed markets: 1) the market structure may rapidly evolve; 2) the demand is tremendous; 3) many industries are highly fragmented; 4) a high proportion of youth in population; 5) the average income levels are lagging behind those of

---

developed countries; 6) the institutional frameworks are incomplete; 7) infrastructure and distribution channels are inefficient; 8) technology is underdeveloped; and 9) cultural background as well as traditional custom are unique. However, the fact is these emerging markets are also different from each other.

In any international marketplace there are always two major types of participants: Local Corporations (LCs) and Multinational Corporations (MNCs). They vary greatly in terms of cultural background, developing status, corporate mission and structure, target market segments, competitive advantages and marketing strategies deployed. In emerging markets, LCs and foreign MNCs are acting as two major players, too.

In emerging markets, LCs are referred as homegrown companies with purely domestic strategies. They focus on domestic scope with no or very limited activities outside their national scope. Generally, LCs are mainly transitional state-owned enterprises and numerous medium- and small-size private companies. Moreover, some large, diversified and family-owned businesses are also dominant local players in many emerging markets. Typical family conglomerate is owned and controlled by a family. Although family members may serve as executives in the business, there has always a single founder who dominates the family conglomerate. Of these LCs from emerging economies, a group of MNCs grows to the so-called emerging MNCs.

Another impressive outcome of globalization has been the MNCs’ presence. MNCs are those well-established companies from Western Europe, North America, South Korea, and Japan. These companies operate throughout the world and take dominant positions in an industry.

LCs and MNCs have their own advantages and disadvantages in emerging markets. For foreign MNCs, they are able to benefit from potential economies of scale, superior access to certain types of resources, the flexibility to transfer information and skills from one part of the world to another, and so on. However, they might encounter hostile attitudes like emerging market governments’ restrictions on ownership, taxation and entry model. Moreover, their flexibilities might be hampered because of their operations on a global

153 Kim, D. et al. (2003), p. 1  
154 Ibid., pp. 1-3
level by standardizing product characteristics, administrative practices, and even pricing. For LCs, they have the priority of government’s assistance, and generally they can benefit from the good relationship with officials, the products tailored to local consumers’ preferences, a close connection with local distributors, and a flexible and rapid response to emerging trends. However, LCs are far behind those foreign MNCs in terms of management skills, resources and distribution channels.

Particularly in today’s emerging markets, these two major participants compete fiercely, since globalization provides emerging market firms with numerous opportunities, and meanwhile exposes them to foreign competition. This makes emerging market firms very vulnerable.

On the one hand, it is an inevitable trend for foreign MNCs’ to enter into tremendous emerging markets in the wave of globalization. Two reasons stand out. Firstly, developed markets become saturated and MNCs have to turn to emerging markets for further development. Simultaneously, these MNCs are pursuing above-average revenue opportunities and lower-cost operations; they need to expand into developing countries. Secondly, there seem to be tremendous opportunities offered in those emerging markets. On account of a rapidly expanding middle class, low labor cost, plentiful natural resources, more and more MNCs seeking for more business opportunities have been allured into these unsaturated markets. For foreign MNCs, the emerging market is not only the origin of resources but also the destination of their products and services. Consequently, the aforementioned situations have resulted in fierce competition domestically. For instance, Unilever rapidly controlled almost half of detergent market in India; Nestle occupied 80 percent of Chinese coffee market; and Colgate had 75 percent market share in Brazil’s toothpaste market. Meanwhile, increased competition from foreign firms is expected to impact LCs’ corporate strategy in general.

On the other hand, with introduction of free-market economy, those homegrown companies have had significant development and become strong competitors that foreign MNCs can not ignore. Most of these LCs no longer take competition passively; they start to actively fight back by adoption of a series of corporate strategies.

---

156 Li, Y. X. (2000), pp. 19-23
Therefore, the fierce competition between LCs and foreign MNCs results in a hypercompetition environment in emerging markets. It is worthy to note that such competition has a unique characteristic. That is, LCs and foreign MNCs are competing in a seriously asymmetric way.

This characteristic further implies that LCs have to adopt an efficient corporate strategy, whereby LCs protect their domestic turf by fending off foreign MNCs’ attacks, and in the meantime compete with foreign MNCs on a global basis by updating their competitive advantages. In battles for emerging markets, it is hard for foreign MNCs to occupy all competitive advantages. All in all, resistant reaction taken by LCs as appropriate corporate strategy enables them more opportunities to fend off MNCs’ invasion and expansion and even to outperform them. Facts and past story prove that it is not so impossible for a dwarf to defeat a giant.

2.2.2 Definition and Research Propositions

According to the previous research in terms of strategy and strategic management as well as the pertinent background of globalization and emerging markets, an official concept of resistance strategy will be addressed as it is the major research target of this dissertation.

Starting by understanding literal meaning, CAMBRIDGE dictionary defines the term “resistance” as actions, effects or forces that tend to oppose or retard the progress of something. Combining together, “resistance strategy” thereby refers to a long-term, elaborate and systematic plan of action adopted by resister for the sake of opposing or retarding challenger’s motion as well as preventing the firm from being affected. In this dissertation the term resistance strategy refers to the commonly known corporate level strategy which is illustrated in the previous figure 2-2. Equally important, a thorough resistance strategy should be planned and be comprehended as a main part of the integrated process of strategic management which consists of strategic planning, implementation and control as examined in previous section 2.1.2.2. Furthermore, resistance strategy is designed to achieve a firm’s long-term success in the context of its ever-changing external environment and internal competences.

---

Finally, the definition of *resistance strategy* in this dissertation is proposed as follows: *Thorough strategic decisions and corresponding competitive responses taken at the corporate strategy level by LCs against foreign MNCs’ invasion and expansion in LCs’ home markets, according to LCs’ external competitive environment and internal competitive assets.*

After the definition of resistance strategy is proposed, several pertinent research propositions need to be clarified from the theoretical perspectives of strategy and strategic management, as well as from a practical perspective of emerging markets.

*Firstly*, the essential of resistance strategy refers to LCs’ survival strategy through resisting foreign competition on their home turf. There is a substantial body of research in strategic management literature analyzing companies’ competitive responses with respect to business environment changes on a corporate strategy level. However, resistance strategy or relevant strategic options which can be adopted to guide emerging market incumbents to resist foreign competition in their domestic markets are clearly under-researched themes, comparing with numerous contributions on MNCs’ strategies for invading and penetrating emerging markets.

*Secondly*, resistance strategy is one type of corporate strategies, and therefore, it determines LCs’ organizational scope and impacts all other strategic decisions throughout the whole business activities. Resistance strategy represents a synthetically theoretical foundation concerning a series of active competitive responsivenesses and typologies of reactive behaviours. Further, a complete resistance strategy involves three important and closely related processes, i.e. strategy planning, strategy implementation, and strategic control. Meanwhile, strategic environment analysis plays a vital role in each aforementioned process.

*Thirdly*, after all, there are few situations of completely and purely competition-ignored or competition-autonomous behaviour in emerging market companies. As foreign MNCs have their obvious interest in driving out domestic firms, LCs have to resist such pressure and map out new, unique strategies in response to ever-changing environment and own competences. Moreover, there are multiple objectives of adopting resistance strategy for
LCs in emerging markets. For instance, in addition to mere survival, LCs tend to not only consolidate their performance in domestic markets but also set foot in international or even global markets. In doing so, on the one hand, the international influence and positions of emerging market companies can be enhanced; on the other hand, the national pride of these developing countries can be also increased.

**Fourthly**, resistance strategy contains many dual natures which are represented as a series of hybrid behaviours in terms of 1) survival and growth, 2) adaptive and repulsive activities, 3) proactive and reactive activities, 4) defensive and offensive activities, or 5) cooperation and competition, as shown in figure 2-15 below:

![Figure 2-15: Dual Natures of Resistance Strategy](image)

Source: self-designed according to the research

Therefore, resistance strategy is comprehended as a hybrid and sophisticated strategy, as it is not simply and discretely represented in either of those dual natures, rather those dual natures are intertwined to form a series of new representative strategic actions and thinking. All above-mentioned dual natures will be simultaneously considered under resistance strategy. In other words, resistance strategy represents an integrative theoretical bridge which stretches to join those two contrasting perspectives mentioned above.\(^{159}\)

---

2.2.3 Literature Review

LCs’ strategic options in response to foreign competitors’ invasion and expansion in LCs’ home market can be analyzed through the usage of various dimensions and criteria. The strategy typologies on the corporate level examined in section 2.1.1.2.1.1 are not sufficiently clear and complete to examine the complexity of LCs’ strategic response models and resistant behaviour against foreign competitors. There must be some other pertinent or deductive strategy typologies that can further facilitate the analysis of resistance strategy.

The following research involves several strategy typologies that concentrate on the strategic behavior or reaction of incumbent companies against their competitors. It is worthy of note that typologies are classification schemes which provide “a means for ordering and comparing organizations and clustering them into categorical types”160. The reason why strategy typologies are highly advocated in this theoretical framework is that strategy typologies can offer a concise and comprehensive framework to analyze resistance strategy by describing complex organizational forms and enduring patterns of strategic behavior, explaining outcomes, and finally deducing a dominant strategy typology. Furthermore, although some strategy options are not exactly applicable for LCs in the face of foreign competition, they are expected to underpin the analysis of resistance strategy by virtue of applying various analyzing criteria.

A detailed explanation along with a short evaluation will be given to each typology. Finally, a summary and a critical analysis of these strategic options will be presented, and the strategy typology applied in this dissertation will be indicated.

2.2.3.1 Miles and Snow’s Strategy Typology161

One of the well-known business strategy typologies is Porter’s (1980) framework of three

---

generic competitive strategies: “cost leadership, differentiation, and focus”\textsuperscript{162} which is examined in previous section 2.1.1.2.2. In addition, Miles and Snow’s (1978) competitive strategy typology is another one widely used in competition analysis thanks to its comprehensive treatment of strategy, structure and processes, its support in empirical studies, and its predictive utility.\textsuperscript{163}

Miles and Snow’s typology of strategic orientation has had a significant influence on the fields of strategic management and organization theory since its publication.\textsuperscript{164} With an extensively detailed theoretical orientation and a strong generalizability across settings, Miles and Snow’s typology has been widely used and validated in numerous empirical studies of strategic fit.

Miles and Snow proposed that an organization in general develops distinctive and relatively stable patterns of strategic behavior in order to co-align the organization with its perceived environment.\textsuperscript{165} The patterns of interaction between the organization and its environment result from how the organization responds to three major problems, that is, “entrepreneurial, engineering, and administrative”\textsuperscript{166}. Precisely, the entrepreneurial problem defines an organization’s product/market domain; the engineering problem focuses on the choice of technologies and processes for production and distribution, and the administrative problem involves the formulization, rationalization and innovation of an organization’s structure and policy process.\textsuperscript{167}

Based on these three main problems, the authors classify firms within a given industry into the following four strategic types: defenders, prospectors, analyzers and reactors. Figure 2-16 below illustrates aforementioned three dimensions and corresponding four strategic types with the help of a 2 x 2 grid, and each organizational type will be examined further.

\textsuperscript{162} Porter, E. (1980), pp. 34-46
\textsuperscript{163} McLaren, T. S. et al. (2004), p. 49
\textsuperscript{164} Tan, H. et al. (2004), p. 3
\textsuperscript{165} Gimenez, F. A. P. (2001), p. 1
\textsuperscript{166} Miles, R. E. and Snow, C. C. (1978), p. 20-23
\textsuperscript{167} Ibid.
Defenders are organizations, which have a limited range of product/market domains and focus on efficiency and process improvement. Top managers in this organizational type are highly expert in their organization’s limited area of operation, but they don’t search outside of their domains for new opportunities. The strategic objectives of defenders include: 1) aggressively maintaining a stable position through protecting their product-market activities; 2) ignoring development opportunities outside of this domain; 3) penetrating deeper into current markets; 4) resisting industry change; and 5) realizing growth cautiously. Furthermore, the main behavioral characteristics of defenders involve: 1) operating within a narrow product-market domain and maintaining a secure niche; 2) having relatively few core technologies; 3) stable structure and process; 4) intensive rather than extensive planning; 5) dominant coalitions are finance and production; 6) mechanistic organizational structure; and 7) high fixed-asset intensity.

Prospectors are organizations, which have broad product/market domains and tend to
lead change in the industry. Prospector’s strategic objectives include: 1) continually searching for market opportunities; 2) monitoring a wide range of environmental conditions, trends, and events; 3) creating industry change and uncertainty to which their competitors must respond; and 4) realizing growth primarily through expanding into new markets and offering new products. Moreover, the prospector’s main behavioral characteristics include 1) operating within a broad product-market domain through product or geographical divisionalized structure; 2) heavy R&D and IP investments; 3) extensive rather than intensive planning; 4) dominant coalitions are marketing and R&D; 5) organic organizational structure; 6) low fixed-asset intensity; and 7) incompletely efficient.

➢ Analyzers

Analyzers are organizations operating in two types of product/market domains: one is relatively stable; and the other is changing. In the stable areas, these organizations operate routinely and efficiently through formalized structure and processes; in the turbulent areas, top managers keep close watch on their competitors for new ideas and then rapidly adopt those which appear to be the most promising. Analyzers’ strategic objectives include: 1) successfully imitating through extensive marketing surveillance; 2) avidly following the industry change; and 3) growing through market penetration or product and market development. The analyzer’s main behavioral characteristics involve: 1) maintaining core products and use of applicable innovations; 2) large matrix of organizational structure; 3) mix of processes and technologies for efficiency and flexibility; 4) dominant coalitions are marketing, applied research and production; and 5) planning is both intensive and comprehensive.

➢ Reactors

Reactors are organizations, in which top managers frequently perceive change and uncertainty occurring in their organizational environments but are unable to respond effectively. Generally, this type lacks a consistent strategy structure relationship, and in this instance, organizations are forced to respond only under environmental pressure. Concretely, reactors’ behaviors are illustrated by the following cases: 1) they fail to

---

171 Tan, H. et al. (2004), p. 3
173 Ibid.
work out a viable organizational strategy; 2) although they have an appropriate strategy, technology, structure and process still can not be applied properly; and 3) they adhere to a particular strategy-structure relationship that is not suitable for the business environment. Furthermore, their main behavioral characteristics include: 1) rapid and opportunistic responses to immediate market demands; 2) project-oriented processes and organizational structure; 3) negligible long-term planning; and 4) inconsistent or uncoordinated responses to competitive environment.

According to Miles and Snow, actually, the prospector is comprehended as an outside-oriented strategy and the most dynamic organizational form; in contrast, the defender is regarded as an inside-oriented and a less dynamic one. Meanwhile, the analyzer is viewed as a “unique combination of the prospector and defender types”. Lastly, firms adopting defender, analyzer and prospector strategies are expected to outperform those applying reactor strategies. As the reactor archetype lacks a consistent strategy, it is usually omitted from studies in which the Miles and Snow's typology is adopted.

In conclusion, although these four strategic typologies are built on the business level, they can facilitate the analysis of resistance strategy. That is, the reactors contain no resistant action as they only passively react in response to the environment change. Other three types: defenders, analyzers and prospectors involve resistant behavior against competitors, and meanwhile, their resistant degrees range from weak to strong, respectively.

2.2.3.2 Meffert’s Strategy Typology

Competitor-oriented marketing strategies refer to long-term and conditional plans for the specific behavior against competitors. Meffert (1994) made a contribution on competitor-oriented strategies by virtue of classifying corporate behaviors in competition into four specific types.

175 Miles, R. E. and Snow, C. C. (1978), p. 68
176 McLaren, T. S. et al. (2004), p. 50
178 The following research is based on the translation of Meffert, H. (1994), pp. 155-163
According to Meffert’s contribution, the decisive factors of competition underpin corporate decisions on their behavior against competitors. With the help of strategy typology, competitor-oriented strategies can be first classified into active and passive competition behaviors.

A passive behavior is that competitors’ activities don’t have an implicit or explicit effect on the enterprise’s decisions. Under the circumstances, enterprise with a passive feature neither formulates a competitor-oriented strategy concerning a long-term behavioral plan, nor takes any competitor-oriented actions against competitors. Such a behavioral character is especially advantageous to those large enterprises with either dominant market positions (competition-autonomous behavior) or ignorance of the importance of competitor—orientation (competition-ignored behavior).

In contrast, an active behavior implies that competitive countermeasures are involved in enterprise’s strategic decisions. Therefore, competitor-oriented strategies can be only realized by enterprises which oppose the emergence of competition actively.

In general, the typology of active competitor-oriented behavior can be further carried out according to different typological dimensions. In literature one briefly classified the behavior into the following basic dimensions:

- Innovative versus imitative (conservative) and;
- Competition-avoidant versus competition-adaptive.

Particularly, in the traditional competition theories and American industrial organizations, there is a primary difference between innovative behavior and imitative behavior. Competition, in this regard, is comprehended as “a process of creative destructions” and is interpreted as “a search process and a discovery action”. However, the inherited mode, product or marketing conceptions have been challenged by content- and process-related innovation, and have already been replaced. Thereby, the competition process depending on different competitors’ behavior can be either an “imitation procedure” by adjusting to a

---

179 Schumpeter, J. A. (1950), p. 137
180 Hayek, F. A. (1968), p. 249
long-term balance or a “discovery procedure” by technological development. Further, in the modern management literature the difference is reflected between innovative- or entrepreneur-oriented behavior and conservative behavior. Such insight can be represented by some strategy typologies, for instance, the aforementioned “prospector” and “defender” according to Miles and Snow (1978).

Besides, the dimensions of competition-adaptive and competition-avoidant behavior are often discussed in literature as offensive and defensive, or proactive and reactive behavior. Competition-avoidant and competition-adaptive behavior are differentiated mainly by the time of initiating measures in competition field.

Concretely, a competition-avoidant behavior is based on an adjustment of an enterprise’s managerial decisions on dealing with its competitors. This behavior is thereby characterized by that competition measures can be only carried out according to an actual competitive situation, in which the enterprise deals with one or more suppliers by means of an offensive approach.

Contrarily, competition-adaptive behavior refers to that the enterprise is ready for responding to the first “weak signal”\(^{181}\) of competitors’ endeavors in the frontal area and introducing the possible countermeasures explicitly into its strategy. Enterprises featured with competition-adaptive behavior are often able to achieve the advantage of time as a result of early identifying consumers’ demand compared with reactive competitors. The advantage of time can be transferred to the advantage of image or returns, if it is successful for the enterprise to profile itself, for instance, a technology leader can be profiled through the proactive development and the transformation of innovative product and manufacturing technology in marketplaces.

Therefore, on the basis of aforementioned dimensions, enterprises’ competitor-oriented behavior can be categorized into the following four basic strategies shown in figure 2-17 below:

\(^{181}\) Ansoff, H. I. (1976), p. 129
Cooperation strategy aims primarily at dealing with long-term competition conflicts among those enterprises that have no clear competitive advantages or resources available. This kind of confrontation is presented by some open or implied agreements concerning definite corporate policies. Mostly, cooperation strategy is comprehended as that all competitors can achieve a higher income return through cooperating rather than intensively competing. Usually, a more or less express understanding about the competition behavior prevails particularly in oligopolistic markets, namely informal cooperation.\(^{182}\)

The other form of cooperative behaviors is represented by an assured collaboration, namely a formal cooperation. Forms and characteristics of the formal cooperation are differentiated according to different collaborative degree and relationship type. Based on the previous research on enterprises’ cooperation, contractually confirmed cooperation can be mainly categorized into:

- Licensing Agreements,
- Contract Manufacturing,
- Management Contracts, and
- Joint Ventures

Licensing involves a contractual arrangement, whereby a licensee acquires the rights from licensor to use its industrial property rights or non-protected knowledge, technological know-how and experience. In contrast to the licensing agreement, a

\(^{182}\) Lambin, J. J. (1987), p. 180
contract manufacturing occurs under the exact instructions and expectations of contract body. A management contract represents a form of cooperations, by which a separate enterprise performs the necessary managerial functions. And the management contract may involve technological operation of a production facility, management of personnel, accounting, marketing services, or training. And function-specific JVs are thereby characterized by that collaborations take place within one or more functional fields, such as R&D, manufacturing, and marketing. And most of cooperations are put into practice in high technology industries such as computer, telecommunication, space and aviation as well as automobile.

**Conflict Strategy**

Conflict strategies are mostly connected with that a company aims to win market share through innovative behavior, and probably become the market leadership. Thereby, confrontation with competitors is often unavoidable.

From an aggressive perspective, conflict strategies seek for weakening competitors through a frontal attack as strong as possible or driving them out of the market. In this case the infringements of competition law are often accepted. Usually, aggressive behavior can be observed in those markets which stay in the stagnation or contraction phases, as improving a position is possible only at the expense of the market positions of other suppliers (namely a zero-sum game). Further, oligopolistic markets are often characterized by a series of aggressive competition behavior.

Particularly, competitors’ offensive activities are often described into military category in literature. Accordingly, attack strategies are differentiated as follows:

- **A direct attack** aims at attacking target competitor’s strengths instead of weaknesses, for instance, its main and core products. In doing so, the incumbent shakes the competitor’s established market position, for example, by virtue of offering new, improved, or unique products or reducing the price.

- **An encirclement attack** involves disorganizing target competitor’s market position from all directions. For instance, the incumbent not only offers the same products
as its competitor’s, but also introduces a premium product or a valuable product alternative into other market fields.

- **A flanking attack** aims at attacking the competitor’s weak or vulnerable spots. In such a way, the attempt that an enterprise invades its competitors’ market field may be realized by entering into completely other markets.

➢ **Dodge and Adjustment Strategies**

Dodge strategy refers to that an enterprise tries to evade the increasing competitive stress caused by its competitor’s innovative activities. In particular cases, dodge strategies can be realized through screened market segments, innovative products, manufacturing technology, or distinct marketing effort. The primary prerequisites to dodge strategy are the possibilities of initial development of market entry barriers and the implementation of specialized and experiential effects.

Adjustment strategy aims at maintaining the established product-market-position. This behavior is consistent with the competitor’s reactions. This competitor-avoidant, defensive orientation often maintains for a long time, as the company’s own position is not weaken due to the competitor’s thrusts.

A complex issue comes forth if the enterprise often competes with one another in several markets (namely multipoint competition). In this instance, the enterprise may attack one competitor in certain market, and there are different possibilities to react: the concerned enterprise evades the invasion of competitors in the same market; alternatively, it launches countermeasures in other markets and finally obtains the possibility to react in all markets.

To sum up, although these four strategic typologies are built on the business level, they can facilitate the analysis of resistance strategy by focusing on a series of active strategic behavior of incumbents against competitors. That is, the passive response encompassing both of the competition-autonomous and the competition-ignored represents no resistant stances as they have neither corresponding enterprise strategy guiding their long-term
behavioral plan nor real reaction against competitors. However, in the context of active response behavior, four basic strategies including dodge, adjustment/imitation, conflict, and cooperation present more or less resistant behavior against competitors according to two varieties: one is the enterprise’s nature – innovative or imitative, and the other is the enterprise’s activities – competitor-avoidant or competitor-adaptive.

2.2.3.3 Kuester, Homburg, Robertson and Schaefer’s Strategy Typology

In the context of globalization and the increasing competition caused by saturated markets, enterprises must frequently defend themselves against new products in their established markets. Accordingly, the research of Kuester, Homburg, Robertson, and Schaefer (2001) is concerned with corporate-level enterprise strategies, by which enterprises intend to defend themselves. Precisely, they made a contribution to the established companies’ retaliation strategies against new product/competitor entrances “as a multi-dimensional construct in order to gain a more comprehensive understanding of the nature of defense mechanisms” on the basis of previous empirical studies.

The authors’ research target is defensive strategy, which can be interpreted as a particular case under Meffert (1994)’s adjustment strategy. That is, defensive strategy helps to protect enterprise’s own competition position through an adjustment of the enterprise’s internal marketing strategies in response to externally changing competition conditions.

In a competitor-oriented economic system, enterprises are forced to redefine their markets continuously and to deal with their existing or potential competitors. However, while searching for new growth field, enterprises always come up against those markets which are already occupied by other players. For incumbents in those markets, these new players imply invaders with substantial threats, as they are established through supplanting the existing competitors. Hence, defensive strategy is a strategy by which an incumbent tries to

---

183 The following contents are based on the translation of Kuester, S. et al. (2001), pp. 1191-1195
184 Ibid., p. 1215
avoid or retard the entry of potential competitors or the introduction of new products into certain marketplace. Defensive reactions such as an aggressive price setting, cost reduction, diversification, and advertising tactics can work either as a direct preface or as a prior signal.\textsuperscript{185} Not only for an attacker but also for a defender, the relationship between the different determining factors of entry and the expected variety of reactions plays a decisive role.

Therefore, the basic purpose of their research is to identify influencing factors of the enterprise’s decision on defensive strategies according to the empirical investigation. Meanwhile, defense or retaliation strategies should be comprehended as strategic choices and activities, which encompass retaining defenders’ competition positions or impeding attackers’ entry into new markets.

Taking no influencing factors into account, these possibilities of reactions can be generally classified into two major situations: without defence and with defence, as shown in figure 2-18 below:

**Figure 2-18: Classification of Reactions to Threats from New Competitor/Product**

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure2_18}
\caption{Classification of Reactions to Threats from New Competitor/Product}
\end{figure}

Source: Kuester, S. et al. (2001), p. 1195

\textsuperscript{185} Kuester, S. et al. (2001), p. 1192
According to the authors’ research in terms of reactions to threats of new products/competitors, a firm must decide first whether takes defence or not.

If the firm decides to take no defensive action, there will be three fundamentally different reactions. Firstly, Bain (1956) in his classic “barriers to new competition” pointed out two possibilities of defence, which are ignoring potential invaders and accepting invaders’ entrance to markets or even supporting them through cooperation. Then, Gatignon (1990) added one more alternative: withdrawing the established involvement from the market.

If the firm decides to take defensive action, it should consider a series of integrative aspects instead of only taking a single aspect into consideration as some others did previously. Principally, the firm should make decisions on the following variables: applied instruments, the intensity of reaction, the dimension of reaction, the speed of reaction and the field in which they should respond.

✔ Available *instruments* include all marketing mix in terms of product, price, promotion, and place.

✔ Reactive *intensity* refers to the intensive degree of a deployed instrument, for instance, the budget for defensive promotion.

✔ *Dimension* of reaction describes the number of instruments which get to be applied for defence.

✔ Responsive *speed* is concerned with a temporal delay between the launch of threats and the arrangement of countermeasures.

✔ Lastly, variable of *field* refers to those markets where the defender takes action against the attacker. According to the vulnerability of attackers, defenders can respond by choosing the same marketplace as attackers or other marketplaces.

In conclusion, “building on an extensive literature research the integrative framework

---

186 Bain, J. S. (1956), pp. 42-52
combined the analysis of the marketing instruments used to react with the analysis of the
speed and the breadth of retaliation.\textsuperscript{188} And from a defender’s perspective, the following
measures are prevalently used or at least should be considered: 1) intensive product
defence is adopted in the context of high innovativeness of rivals’ products, high market
growth, low concentration grade and small enterprise size; 2) intensive price defence is
adopted in the context of new products with a price sensitivity but with low innovative
grade and small enterprise size; 3) rapid retaliative reactions are adopted in the context of
new products with low innovative grade, high market growth and significant threats; and 4)
intensive usage of marketing instruments can be adopted in a low concentrated market with
high price sensitivity.\textsuperscript{189} Furthermore, results emphasize 1) the importance of the rival
products’ innovativeness in generating a reciprocal retaliation, although innovativeness
slows the incumbent’s reaction time considerably; 2) market growth encourages rapid
retaliation, especially on the product mix, whereas in concentrated markets firms react less
strongly on the product mix; and 3) considering the phenomenon of incumbent inertia,
larger incumbents retaliate less strongly and slower.\textsuperscript{190}

Noteworthily, the authors did not point out that this contribution was exactly tailored to the
situation of LCs against foreign competition; however, the responsive framework which
reveals various reactive patterns and influencing measures employed by defender can
supply valuable references. Actually, in the reactive patterns of incumbent firms to
competitive threats brought by new products/competitors, ignoring attack and leaving the
industry are regarded as neither defensive nor resistant reaction of defenders. However, the
pattern of accepting or supporting invader is regarded as no defence but with resistant
behavior in this research, since supporting invader through cooperation is one kind of
resistant behavior. Furthermore, the market defence in terms of instruments, intensity,
speed, dimension, and field can be viewed as an active resistant response.

\textsuperscript{188} Kuester, S. et al. (2001), p. 1215
\textsuperscript{189} Ibid., p. 1209
\textsuperscript{190} Ibid., p. 1215
2.2.3.4 Raffée and Segler’s Strategy Typology

Raffée and Segler (1984) pointed out in their research “marketing strategies in export”\(^{191}\) that enterprises could develop an orientation regarding export strategy by virtue of determining different degrees of competitor-related strategic approaches. In the meantime, many enterprises strive to realize a consistent arrangement for customers’ expectations and requirements as well as marketing essentials. If competitors can meet customers’ requirements more effectively, a question about the enterprise’s behavioral models against its competitors needs to be clarified imminently.

In those markets where a competitor-orientation is inescapable or appears appropriately, there are several strategic (re)action alternatives shown in figure 2-19. Among these strategic possibilities, an enterprise’s strategic choice depends essentially on its unique competition position.

![Figure 2-19: Alternative Competition-related Directions of Impact](image)

As illuminated in the above figure, weak companies with insufficient resources and requirements have limited strategic options compared to stronger competitors. The figure illustrates the impact of competition orientation on strategic possibilities, categorized by market abandonment, niche strategy, imitation strategy, contrast strategy, and conflict strategy, with varying levels of resources and competitive potentials.

\(^{191}\) The following content is based on the translation of Raffée, H. and Segler, K. (1984), pp. 286-288
competitive potentials should evade competitors by means of giving up some markets or adopting retreat strategy. Medium companies with some but limited resources and competitive potentials can focus on niche strategy in order not to be involved in price wars, or can lean themselves against strong competitors without making a large amount of market investment (namely “me-too” strategy). Lastly, the company with abundant resources and competitive potentials can attempt to create a different market position for its own products from its competitors by means of product innovations or intensive advertising efforts, without immediately being involved into conflict strategies such as price war and so on.

Based on Raffée and Segler’s (1984) contribution, Gorynia, Jankowska, and Owczarzak (2005) made a further development in this regard in their research “strategies of Polish companies as a response to foreign investors’ expansion into the Polish market”\(^{192}\).

They pointed out that response strategies of a company confronting competitors can be classified in the light of the company’s attitude towards competition. They also emphasized that this classification was not applicable especially to foreign or local companies; however, the strategy typology presented here should be regarded as the representative situations concerning different response attitudes of LCs in the face of foreign rivals.\(^{193}\)

Therefore, according to a company’s competitive potentials and the attractability of its located industry, incumbents can choose any of battle, imitation, market-gap, or withdrawal strategies based on their different attitudes towards their competitors.\(^{194}\) A description of each strategic option, the required conditions for companies which intend to pursue these strategies, and advantages and disadvantages of each typology are listed in table 2-9 below:

\(^{192}\) Gorynia, M., Jankowska, B., and Owczarzak, R.(2005), pp. 44-65
\(^{193}\) Ibid., pp. 46-47
\(^{194}\) Ibid., p. 46
In conclusion, except the strategy of withdrawal from the market, battle strategy, imitation strategy and market-gap strategy all contain resistant reactions of incumbents against competitors regardless of passive or active behavior, and this can facilitate the analysis of resistance strategy.
2.2.3.5 Gorynia and Wolniak’s Strategy Typology

Gorynia and Wolniak (2000)\textsuperscript{195} made a further contribution on another strategy typology for LCs as a result of their research on competition strategies of LCs in the face of MNCs’ invasion and expansion in Poland. According to Gorynia and Wolniak’s research, due to the great disparity and asymmetry of competitive position of foreign MNCs and LCs in Polish domestic markets, Polish firms are forced to compete.\textsuperscript{196} And they further put forward to “four interrelated strategic options”\textsuperscript{197} available to Polish firms as outlined below:

- **“National Champion” Strategy**

  “National Champion” refers to “companies operating in industries with an oligopolistic market structure (involving domestic companies) or in industries experiencing consolidations and mergers which lead to the creation of holding companies and/or strategic alliances”.\textsuperscript{198} This group of companies plays a strategic role in Poland economy. For instance, Polish petroleum industry and banking sector belong to the national leaders. Promoting “national champion” aims at supporting national companies so that they can effectively counter foreign competition, and the corresponding measures involve, for example, encouraging amalgamations and offering financial support.\textsuperscript{199} Actually, the survival and growth of state-owned firms in these sectors benefit greatly from government pressure and intervention, although those state-owned firms and Polish industrial policy-makers in these sectors know how strong pressure and great urgency to improve these firms’ competitive positions.\textsuperscript{200}

- **Aggressive Defence Strategy**

  With the guidance of aggressive defence, domestic Polish firms compete aggressively

\textsuperscript{195} The following content comes from Gorynia, M. and Wolniak, R. (2000), pp. 87-97; Gorynia, M. et al. (2005), p. 48
\textsuperscript{197} Gorynia, M. et al. (2005), p. 48
\textsuperscript{198} Ibid.
\textsuperscript{200} Ibid.
with foreign competitors for sales and market shares, mainly through continuous adjustment to meet the standards of their foreign competitors, encompassing a series of improvements in quality of products and service, promotional activities and expansion of distribution networks.\footnote{Gorynia, M. and Wolniak, R. (2000), pp. 91-92} Polish firms pursuing this strategy always face a serious issue --- the shortage of adequate resources, experience and expertise, which places Polish firms in a much weaker competitive position than their foreign rivals.\footnote{Ibid., p. 91} However, if these deficiencies can be overcome, this strategy does help Polish firms to increase their market shares.

- **Co-operation Strategy**

The principle of conducting this approach is that if Polish firms can not effectively compete against foreign competitors, it is best to join them, even if this may place Polish firms in a minority shareholding position, or make them play a marginal role in corporate governance, or make them even deprived of the corporate governance completely.\footnote{Ibid., p. 92}

To specify, there are three means which facilitate to realize co-operation strategy available to Polish firms: *first*, a straightforward acquisition, by which a domestic Polish firm abandons its survival and becomes a wholly owned subsidiary or a branch of the foreign parent; *second*, establishing a JV between a Polish firm and a foreign counterpart by keeping the Polish company a minority stake; *third*, cooperating with foreign competitors by entering into contractual agreements, which are similar to alliances and coalitions rather than to mergers and JVs.\footnote{Ibid.} Under such agreements, Polish firms occupy dominant position and determine their overall strategic development, whereas foreign firms are expected to contribute their specific competencies such as new products, technologies, management skill and experience, marketing know-how, and expertise.
Polish companies pursuing co-operation strategy are mostly newly formed and generally small- or medium-sized, that is, they are only in their initial stages of the firm’s life cycle.\textsuperscript{205}

Finally, Gorynia and Wolniak pointed out how important Polish firms should maintain their identity when applying this strategy, and moreover, a better situation for Polish firms would be that this survival strategy worked for a certain time period, and it would be replaced by other strategic options eventually.

- **Lobbying and building non-market barriers to foreign entry**

This strategy aims at keeping foreign firms out of Polish domestic market or restricting their competitive impact and freedom to operate in this market for as long as possible.\textsuperscript{206} This is especially applicable for those sectors which have a fragmented market structure or where there exist wide gaps in the capital, management and technology between Polish firms and MNCs.\textsuperscript{207} And this strategy “consists in trying to exert direct or indirect pressure (through political parties and other pressure groups) in order to create new or keep the existing tariff and no-tariff barriers”.\textsuperscript{208}

To sum up, the above-mentioned four strategic responses of Polish firms against foreign competitors’ invasion and expansion proposed by Gorynia and Wolniak should not be regarded as isolated approaches, but a combination of more than one alternative in practice. Nonetheless, it is still insufficient. The authors put forward further: \textit{firstly}, in the case of foreign firms taking over Polish firms and controlling the whole sectors, Polish firms are unable to compete with foreign companies which occupy most competitive advantages. \textit{Secondly}, in face of the asymmetric competition with foreign rivals, the long-term survival and growth of Polish firms depend primarily on their evolution as transitional companies,

\textsuperscript{206} Ibid.
\textsuperscript{207} Ibid., p. 93
\textsuperscript{208} Gorynia, M. et al. (2005), p. 48
namely the process of consolidating and internationalizing their operations. In particular, depending only on exporting is not enough for Polish firms to maintain their competitive positions. They should expand their footprint to other developing markets with similar market condition rather than those highly developed regions. Thirdly, if it is too hard for Polish firms to grow and expand individually, they should consider forming strategic alliances with other Polish firms or even with foreign MNCs. To avoid a weaker or subservient position in the strategic alliances with Western firms, Polish firms should focus on developing their core competencies in terms of new products and technologies, though it may be time-consuming. Fourthly, if Polish firms tend to compete aggressively against foreign counterparts, depending on quality alone will not ensure their long-term success. They should concentrate not only on some internationally acknowledged determinants such as customer services, product differentiation and innovation, but also some specialized, high-value niches of mass markets.

By examining more closely, there are actually not so many resistant behaviors in these four strategies, except the aggressive defence by improving quality and forming contractual agreements with foreign competitors. Other strategic approaches are more concentrating on what the government or pressure groups can do or actually do for firms to be as effective as possible in the presence of foreign competition rather than a viewpoint of Polish firms themselves, that is, how Polish firms strategically behave and react to changes in the externally competitive environment. Actually, what domestic Polish firms should do in face of foreign invasion and expansion are those strategic options that Gorynia and Wolniak put forward in their conclusion. Therefore, in order to facilitate the analysis of resistance strategy in this dissertation, it is necessary to find a more complete framework which covers more active resistant response from the perspective of Polish firms.

210 Ibid.
211 Ibid.
2.2.3.6 Dawar and Frost’s Strategy Typology

In addition to above-mentioned strategic options for incumbents against challengers, “Dawar and Frost”212 contributed some strategy options for LCs in competing against global challengers. And these strategy options are categorized into four generic alternatives: dodger, defender, contender, and extender according to two variables: the pressure to globalize within a given industry and the international transferability of the company’s assets. Meanwhile, Dawar and Frost also emphasized the importance of strategic alliances in the framework of each strategy typology. Dawar and Frost’s strategy typology will be considered in detail in the part 2.2.4.

2.2.3.7 Analysis of the Existing Approaches

In this section, aforementioned existing approaches will be summarized at first, and then classified according to their different resistant stances and degrees. In doing so, an analysis will be offered in order to search the best approach which is applicable to this research, and finally analyzed results will be presented.

2.2.3.7.1 Summary

Actually, there are many similar strategic typologies available to incumbents against challengers in addition to the aforementioned ones. For instance, Etgar (1997) proposed that three strategies could be applied by domestic firms when he studied response strategies of Israeli retail chains to the entry of international chains: first, competitive, focusing on a specific target market; second, market, focusing on a niche segment or internationalize; third, operational, improving customer service or change the scope of operation.213 Alternatively, Fiegenbaum and Lavie (2000) put forward that there are six response strategies available to Israeli firms in response to MNCs’ entry into the cosmetic and food industries, and these six response strategies involve niche strategies, acquisition of foreign firms, internationalization, “wait and see”, divestment and exit.214 Further, Jaffe, Nebenzahl and Schorr (2005) contributed four strategic options of home country firms in

---

212 Dawar, N. and Frost, T. (1999), pp. 119-129
face of MNCs’ entry: contender, contester, cooperator, and defender, according to two variables: the pressure to globalize/localize products and the strategic strength of domestic firms.\textsuperscript{215} There are still many similar examples, just to name a few here.

However, the strategy typologies which have been examined in detail are summarized in table 2-10 below:

<table>
<thead>
<tr>
<th>Authors</th>
<th>Strategy Typology/Enterprise Behavior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miles and Snow</td>
<td>Defender</td>
</tr>
<tr>
<td></td>
<td>Prospector</td>
</tr>
<tr>
<td></td>
<td>Analyzer</td>
</tr>
<tr>
<td></td>
<td>Reactor</td>
</tr>
<tr>
<td>Meffert</td>
<td>Competition-autonomous Behavior</td>
</tr>
<tr>
<td></td>
<td>Competition-ignored Behavior</td>
</tr>
<tr>
<td></td>
<td>Dodge Strategy</td>
</tr>
<tr>
<td></td>
<td>Adjustment/ “Me-too” Strategy</td>
</tr>
<tr>
<td></td>
<td>Conflict Strategy</td>
</tr>
<tr>
<td></td>
<td>Cooperation Strategy</td>
</tr>
<tr>
<td>Kuester, Homburg, Robertson, and Schaefer</td>
<td>Attack-ignored Behavior</td>
</tr>
<tr>
<td></td>
<td>Accept/supporting through cooperation</td>
</tr>
<tr>
<td></td>
<td>Withdrawal Strategy</td>
</tr>
<tr>
<td></td>
<td>Market Defence Strategy</td>
</tr>
<tr>
<td>Raffée and Segler</td>
<td>Battle Strategy</td>
</tr>
<tr>
<td></td>
<td>Imitation Strategy</td>
</tr>
<tr>
<td></td>
<td>Market-gap Strategy</td>
</tr>
<tr>
<td></td>
<td>Withdrawal Strategy</td>
</tr>
<tr>
<td>Gorynia and Wolniak</td>
<td>“National Champion” Strategy</td>
</tr>
<tr>
<td></td>
<td>Aggressive Defence Strategy</td>
</tr>
<tr>
<td></td>
<td>Co-operation Strategy</td>
</tr>
<tr>
<td></td>
<td>Lobbying and building non-market barriers to entry</td>
</tr>
<tr>
<td>Dawar and Frost</td>
<td>Defender</td>
</tr>
<tr>
<td></td>
<td>Extender</td>
</tr>
<tr>
<td></td>
<td>Dodger</td>
</tr>
<tr>
<td></td>
<td>Contender</td>
</tr>
</tbody>
</table>

Source: self-combined on the basis of the previous research, pp. 70-92

In the context of analyzing incumbent companies against competitors, each of those strategy typologies has its own merits and insufficiencies based on different levels of enterprise strategies and determining factors. According to conclusions made by those researchers and the internal connections among those strategy typologies, a further

\textsuperscript{215} Jaffe, E. D. et al. (2005), pp. 183-195
classification of LCs’ actual possible behavior patterns towards foreign invasion and expansion can be outlined in the following section.

2.2.3.7.2 A New Classification and its Analysis

These strategy typologies can be classified into three essential statuses according to diverse resistant degrees of LCs against foreign competition. They are no resistance, passive resistance and active resistance, ranging from weak to strong, as shown in table 2-11 below:

<table>
<thead>
<tr>
<th>Resistant Degree</th>
<th>Strategy Typology (Authors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Resistance</td>
<td>---Reactor (Miles and Snow)</td>
</tr>
<tr>
<td></td>
<td>---Competition-autonomous Behavior (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Competition-ignored Behavior (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Attack-ignored Behavior (Kuester, Homburg, Robertson, and Schaefer)</td>
</tr>
<tr>
<td></td>
<td>---Withdrawal Strategy (Kuester, Homburg, Robertson, and Schaefer)</td>
</tr>
<tr>
<td></td>
<td>---Selling out and leaving the industry (Raffée and Segler)</td>
</tr>
<tr>
<td>Passive Resistance</td>
<td>---Adjustment Strategy/“Me-too” Strategy (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Imitation Strategy (Raffée and Segler)</td>
</tr>
<tr>
<td></td>
<td>---“National Champion” Strategy (Gorynia and Wolniak)</td>
</tr>
<tr>
<td></td>
<td>---Lobbying and building non-market barriers to entry (Gorynia and Wolniak)</td>
</tr>
<tr>
<td>Active Resistance</td>
<td>---Analyzer (Miles and Snow)</td>
</tr>
<tr>
<td></td>
<td>---Dodge Strategy (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Defender (Miles and Snow)</td>
</tr>
<tr>
<td></td>
<td>---Market Defence Strategy (Kuester, Homburg, Robertson, and Schaefer)</td>
</tr>
<tr>
<td></td>
<td>---Market-gap Strategy (Raffée and Segler)</td>
</tr>
<tr>
<td></td>
<td>---Aggressive Defence Strategy (Gorynia and Wolniak)</td>
</tr>
<tr>
<td></td>
<td>---Prospector (Miles and Snow)</td>
</tr>
<tr>
<td></td>
<td>---Conflict Strategy (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Battle Strategy (Raffée and Segler)</td>
</tr>
<tr>
<td></td>
<td>---Cooperation Strategy (Meffert)</td>
</tr>
<tr>
<td></td>
<td>---Accepting/supporting through cooperation (Kuester, Homburg, Robertson, and Schaefer)</td>
</tr>
<tr>
<td></td>
<td>---Co-operation Strategy (Gorynia and Wolniak)</td>
</tr>
<tr>
<td></td>
<td>---Defender, Extender, Dodger and Contender (Dawar and Frost)</td>
</tr>
</tbody>
</table>

Source: self-classified on the basis of the previous research, pp. 70-92
As indicated in table 2-11, there are three fundamental resistant degrees. Each status and its corresponding response strategies and behavior will be analyzed further as follows:

**No Resistance**

There are mainly four possible reactions reflecting no LCs’ resistance when facing foreign MNCs’ threats.

1) Reactor: companies have no consistent strategies but react passively in response to the environment change.
2) + 3) Simply maintaining autonomy or ignoring competition in the present of foreign attacks, which may occur under the following situations: LCs occupy the dominant market position and believe that foreign MNCs will not threat their business or affect in a negative way. Alternatively, LCs may be uncertain about the best approach to respond or may lack relevant resources and competences such as “managerial expertise”\textsuperscript{216} to take any strategic options to fend off or even fight back. What these LCs can do is to let their business emerge and perish by itself.
4) Withdrawal: companies sell off and leave the industry completely, which signals a closure of the business. However, in this case LCs may recover investment outlay.

In a word, these four response stances described those evaders without taking any resistant countermeasure and reaction against foreign MNCs. Thus, this kind of gesture is not the research target in this dissertation.

**Passive Resistance**

There are three reactive models to some extent presenting LCs’ resistant power against foreign threats, but in a passive way. They are:

1) Imitating the selected products or activities of foreign MNCs;
2) Becoming a national champion with the help of government’s support and intervention;
3) Lobbying and building non-market barriers to foreign entry.

On the one hand, LCs’ response model of becoming a subordinate of foreign MNCs or

\textsuperscript{216} Kalra, A. et al. (1998), p. 384
acting as an OEM of foreign products happens frequently in emerging markets, partly because in such a way LCs can maintain their survival with small and quick profits, which is in a sense better than dying out totally. However, as the likely results of doing so, LCs are probably used because of their lower costs of resources and work force. They will fail to build strong local brands and may gradually lose their motivations on exploiting own core competences, especially the capabilities in R&D and so forth. In this instance, these LCs may never get a real development, and thereby they are not qualified to compete with foreign MNCs on the same stage. The same problem also exists in the situation that LCs clone or imitation of foreign MNCs’ products or activities. This situation may finally lead to a large scale of intense and out-of-order price wars, which in turn shall harm market competition between LCs and foreign MNCs. From a long-term perspective, through aforementioned three possibilities, LCs may never achieve final victory when competing with foreign MNCs in their emerging markets.

On the other hand, lobbying for government protection is another frequently used approach for LCs to defend their home market. In essence, this approach has surely played a significant role in the growth of LCs by “providing the opportunity to develop advantages with a high level of stability”217. However, this is more feasible for those LCs in infancy or adolescence stage. The patronage and intervention of government may take the form of government subsidies, interest-free loans, market entry or operation restrictions on foreign MNCs and supporting measures with distribution channels, since public transportation and information service are normally state-owned in many emerging markets. However, these protective policies made a negative impact on LCs by allowing them to achieve high growth but with limited external competition.218 In other words, LCs cannot achieve a long-term success in a head-on match with well-established MNCs if they rely solely on government patronage and protectionist barrier or even are addicted to government’s continued support.219 Three reasons stand out. Firstly, long-term dependence on government protection may weaken LCs’ enthusiasm for enhancing their competences and capabilities in key facets

218 Ewing, M. et al. (2001), p. 54
such as innovation and R&D. Secondly, protection measures such as tariffs or other barriers to imports into an industry may be eroded if foreign MNCs set up local production and accordingly get around the trade barriers, for example, at the beginning of 1950s Nestle and Levi’s adopted this means to deal with Latin American trade barriers.\textsuperscript{220} And lastly, a series of protectionist barriers may be finally cancelled in tandem with the global economic integration. At this rate, those LCs that rely only on government protection will ruin very soon once they lose this advantage.

In a word, these passive strategic options are not the primary research objectives in this dissertation.

- **Active Resistance**

Lastly, there are some alternatives to a great extent reflecting LCs’ active strategic reaction against foreign competitors. By and large, these active approaches can be ranged into several possibilities according to their inherent competitive gestures: dodge, defensive, offensive, and cooperation. Accordingly, the key research target of this dissertation is to analyze LCs’ active resistant reactions against foreign competition.

Moreover, each framework of strategy typology proposed by those authors is concerned with one or more active resistance. However, besides the framework proposed by Dawar and Frost, all others seem insufficient with regard to the complexity of competition relationship between LCs and foreign MNCs on a corporate level. On the one hand, it is not comprehensive to use those frameworks to analyze LCs active resistant reactions. Most of these frameworks are concerned with passive response models or only one or two active models. On the other hand, those strategy typologies are based on their specific context and are restricted to explore unique corporate-level strategy which is particularly tailored to emerging market companies. Noteworthily, they do not sufficiently consider the key determining variables by which LCs’ response typologies can be sorted. Therefore, none of these strategy typologies is considered to be the dominant framework for analyzing resistance strategies here.

\textsuperscript{220} Grosse, R. (2003), p. 3
2.2.3.7.3 Contribution

As a result, there should be a framework of strategic options which can be used by LCs in order to achieve long-term survival and growth in the present of intensive foreign invasion and expansion in emerging markets. The framework is Dawar and Frost (1999)’s four strategy typologies: defender, dodger, extender, and contender determined by taking two variables into consideration: the strength of globalization pressures in an industry and LCs’ transferable assets.

Four reasons for choosing Dawar and Frost’s strategy typologies as the theoretical framework in the dissertation stand out:

Firstly, these strategy typologies are built in the light of a detailed examination of the relationship between LCs’ external environment and internal competencies.

Secondly, all involved strategy typologies are applicable for LCs from an active perspective;

Thirdly, they have special background for LCs in the face of foreign invasion and expansion in emerging markets;

Last but not least, they actually offer two frameworks: one is applying dodge, defend, extend, or contend without strategic alliances, and the other is those four strategies with strategic alliances. In this case, significant attention will be paid to the importance of strategic alliance in resistance strategy, and this is also the requirement of the dissertation.

To sum up, Dawar and Frost’s framework will be adopted as a theoretical background to examine LCs’ resistance strategies, which will be addressed in detail in the following sections.

2.2.4 Alternative Resistance Strategies

Dawar and Frost (1999) of Harvard Business School made an impressive contribution by putting forward a framework that helped LCs find their competitive positions and corresponding survival strategies in the face of MNCs’ invasion into their emerging
markets. These strategic options available to LCs are fundamentally distinguishing from those of foreign MNCs. It is worthy to note that Dawar and Frost’s framework has become one of the most popular strategic typologies and therefore has been widely employed and validated by a number of researchers in studying survival strategies of local companies in emerging markets in the face of foreign competition. For instance, by virtue of this framework, Du, Y. P. (2003) examined the strategic internationalization of Chinese Haier Group; Yip, G. S. (2005) studied globalization strategies for India-based companies; Gupta, P. and Mundhra, S. (2005) also adopted this as a theoretical framework of “restructuring of India firms for catering to emerging markets”\(^{221}\), and so forth. To sum up, taking account the considerable influence, Dawar and Frost’s strategy typology will be also applied in this dissertation, and this provides confidence for the present research.

2.2.4.1 Two Required Parameters

Dawar and Frost’s framework classifies LC’s survival strategies into four positions on the basis of two variables: the pressure to globalize within a given industry and the international transferability of the company’s assets.\(^{222}\)

A LC needs first to identify its located industry in order to find out the degree of pressure to move toward global competition. Although the globalization trend is overwhelming by spreading to most industries, the pressures that different industries force companies to sell internationally are different. On the one hand, some industries requiring enormous fixed costs for product development, capital equipment, marketing and distribution are better to reach multiple markets. Good examples can be aircraft engines and telecommunications switches. In this case, these industries can benefit from customers’ preferences for standardized products. On the other hand, some industries such as beer and retail banking that focus on meeting specific needs and capitalizing on the closer and better relationship with local customers, can still prosper by merely selling or serving in their domestic markets. Under the circumstances, MNCs may suffer from standardized products which are not tailored to home preferences or possibly high transportation costs.

\(^{221}\) Gupta, P. and Mundhra, S. (2005), pp. 3-4
\(^{222}\) The following content of these two parameters comes from Dawar, N. and Frost, T. (1999), pp. 120-121
After examining its located industry, the company proceeds to evaluate its competitive capabilities. On the one hand, some companies may have a series of internal assets which are only suitable for operating in their domestic market, for instance, a well-established and intensive distribution network through which their offerings can reach remote segments; a proprietary knowledge of local consumers and their specific preferences; a well-recognized brand and so on. All of those capabilities can generate formidable sources of competitive advantages, and it is difficult for foreign MNCs to copy or imitate these advantages, at least not easy to catch up in a short term. On the other hand, other companies may have a series of competitive assets which can be transferred abroad or the basis for expanding and competing in foreign markets, such as marketing skills, low-cost raw materials at home, expertise with rich experience in operating overseas, ties to existing clients, or ethnic connections.223

Based on a careful identification of these two parameters, there are four strategic options available to LCs threatened by foreign MNCs’ entry into their home market, which are defender, extender, dodger, and contender strategies. By taking strategic alliances into account, these four strategic options can be further realized by two possibilities: one is survival strategies without strategic alliances, and the other is survival strategies with strategic alliances, accordingly generating eight alternatives. Subsequently, each of those eight strategic and competitive responses of LCs against foreign MNCs in their home market will be addressed in the following sections, respectively.

### 2.2.4.2 Options of Resistance Strategies without Strategic Alliances

In virtue of a 2 X 2 grid model, figure 2-20 presents four basic strategic alternatives: defender, extender, dodger, and contender in the context of without strategic alliances. As a function of two dimensions identified in previous section, each strategic position displays a unique response pattern of LCs against foreign MNCs’ competition in their domestic market, which is crucial for LCs’ long-term survival and development.

2.2.4.2.1 Defender

LCs in defender quadrant where they have low globalization pressure and their competitive assets are customized to home market should focus on protecting their existing market positions against foreign MNCs’ onsets.

A fundamental of the defender strategy is that LCs fully exploit and capitalize on their comparatively competitive advantages in domestic market segments where MNCs are weak. Concretely, these competitive advantages can be represented by the following facets:

*Firstly*, a remarkable competitive advantage that LCs occupy is low-cost, which results from lower wage and salary costs, simpler product design, or lower operating and overhead costs. The low-cost advantage enables LCs to compete heavily on price against foreign MNCs. Although it may be difficult for LCs to defend the low-cost advantage if the foreign competitors establish production bases in emerging markets, low cost still provides competitive advantage against firms that import into these markets.

*Secondly*, LCs are armed with both perceptual and rational knowledge of unique local tastes and customer needs as well as the in-depth cultural value. By comparison, foreign MNCs can not have the same condition to adapt to local market even if they tend to think globally and act locally.

---

225 Grosse, R. (2003), p. 4
Thirdly, LCs are well equipped with “considerable experience and cultural familiarity” in dealing with immature market conditions. In other words, LCs have closer relations with local distributors and subsidiaries, and are familiar with how to tackle with highly fragmented distribution channels and underdeveloped logistics networks; they have longstanding relationships with government officials; they are more flexible in face of institutional voids and information insufficiency which pervade in emerging markets; and they hold priorities of natural and labor resources. It is not easy for MNCs to simply replicate or imitate all these capabilities and experience that LCs have.

In particular, consumers in emerging markets are often segmented into four tiers: global, glocal, local and bottom. Consumers of *global segment* are characterized by preferring products with global quality, global features, world-class brand and west-countries’ cultural value, as well as willing to pay a premium price; *glocal segment* refers to those consumers who want to have products with global quality but with local features at less-than-global price; *local segment* involves those who are in favour of local products with local features at local price, as they have traditional attitudes and beliefs that LCs are more trustful suppliers in terms of competitive price, superior service, timely delivery and efficient response in comparison with MNCs; lastly, *bottom tier* covers customers who can only afford basic products. Therefore, LCs as the defender should offer unique products and services especially to their target customers, instead of imitating foreign MNCs’ products or trying to cover all customers. That is, LCs provide glocal, local and bottom customers with unique products according to their special requirements. However, as a result, they might ignore the global consumer segment. Noteworthily, there is a tendency that “consumers are expressing a return to their roots, reconfiguring global goods and their meanings to better fit local culture and, especially, mixing the old and the new from disparate sources.” Therefore, as the revival consumption tendency --- localism has become predominant gradually, LCs deserve a sound opportunity to grow further.

The following two examples concern LCs whose behaviors are consistent with the logic of defender strategy.

---

227 These four categories and the following content come from Khanna, T. and Palepu, K. G. (2006), pp. 63-65
228 Ger, G. (1999), p. 65
A successful example is the case of Bajaj Auto (hereinafter Bajaj), India’s largest producer of scooters, defended its turf against Honda by focusing on meeting the special demands of local customers. With the opening up of automotive industry in India, Honda has aggressively entered this market with a local JV partner to sell scooters, motorcycles, and other vehicles on the basis of its superior technology, quality, and brand appeal. However, Bajaj concentrated on customers who wanted low-cost, durable scooters and easy access to maintenance in the countryside by launching a series of strategic approaches: they designed a rugged, cheap-to-build scooter for India’s rough roads, invested more in R&D to improve reliability and quality, and created extensive distribution channels and roadside-mechanic stalls. Bajaj’s defensive strategy enabled itself to beat Honda, and successfully maintained its market share of over 70 percent, while Honda captured only about 11 percent. Finally, in 1998 Honda announced that it withdrew from its scooter manufacturing JV in India.229

Another prominent situation in Indian also reveals that a successful defender strategy can be achieved by capitalizing effectively on local assets, like human resources. Some Indian Information Technology (IT) players, such as Tata Consultancy Services (TCS), Infosys Technologies, Wipro Limited, and Satyam Computer Services, are competing actively and successfully against foreign MNCs, partially because of their priorities in attracting domestic human resources. On the one hand, India’s education system cultivates many engineers and technical graduates every year; on the other hand, local Indian IT companies know how to recruit the talent all over India and maintain them even if their salaries are lower than those of foreign MNCs. By comparison, it is very difficult for foreign MNCs with no such background to get the right person with right skills, as the level of people’s skills and quality of educational institutions vary greatly in India, and the encouragement system and motivation for employees are different from those in foreign MNCs.230

In a word, the essence of the defender involves exploiting and capitalizing on those comparatively competitive advantages, “leveraging local assets in market segments where multinationals are weak”231, and avoiding the head-on militancy with foreign MNCs. By focusing on defender strategy, it is unquestionable for LCs in emerging markets to achieve a promising business, especially when the local market size is considerable.

2.2.4.2.2 Extender

LCs with transferable assets can adopt this strategy when the globalization pressure is weak. Adopting an extender strategy is expected to benefit from geographic expansion, i.e. from local to national, from national to international, and from international to global level.

The fundamental of the extender strategy is applying what LCs have achieved at home as a base for extending into a limited number of other analogous markets. Generally speaking, assets that work for defenders in domestic markets may also work in similar markets abroad. Specially speaking, LCs may extend their footprint in the following three ways. First, they look for new analogous market territory at home, which they have ignored before; second, they expand business beyond their national borders and seek for the similar markets with analogous resources and conditions in terms of “consumer preferences, geographic proximity, distribution channels, or government regulations”\(^\text{232}\) in other emerging countries; third, by stretching the concept of analogous markets, LCs may expand their operations not only into other emerging markets but also into those developed markets, and exploit new markets there based on their sound competences and advantages on their home turf.

A representative example is Marico Industries Ltd. (hereinafter Marico), a midsize Indian manufacturer in fast-moving consumer goods sector for beauty and wellness. Marico obtained significant achievements in domestic markets, by focusing on the customer, product innovations, a wide-ranging distribution network, and cost management. With the tough economy and increasing competition from foreign MNCs, no other companies in this sector obtained double-digit growth like Marico, and its nine major brands held leading market positions, mostly first and second place. In recent years, to reduce its reliance on its three biggest brands, Marico has deployed a long-range business strategy by introducing more brands and more value-added, affordable product enhancements. The most important thing is that Marico intended not only to penetrate more deeply into India’s rural areas, where 70% of the population is located and competition from foreign MNCs is rare, but also to expand internationally. On the one hand, in order to reach more areas of the nation, especially those remote locales, Marico sold its products to about 1,000 distributors. Then these intermediaries store sell and deliver directly to 1, 6 million retailers or indirectly to

\(^\text{232}\) Dawar, N. and Frost, T (1999), p. 124
2,500 stockists. Finally, Marico’s products reach rural consumers effectively. On the other hand, Marico started to cross national border by concentrating on those international markets where there were a number of Indian with product preferences which are similar to the domestic market and then capitalizing on this as a platform to expand further. Today, Marico’s international business is among the top three Indian consumer goods companies and its products are sold in more than fifteen countries in the Middle East and the Asian sub-continent.\footnote{Case comes from Yip, G. (2005), p. 2; Shah, J. and Pantages, A. (2003), pp. 3-10}

Karel, a Turkish company selling switchboards, was established in 1986 in order to meet a big demand for low price telephone switchboards in small offices and rural areas in Turkish domestic market. On the basis of its success at home, Karel became globalization by selling innovative PBXs, PBX add-ons and other complementary products to around 22 countries, such as Poland, Hungary, Romania, Jordan, Tunisia, Egypt, Iran, Greece, Portugal and even the USA.\footnote{Case comes from Ger, G. (1999), pp. 78-79}

Another successful example of adopting extender strategy is Singaporean-owned Yeo’s. As it was forecasted that the ascending room for local demand was limited, Yeo’s began to expand its business regionally, then globally after having achieved some successes in the local marketplace during 1960s and 1970s. Today Yeo’s manufactures and distributes its soft drinks, canned foods, and snacks to several overseas markets.\footnote{Case comes from Ewing, M. et al. (2001), p. 53}

In a word, the essence of extender strategy is for the sake of a long-term growth, a LC replicates its success at home into a broader geographical area whose market conditions in terms of political climate, regulatory environment, economic development, cultural background, etc. are similar to its domestic ones.

### 2.2.4.2.3 Dodger

LCs occupying the dodger quadrant are located in a highly precarious position. That is, they are vulnerable to global competition, and in the meanwhile, they haven’t transferable competitive assets. In order to avoid suffering from tough competition, LCs have no option but to dodge through any of the following several possible options.
The first option available to LCs is to find a way to cooperate with their more powerful foreign competitors in the context of “pro-cooperative attitudes”\(^{236}\). Under the circumstances, either setting up a JV with foreign MNCs or selling totally out to foreign MNCs makes much sense.

Actually, in emerging markets there are numerous cases of implementation of the dodger strategy. For instance, since the economic liberalization, Peruvian family businesses have been gradually lost their home turf with the entrance and expansion of foreign capitals. In face of an untenable situation, Banco Wiese, one of the major banks established by national capital, was sold to an Italian financial group in 1999. In 2002, beer company Backus, which absorbed all national breweries and enjoyed a monopoly in the national markets, was acquired by Colombian company that aims to integrate the regional market.\(^{237}\) There are also many local Polish companies that have shifted their strategies to the dodger strategy with the introduction of free market economy. For example, Polar, a Polish domestic appliance manufacturer, sold a majority of its stake to the Brand Moulinex group firstly. Now the company is owned by Whirlpool, a global appliance producer. Although this company was acquired by foreign capital, Polar’s products such as washing machines and refrigerators are still present in the market, as Polar’s brand image was very strong in the Polish and Central European markets. Last but not least, Wrozamet S.A., which sells domestic appliances under the brand of Mastercook, has achieved impressive development since 1999 due to its two Spanish strategic investors: Fagor Electrodomesticos and MCC Inversiones S. Coop.\(^{238}\) In brief, by adoption of the dodger strategy, the above-mentioned emerging companies successfully escaped from intensive competition that derived from foreign giants’ invasion, and achieved a key breathing space for further development.

Besides selling to and cooperating with foreign MNCs, there are some other strategic options which enable LCs to compete against foreign MNCs under the dodger strategy. These options involve firstly, LCs can “redefine their core business”\(^{239}\). That is, to avoid head-to-head with foreign MNCs, LCs focus on penetrating those markets where MNCs have weak positions or have no business activities so far; alternatively, they can supply the products that can either complement foreign MNCs’ offerings or adapt them to local

\(^{236}\) Gorynia, M. et al. (2005), p. 61  
\(^{237}\) These two Peruvian cases come from Shimizu, T. (2004), pp. 3-4  
\(^{238}\) These two Polish cases come from Gorynia, M. et al. (2005), p. 64  
\(^{239}\) Dawar, N. and Frost, T. (1999), p. 125
Thirdly, they can shift the business to those value-chain links where they still have competitive advantages that make LCs outmaneuver foreign well-heeled MNCs, and this involves extensive distribution networks or after-sale service tailored to local demands.

There is a representative example of how Russian PC maker Vist dodged the incursions of global players such as IBM, Compaq into their domestic markets. Foreign MNCs mainly focused on big cities, Vist has extended into the interior of the country through exclusive distribution agreements with selected local retailers. Besides, foreign MNCs offered extended service contracts, while Vist provided customers with lengthy warranties by its company-owned full-service centers in many Russian cities. Furthermore, Vist was concentrating on assembling very low-cost models. All those actions Vist taken to dodge foreign competition were well suited to the Russian computer market, where the PC industry was still in its initial stage and thereby was characterized by requiring much more information and easy access to maintenance. As a result of employing dodger strategy, Vist maintained the market leader position, with a market share of 20 percent.

It is not hard to find other examples. Inventec Corporation is a Taiwanese manufacturer of notebook computers, PCs, and servers. In addition to serving the needs of HP and Toshiba, Inventec has begun to sell computers in Taiwan and China mainland with its own brand name. Inventec would not compete directly against foreign MNCs as Inventec’s computers are equipped with operating system and software in Chinese. Pizza Point is a local Andhran chain of pizza restaurants in Southern India. Although this industry has been globalized, Pizza Point competes in product categories local to the home markets and thereby can take advantage of local cultural capital. Inter Groclin, a Polish company, has obtained a 5 percent share of European market through concentrating on the production of car upholstery for international automotive corporations.

---

244 Case comes from Eckhardt, G. M. (2005), pp. 57-79
245 Case comes from Gorynia, M. et al. (2005), p. 64
2.2.4.2.4 Contender

The contender refers to LCs with transferable assets and a high pressure to globalize their business. Contending actively and directly with foreign MNCs is an effective means for emerging companies and some established brands to expand business. When protecting their home turf, contenders can compete against foreign MNCs on a global basis by concentrating on a locally oriented link in the value chain. Advantages for LCs can be obtained by investing more in R&D, establishing large-scale production and raising money through offering a stock. Furthermore, “for would-be contenders that lack access to key resources, finding a distinct and defensible market niche is vital.”\(^\text{246}\) With fierce competition in emerging markets, LCs might become untenable finally and seldom have long-term and promising future by merely relying on defence.

Mahindra & Mahindra Ltd. (hereinafter M&M), a leading Indian company in the Automobile-Tractors sector, is a representative example to illuminate how an emerging market company can win top honours ahead of global best sellers by focusing on market niche. India started to integrate itself into global economy in 1991, and since then, its automobile industry has experienced a rapid change and become one of the most competitive automobile markets in the world and a major export base for automobile components, which accordingly attracted most of global players to present there. Global giants such as Mercedes-Benz and Toyota concentrated on passenger vehicle segment and targeted Indian urban market, which resulted in an intensive competition there. Facing foreign invasion by aggressively launching new products, M&M has gradually lost its market share in India. Although it had a wide product range comprising passenger vehicles, commercial vehicles and tractors, M&M focused mainly on Indian semi urban and rural markets, where demand seemed to be almost saturated, and meanwhile, M&M lacked especially tailored offering to the needs of modern urban consumers. In order to contend with global players and also to occupy the void in urban market, M&M rapidly upgraded its manufacturing technologies by setting up an R&D centre. Furthermore, it launched a Project Scorpio which demonstrated that M&M would not directly participate in the car market, but would focus on its farm equipment sector: the utility vehicle market niche in both India and global market. With good performance in domestic market, M&M made a

forward movement to become a global niche player by setting up joint ventures in markets such as Spain, Italy, South Africa, Indonesia, and Russia.\(^{247}\)

In order to compete against foreign MNCs effectively and efficiently, LCs can reshape themselves to emerging giants through upgrading their own capabilities. The development of the Acer Group (hereinafter Acer) in the past 25 years is a very representative example which has been widely used to examine how an emerging company grows to become a global MNC through reformulating its corporate strategies and readjusting its organizational structure. Acer was established as a local Taiwanese company in 1976, producing and selling PCs as well as marketing a wide range of IT and Internet enabling technologies, products and services in many different countries. Competing in the rapidly changing IT industry, Acer has already reconstructed itself and modified its corporate strategy three times since the early 1990s, CEO Stan Shih said that Acer needed to be flexible and adaptable to grow its business. In the start-up stage from 1976 to 1991, Acer adopted gradual diversification and globalization. Its diversification strategy went closely with its steps towards globalization, through the acquisition and relocation of part of its manufacturing process offshore. In response to the changing industrial environment and its internal development, the first reorganization of Acer was the application of a fast food business model for making computers and a supporting Client-Server organizational structure. And its second reorganization was characterized by gradual streamlining of its hardware and components business and positioning itself as an Internet Enabler in Asia as well as implementing a new version of the client-server organization structure called the Internet Organization. After its third reorganization, Acer achieved a successful transformation from a manufacturing business group to a service provider. All Acer’s movements reveal its constant evolvement of adaptability to the changing markets and adoption of a simplified, focused, and forward looking approach. Finally, Acer has developed from a local Taiwanese company concentrating on the manufacture of computers and peripherals to a MNC manufacturing and marketing a wide range of IT technologies, products and services in different parts of the world.\(^{248}\)

To sum up, LCs’ survival strategies can be achieved by either internal development or forming strategic alliances. The aforementioned research concentrates on four generic

\(^{247}\) Case comes from Jejurikar, R. and Nakra, V. (2001), pp. 1-7

\(^{248}\) Case comes from Poon, T. S. (2002), pp. 82-97
strategic options: defender, extender, dodger, and contender in the context of without strategic alliances. Subsequently, as Dawar, N. and Frost, T. (1999) pointed out in their research the importance of strategic alliances for LCs facing the threat of foreign MNCs, the following research will focus on four derived strategic alternatives in the context of strategic alliances. Accordingly, the theoretical framework is extended into a broader one that covers not only four generic alternatives without strategic alliances but also other four derived alternatives with strategic alliances.

### 2.2.4.3 Options of Resistance Strategies with Strategic Alliances

Under the pressures of globalization and increased competition, any company, regardless of its size or age, can not hold all the resources and competences which ensure that the company’s corporate strategy is implemented in each aspect, phase and area efficiently and effectively. To address this issue, forming strategic alliances with one or more firms in the same or related industries is regarded as a strategic necessity rather than just a planning. Based on the previous study in this regard, a strategic alliance either in a passive or an active way is very useful especially for small companies. The reasons are twofold: on the one hand, strategic alliances help firms catch new opportunities through bypassing their comparatively weaker aspects and offering them complementary resources; on the other hand, to some extent, it is better for a firm to survive by collaborating with competitors than to die out after brutal competition.

A strategic alliance can be divided into different types depending on various criteria. According to the nature of management resources to be exchanged, strategic alliances can be divided into two categories: *symmetrical alliance* and *asymmetrical alliance*. If the resources being contributed into an agreement from both sides are the same, this refers to a symmetrical alliance; if different, then an asymmetrical alliance. An asymmetrical alliance is expected to be more effective for companies to gain their missing resources from the partners. Alternatively, according to various scale and scope of resources and

---

250 Yasuda, H. (2005), pp. 2-3
competences contributed by involved partners, strategic alliances can be classified into two categories: “endogamic and exogamic” cooperation. Exogamic alliance is thought to be more difficult than endogamic one, as the involved partners are greatly diverse in many aspects regarding objectives, size, structure ownership, culture, and management styles.

Strategic alliances can be formed not only between LCs and foreign MNCs, but also among LCs themselves as a competitive deterrent. In general, the former refers to asymmetrical and exogamic alliance, while the latter refers to symmetrical and endogamic alliance. Accordingly, strategic alliances between LCs and foreign MNCs will be more complex than those among LCs themselves, but will offer LCs more competitive advantages through the effective use of resources owned by foreign MNCs. Cooperation among LCs as a strategy to deter foreign MNCs’ entry will not be considered in this research. Accordingly, the term “strategic alliance” will be used only for describing the cooperative relationships between emerging market companies and foreign MNCs.

The number of strategic alliances between LCs and foreign MNCs has been increasing in the past few years and is expected to increase even more in the future. For emerging markets companies, strategic alliances are thought to be more important for their long-term survival and prosperity toward a global player than for foreign MNCs. Strategic alliances can be formed in several ways, such as JVs which are either equity JV or LCs keep a minority stake, licensing agreements, manufacturing, distribution and supply agreements, R&D partnerships, marketing, and technological exchanges. Each strategic alliance contains one, or a combination of, or all of those agreements.

Strategic alliances between LCs and foreign MNCs are expected to bring the following benefits to LCs: developing new markets (domestic or international), developing new products, developing and sharing technology, combining complementary technology, pooling resources to develop a production/distribution facility, acquiring capital, executing government contracts, and accessing to new distribution channels, networks or sales and

252 Adapted from Jaffe, E. D. et al. (2005), p. 191
253 Ibid.
254 Likhi, D. and Sushil (2005), p. 30
marketing. However, LCs may provide foreign MNCs pursuing their own growth opportunities with “a local business network, government contacts, and knowledge of local markets, established channels, an agile decision-making process, and more”.

It is worthy to note that strategic alliance on R&D is particularly valuable for LCs in a knowledge-driven economy, as most of LCs are lagging far behind their foreign counterparts in this regard. It seems very necessary for LCs to strategically ally with foreign MNCs either in a passive or an active way, though this might bring the risk that LCs lose their own identity. The reasons are twofold: on the one hand, it is better for LCs to survive and even grow by collaborating with competitors than just die out after brutal competition. On the other hand, strategic alliance does improve LCs’ competitiveness by accessing to key skill and organizational learning. Moreover, “collaboration helps to limit competition and can provide a means for a group of small firms to compete more effectively against large firms in an industry.” In a word, strategic alliances and the abilities to adopt alliance strategy are considerably essential for emerging market companies to succeed.

According to Dawar and Frost (1999), LCs using any of those four generic strategies to resist foreign MNCs’ entry and expansion into their markets can benefit from forming alliances; however, the motivations and structure of these alliances will differ according to which strategy they adopt. In other words, defender, extender, dodger, and contender need to employ its distinct alliance strategies according to their type of corporate strategy formulated based on external globalization pressure and internal transferable assets. Therefore, the generic matrix concerning four strategies without strategic alliance is extended into a broader framework that covers another four strategic options with strategic alliances, which refer to defender 2, extender 2, dodger 2, and contender 2, as shown in figure 2-21 below:

---

255 Likhi, D. and Sushil (2005), p. 30
256 Kim, D. et al. (2003), p. 28
258 Ibid., p. 127
2.2.4.2.1 Defender

For defenders that don’t have a high globalization pressure and whose competitive assets are limited to home markets, forming strategic alliance is “an effective strategy and means in which they can enhance their market positions”\(^{259}\) by focusing resources on their specific competences and market segments, and meanwhile, gaining their missing resources from foreign MNCs as alliance partners.

Based on these objectives, defenders more often enter into vertical cooperative strategies with other LCs in terms of raw materials, supply logistics, marketing and sales, distribution sector and human resource management in order to enhance defenders’ competitive advantages tailored to local needs. Besides, they also put emphasis on forming foreign partnerships to complement their insufficiencies in R&D, distribution, or services. However, defenders tend to keep a low level of interdependence in alliances with foreign

MNCs for the sake of maintaining their key control over products.

India’s Wipro Limited (hereinafter Wipro), founded in 1945 as an agro-based industry, has diversified into one of leading IT companies in India. In the IT industry, Wipro has become an active alliance player after experiencing 32 alliances from 1992 to 2002. At the earlier stage of Wipro’s alliance activity (1992-1996), the form of many agreements was JV. It is assumable that Wipro would have taken the form of JVs to reduce the risk of uncertainty and increase the possibility for a successful alliance. Since 1997, Wipro has intended to enter into partnerships with firms from other countries, mostly from America. Since 1999, Wipro has tended to partner with domestic firms rather with regional players. A prominent reason in doing so is to maintain an active player in India’s IT industry by reducing its dependency on foreign support and technology. After Wipro achieved market recognition and experience, alliance agreements took other forms that allowed greater autonomy to exist. In short, alliance activities enable Wipro to enhance its market position in India by increasing domestic partnerships and attracting large American software companies to use Wipro’s services.²⁶⁰

Here is another example from different industry. AIPM is an Israel’s company producing disposable diapers and other paper products. It occupied a dominant market position in Israel, accounting for 35 percent of domestic paper and board consumption. However, its local brand of diapers could not compete against that of Proctor & Gamble, one of its major foreign rivals, because of the inferior marketing budget and expertise. Under the circumstances, when another major foreign rival Kimberly-Clark entered to Israel in 1996, AIPM decided to form a JV between its subsidiary Hogla and Kimberly-Clark, holding 50.1% and 49.9% stake respectively. The Hogla-Kimberly JV intended to defend itself against P&G by presenting the Huggies brand in domestic market. And this new brand had rapidly gained 38 percent market share by 2003, outperforming not only the brand offered by P&G but also the local brand Titolim which held 20 percent. A total 58 percent market share undoubtedly pushed AIPM to be the market leader in this industry.²⁶¹

²⁶⁰ Case comes from Vivio, N. J. (2004), p. 4
²⁶¹ Jaffe, E. D. et al. (2005), p. 190
2.2.4.2.2 Dodger

For dodgers that face high pressure to globalize and whose competitive assets are also limited to home markets, forming strategic alliances seems to be the only way for them to survive, as long as they are not sold out to MNCs. Meanwhile, strategic alliance is an effective way to quickly fill gaps in dodgers’ capabilities “as they move to a different part of the value chain and redefine themselves”\(^{262}\). However, dodgers’ strategic alliances can be represented either in a passive or an active way. A passive alliance is, to some extent, “subservient” to the objectives of partners. Yet an active alliance is still crucial for LCs to play as dodger in the course of their immature stage. For example, Taiwanese Inventec Corporation served the needs of HP Compaq and Toshiba before selling under its own BESTA brand name in Taiwan and the mainland China.\(^{263}\)

2.2.4.2.3 Extender

For extenders that have competitive resources can be transferred abroad and attempt to operate in the global market as impressive competitors, forming strategic alliance is a critical and powerful means for their continual expansion. Particularly, a cross-border strategic alliance works as an essential way for extenders to leverage core competencies that are the foundation of its domestic success to expand into international markets, especially in the early stage of the firms’ geographic diversification efforts.\(^{264}\) Through well-chosen strategic alliances, extenders gain access to different forms of resources in terms of capital at a reasonable cost, technological capability, partners’ rich experience and knowledge, or a unique distribution network. However, cross-border strategic alliances are more complex and risky than domestic strategic alliances.

Again, take Indian M&M as an example. Since it started to expand its footprint as a global niche player, M&M has reached Spain, Italy, South Africa, Indonesia, and Russia through setting up JVs. Recently, M&M has performed a strategic entry into Iran with an alliance

---

\(^{263}\) Khanna, T. and Palepu, K. (2004), p. 10
\(^{264}\) Hitt, M. A. et al. (2005), pp. 285-287
with ITMCo which is a government-owned company and the largest tractor manufacturer in Iran. Under the agreement, M&M intended to supply tractors through ITMCo’s channel in Iran and to develop tractors that would be ideally suitable for the tough local conditions. M&M is the first Indian tractor company to enter into a strategic alliance of this nature in Iran which is one of the biggest tractor market regions after India, the USA and China. And Mr. Anand Mahindra, the vice-chairman of M&M has won many awards for his entrepreneurial initiatives, for example, developing best practices and carving out powerful businesses in the global economy.  

Take another example of beer industry. San Miguel Beer is a leading domestic company in Philippines. Its origin lies in a Filipino brewing and distilling company over a century ago. However, this company has reached many areas of Southeast Asia and even parts of Australia, by setting up production facilities and JVs in Hong Kong, mainland China, Vietnam, Indonesia, Australia, Japan and somewhere else, and has occupied the 90% market share of the Filipino market. We see that the same domestic strengths were successfully transformed into a gradually expanding regional presence.

2.2.4.2.4 Contender

For contenders with transferable assets and facing a high pressure to globalize, strategic alliance is therefore a powerful vehicle for their dramatic growth in the global arena. Through forming strategic alliances with foreign MNCs from complementary industries and other industries, contenders obtain competitive positions over their competitors by accessing to advanced technologies, leveraging low-cost manufacturing or capitalizing on a unique distribution network.

For instance, Korean Samsung has experienced several hundred technology licensing arrangements and JVs before it became a world-class electronics company. These alliances concentrated on technology and skills, as listed in figure below:

265 Case comes from Anonymous (2006c), pp. 1-5
266 Case comes from Khanna, T. and Palepu, K. (2004), p. 21
267 Case comes from Adarkar, A. et al. (1997), pp. 120-137
Similar examples are easy to find. Taiwanese Acer made and sold PCs for sale under leading companies’ brand names in the United States, Japan and Europe before becoming an impressive contender; Indian M&M was licensed by Peugot to manufacture diesel engines, just to name a few.

To sum up, foreign MNCs are seeking opportunities in emerging markets for growth; meanwhile, emerging market companies are seeking to integrate themselves into global economy. Under the circumstances, strategic alliance is regarded as a constructive means for both players. However, it is always crucial for LCs to figure out how to formulate appropriate alliance strategies based on different natures and types of their resistance strategies.

2.2.4.4 Summary

The aforementioned four generic alternatives resistance strategies along with four derived ones should not be regarded as several simple, still and isolated recipes for LCs’ survival
and success in face of foreign giants’ invasion and expansion in their home markets. Rather, LCs’ strategic decisions on those strategies have to keep sufficient flexibility to “manage transitions”\(^{268}\), that is, the evolving relationship among LCs’ intended objectives, external environment and internal competitive assets. According to Dawar and Frost (1999), not only do LCs’ strategies evolve over time, but the nature of their located industries may change too.\(^{269}\) Therefore, keeping high flexibility in choosing survival strategies plays a significant role in LCs’ long-term prosperity. Concretely, from a dynamic perspective, the capability of keeping flexible can be represented by the following two possibilities.

One is that LCs may take different strategic options in response to different kinds of foreign competitors, as natures and modes of foreign MNCs’ presence in emerging markets are diverse in a given time period. Normally, foreign MNCs’ entry into emerging markets tends to seek a market for their products, a production site, and source of materials, components, or technology, however, different models of entry are closely and directly related to the responsive patterns and resistance strategies LCs adopt. By and large, foreign MNCs are classified into three categories: firstly, MNCs enter into emerging markets through forming strategic alliances mostly with LCs, and thus foreign MNCs obtain resources which can complement their own insufficiencies, like local market knowledge and experience, well-established relationships with supplier and distributors, and government contacts.\(^{270}\) Meanwhile, their modes of entry depend on the partners’ needs. In response to these foreign MNCs, LCs choose from those four derived resistance strategies with strategic alliance, and in return gain resources from foreign MNCs. Secondly, foreign MNCs enter emerging markets without alliance and accordingly put pressure on LCs.\(^{271}\) In this instance, LCs choose from those four generic resistance strategies without strategic alliance in order to dodge, defend themselves against and contend with MNCs or to make cross-border expansion. Thirdly, foreign MNCs may pursue their own wholly-owned venture after obtaining a good awareness of local market through previous alliances.\(^{272}\) In short, LCs’ strategic options should always keep involving in tandem with the nature of

\(^{269}\) Ibid.  
\(^{270}\) Kim, D. et al. (2003), pp. 24-25  
\(^{271}\) Ibid., p. 26  
\(^{272}\) Ibid., p. 27
competition strategies used by MNCs in emerging markets after their entrance.

The other possibility is that a LC may take different strategic options in tandem with its changing external and internal environment. That is, a LC goes through these eight strategic options in its various developing stages, in which each strategic option plays a different role in competing against foreign counterparts.

Inca Kola introduced in 1935 is a very successful cola soft drink made in Peru. It has experienced various developing stages from a defender to an extender and finally to an active dodger. In early years, Inca Kola defended itself against Coca-Cola and Pepsi successfully by positioning itself as a traditional Peruvian drink. At that time, all the advertising media were used to advocate the identification of local David against the red-labeled Goliath from the United States, along with many impressive slogans, like “There is only one Inca Kola and it’s like no other”, “It’s Ours!”, or “Made of National Flavor!” This series of local resistant responses brought Inca Kola 38% market penetration by matching the needs of those customers who are traditional and are proud to have essentially local products. After Pepsi experienced a severe damage by launching “Pepsi Challenge” in which customers were invited to taste cola without label and then point out which are their favorites, only two rivals were left in Peru to compete in the soft drink wars: Coca-cola and Inca Kola, occupying 21% and 35% market share respectively. Furthermore, based on the unique taste and fierce customer loyalty, Inca Kola started to tap other places. Its expansion strategy relied on selling the product to those areas where the large population of Peruvians was located, such as New York City and Los Angeles. Then, they also aimed at other ethnic groups and main markets. In the process of expansion, many partnerships with foreign companies were formed to bring convenience for its international distribution. In 1997, the Coca-Cola Company began to negotiate with Inca Kola and intended to buy it out. As Inca Kola also looked for a partner, a deal was established in 1999, where a JV agreement was forged for foreign markets, whereby Coca-Cola would use its marketing power to push Inca Kola in other countries. Finally, all Coca-cola products as well as Inca Kola occupied a combined market share of around 60%, and the
rest of markets were filled with other smaller emerging companies like Kola Real, Peru Cola, Cola National which focused on low-end markets.\textsuperscript{273}

In conclusion, strategic options of LCs facing foreign MNCs’ incursion and expansion in their emerging markets depend not only on the external macro- and micro-environment, but also their internal competences and resources. After all, there are few LCs that can compete aggressively against foreign giants on a global basis by reshaping themselves into emerging giants. Most LCs are concentrating on their competitive advantages in domestic markets, and meanwhile, keeping a close watch on other markets abroad. However, LCs’ resistance strategies keep evolving in tandem with the rapidly changing environment.

Therefore, facing tougher competition featured with eat-or-be-eaten, LCs \textit{firstly} have to try their best to build their core competences, as the higher level LCs position in the food chain, the less possibility to be eaten. \textit{Secondly}, LCs should be flexible in response to rapidly changing market opportunities. \textit{Thirdly}, the reacting speed is also crucial for LCs, as the question “how can you let a stone float on the water?” asked by Zhang Ruimin, CEO of Haier Group, and the answer is “speed”.\textsuperscript{274} Similarly, Bill Gates, the former CEO of Microsoft, always says that Microsoft will be ruined in 18 months. These enterprisers reveal fully the importance of reacting speed. Further, realities also prove that “smaller competitor can rise to the challenge and prevail”\textsuperscript{275}, such as David against Goliath, Kola Real against Coca- and Pepsi-Cola, and Lenovo against Dell. And in chapter 4, the main section of this dissertation, representative cases of local Chinese companies in selected consumer goods industries will be studied in detail in order to analyze what the alternatives resistance strategies LCs choose and how they implement these choices. We will see that some successful resistance strategies of local Chinese companies against foreign competition are regarded as the adoption of one or a combination of Dawar and Frost’s strategy typologies.

\textsuperscript{273} Case comes from Lyman, E. J. (1998)
\textsuperscript{274} Du, Y. P. (2003), p. 122
\textsuperscript{275} Dawar, N. and Frost, T. (1999), p. 129
3 Analyzing the Marketing Environment of Domestic Actors in the Chinese Consumer Goods Market

On the basis of the significance of environment analysis in formulating strategy which is examined in the previous theoretical framework, this chapter focuses on analyzing the marketing environment of domestic actors in the Chinese Consumer Goods Market (CCGM) in the following four parts. Firstly, it begins with a detailed examination of Chinese Consumer Goods Companies (CCGCs), including a brief description of consumer goods and consumer goods companies in the global context, types of CCGCs, and major players in the CCGM. Secondly, four major macroenvironmental forces including political/legal, economic, sociocultural, and technological forces will be presented. Thirdly, following macroenvironment, microenvironment will be further examined, encompassing the characteristics of the CCGM and the main domestic actors such as Chinese consumers, foreign competitors, and distributors. Finally, an overall evaluation of CCGCs’ strengths, weaknesses, opportunities, and threats will be summarized as a conclusion of this chapter.

3.1 Chinese Consumer Goods Companies

This section begins with an introduction of consumer goods concerning its definition and typology as well as a description of the current situation of consumer goods companies in the global arena. Subsequently, great attention will be paid to CCGCs by introducing their types and major players in the CCGM.

3.1.1 Consumer Goods and Consumer Goods Companies

3.1.1.1 Definition and Typology of Consumer Goods

Goods, which circulate in the markets, consist of consumer goods, industrial goods and services. Generally, industrial goods are not used in family, such as machinery, equipment,
raw material, fuel etc. Service refers to a non-material equivalent of goods. Thereinto, consumer service directly faces families, such as haircut, education, etc. The typology of goods can be illustrated in figure 3-1 below:

**Figure 3-1: Typology of Goods**

![Diagram of Goods Typology](image)

Source: self-designed on the basis of the research

Consumer goods refer to final goods that are ultimately and directly consumed in mass market to meet human wants, rather than used for resale, production and manufacture. As shown in the above figure, consumer goods can be classified into two sub-categories: Non-Durable Consumer Goods (NDCG) and Durable Consumer Goods (DCG). Thereinto, NDCG refer to Fast Moving Consumer Goods (FMCG), which are also called Packaged Mass Consumption Goods (PMCG). FMCG/PMCG industry can be further categorized into Fast Moving Manufacturing (FMM) and retailing. Thereinto, FMM generally includes personal care, family care, package food and beverage, and cigarette and alcohol.

NDCG and DCG differ in terms of conception, sort, characteristics and consumer buying habit, which are listed as follows:
### Table 3-1: The Comparison between NDCG and DCG

<table>
<thead>
<tr>
<th></th>
<th>NDCG (FMCG or PMCG)</th>
<th>DCG</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conception</strong></td>
<td>Lifetime is shorter and consumption speed is quicker.</td>
<td>Lifetime is longer and can be used repetitiously.</td>
</tr>
<tr>
<td><strong>Sort</strong></td>
<td>Food, tobacco, wine, beverage, commodity, etc.</td>
<td>Home appliances, apparel, furniture, recreational products, automobiles, housing, etc.</td>
</tr>
<tr>
<td><strong>Basic Characteristics</strong></td>
<td>Unit value is lower; Shorter consumption cycle and rapid replacement; Convenient good, one-off usage, lower price, and location convenience-sensitive;</td>
<td>Unit value is higher; Longer consumption cycle (usually more than 2 years) and slow replacement; Long usage time, repetitious usage, higher price;</td>
</tr>
<tr>
<td></td>
<td>Visual goods, easy to be effected by atmosphere;</td>
<td>Buying behaviour and decisions are careful and rational;</td>
</tr>
<tr>
<td></td>
<td>Low degree of brand loyalty, easy to change among different brands, and high price-sensitive;</td>
<td>High degree of brand loyalty;</td>
</tr>
<tr>
<td></td>
<td>Little after-sales support required.</td>
<td>More after-sales support required.</td>
</tr>
<tr>
<td><strong>Consumer Buying Habit</strong></td>
<td>Simple, speedy, impulsive, and sensitive.</td>
<td>Complex, careful, considerate, and rational.</td>
</tr>
</tbody>
</table>

Source: self-summarized from Anonymous (2006d)

Accordingly, Consumer Goods Market (CGM) or final consumer market refers to the market in which individuals and families purchase product/service for their own usage. Consumer goods markets are characterized by 1) small-scale purchase; 2) repetitious purchase; 3) tremendous market diversification; and 4) purchasing behaviours of most purchasers are unprofessional.

### 3.1.1.2 Consumer Goods Companies in the Context of Globalization

The consumer goods industry is “second only to the high-tech industry in its dynamic rate of change and accelerated product life cycles”.

---

plagued by high customer concentration, vicious cycles of price reductions that cause supply chain complexity and the ever expanding deduction problem”\(^{277}\).

Consumer Goods Companies refer to manufacturers that design, manufacture and/or market NDCGs or DCGs, such as linens, apparel, cleaning products, manual tools, home furniture, housewares, and consumer electric appliances.\(^{278}\)

In the context of globalization, consumer goods companies are rapidly evolving from traditional manufacturers that focused on improving productivity and cutting cost to modern ones that concentrate on innovating technology and establishing collaborative business relationships.

Globalization refers to crossing national boundaries, that is, the flow of goods, capital, information/technology and people across national borders.\(^{279}\) Globalization has made a strong impact on most industries. The consumer goods industry was long thought to be less influenced by the impact of globalization, as the barriers of transportation cost, shelf life, and consumer preferences can protect the local markets.\(^{280}\) However, “due to low labor costs, offshore manufacturers are delivering products to the local market at a lower price than domestic or even local manufacturers can achieve”.\(^{281}\) Therefore, the wave of globalization will inevitably lead worldwide consumer goods companies into a hypercompetitive and ever-changing business environment in which there exist numerous opportunities and challenges.

On the one hand, the globalization offers consumer goods companies the opportunities to explore new markets.\(^{282}\) On the other hand, today’s consumer goods manufacturers are facing drastic challenges, including the increasing manufacture costs, a set of powerful retailers, the rise of private label and discount labels, the intensifying competition from some agile and small competitors, a group of increasing sophisticated and value-driven

\(^{277}\) Tao, G. and Eldridge, E. (2005), p. 4 
\(^{278}\) Jeffreys, J. R. (2006), p. 3 
\(^{279}\) Chow, G. C. (2005), p. 1 
\(^{280}\) Thompson, O. (2006), p. 5 
\(^{281}\) Ibid. 
\(^{282}\) Ibid.
consumers, the declining productivity of traditional marketing, the increasing difficulties in search of talents, and so on.\textsuperscript{283}

Under the circumstances, the greatest challenge for some consumer goods companies is simply to survive.\textsuperscript{284} In order to benefit from globalization, to defend against the above-mentioned challenges and to ensure a long-term sustainability of the company and the brand, all consumer goods companies, regardless of their sizes, must keep on adapting themselves to the ever-changing environment. In other words, they should reconsider and readjust their corporate and business strategies by focusing on new product development, technical innovation, robust customer relationships, sophisticated consumer segmentation, qualified human resources, and strategic alliances.\textsuperscript{285}

### 3.1.2 Types of Chinese Consumer Goods Companies

As China has integrated itself into the global economy over the past three decades, Chinese companies have experienced a great development. “Whether for socks or semiconductors, Chinese enterprises have become critical suppliers of goods and components for a host of global production chains”.\textsuperscript{286} If China hadn’t launched its economic reforms, Chinese companies could never emerge at home or even on a global basis. A series of reforms in institution, national industrial policy, and enterprises’ structure have built a favourable environment for Chinese enterprises to survive and prosper, meanwhile, to compete effectively against foreign MNCs domestically and globally.

“The range of corporate entities in china is probably wider than has existed in any other economy in modern times”.\textsuperscript{287} In other words, the ownership forms of local Chinese companies are complex, and two reasons stand out. Firstly, China has experienced the transition from the centrally planned to the socialist market economy; secondly, “the

\textsuperscript{283} Kalish, I. (2007), pp. 3-5
\textsuperscript{284} Ibid., p. 1
\textsuperscript{286} Steinfeld, E. S. (2002), p. 2
country’s huge size and decentralized governance structures produce abnormally large regional differences in the economic policy and business environments.\textsuperscript{288}

Generally, there are seven different enterprise ownerships in China: state ownership, collective ownership, private ownership, individual ownership, foreign ownership, joint ownership, and shareholding corporations (Table 3-2).\textsuperscript{289} And the rest is a kind of small undefined classification: other types of ownership.

**Table 3-2: Classifications of Enterprise Ownership in China**

<table>
<thead>
<tr>
<th></th>
<th>Non-state Owned Enterprise</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Collectives</td>
<td>Individual</td>
</tr>
<tr>
<td><strong>State-Owned Enterprises (SOEs)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Urban</td>
<td>Controlled by some level of government</td>
<td>District and Neighborhood Enterprises</td>
</tr>
<tr>
<td>Rural</td>
<td>N/A</td>
<td>Town and Village Enterprises (TVEs)</td>
</tr>
</tbody>
</table>

Source: adapted from Qian, Y. Y. (1994), p. 1013

In summary, there are three main ownership forms of local Chinese companies: State-Owned Enterprises (SOEs), Town and Village Enterprises (TVEs), and Private-Owned Enterprises (POEs), which will be introduced briefly in the following sections.

### 3.1.2.1 Chinese State-Owned Enterprises

State-Owned Enterprises (SOEs) in China refer to those which are wholly or mainly owned by the central, provincial or city governments.\textsuperscript{290} Originally, they were formed in the

\textsuperscript{289} Asia Development Bank (2002), p. 2
\textsuperscript{290} Wang, X. Z. (2005), p. 2
1950’s to support the development of heavy industry in response to the disparity in output between China and industrialized countries.\(^{291}\) Before China’s economic reforms, SOEs used to be the fundamental pillar of Chinese economy, accounting for the absolute majority of the total industrial output and absorbing most urban labor. Besides, SOEs undertook social welfare for their employees. At that time, they were playing the role of “branches and tools of the government’s planning administration”\(^{292}\). That is, all business operations in terms of raw materials, production, sale, work force, nomination of manager as well as the wage rates were directly controlled and administered by the government. As a result, SOEs used to produce wrong products at improper price and at incorrect time. Moreover, SOEs have been burdened with the so-called “iron rice bowl” which refers to a series of securely social welfare such as health care, housing and retirement pensions for SOEs’ employees. Ultimately, many SOEs have lost their profitability entirely and survived hardly, even though the government offered them protection, subsidies and easy access to bank credits.

With the wave of globalization and China’s integration into global economy since 1978, more and more competitions have emerged in domestic markets, and this has accordingly brought much pressure on SOEs’ reform to raise their efficiency and competitiveness.

An overall and systematic SOEs’ reform started in mid 1980s. Previously, SOEs’ reform appeared mainly at provincial level, and the deployed measures were largely tentative.\(^{293}\) From mid 1980s onwards, the process of SOEs’ reform can be divided into three major stages summarized in table 3-3 below:

\(^{291}\) Morel, E. (2006), p. 4  
\(^{293}\) Wang, X. Z. (2005), p. 2
### Table 3-3: The Process of State-Owned Enterprises Reform

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Representative Measures</th>
<th>Purpose/Effect</th>
</tr>
</thead>
</table>
| 1984        | - January 1987: “contract responsibility system”, by which managers were allowed to share part of the profits that was above what was set in their contract with the government.  
- “Dual-track price system” allowed SOEs to sell their products above the planned quota at the market price.  
- July 1992: give SOEs further rights in setting their own prices and wages, hiring or firing labor, deciding investment of fixed capital and foreign trade.  
- SOEs began to lay off workers. | To give SOEs more autonomy and improve financial incentives to managers. By the end of 1987, about 80% of the large and medium-sized SOEs adopted contract responsibility system, and by 1989 almost all SOEs adopted this system. |
| 1992        | - November 1993, “modern enterprises” based on “Chinese socialist market economic system”, through clarifying the ownership structure and management responsibilities, freeing the operation from government interference and establishing scientific and modern management system.  
- Privatization of small and medium-sized SOEs was allowed.  
- Mid 1990s: corporatization of SOEs by publicly listing them in both domestic and foreign stock exchange markets.  
- 1997: “grasping the large SOEs, letting go the small ones”, in which only about 1000 SOEs were large and must remain state-owned, called “national champions”; the others fell in the category of small or medium size, called the “B team”, left to their own devices, such as fully privatized or closed down. | By the end of 1996, over half of the small SOEs were privatized. At the same time, over ten million workers were laid off from SOEs. |
| 2002        | - Ownership reform has become the centre of SOE reform, and shareholding companies was set to become the main form of SOEs  
- March 2003: the State-Owned Asset Supervision and Administration Commission was established.  
- October 2003: further development of China’s corporate governance. | More SOEs turned into shareholding companies. |
| present     |                         |                |

Source: Wang, X. Z. (2005), pp. 2-4

After almost three decades experimental approach based on trial and errors, SOEs’ reform
has made remarkable progress.\textsuperscript{294} SOEs’ profit-earning capacity and competitiveness have been enhanced greatly. And more than 1,000 SOEs had been listed in domestic and overseas stock markets by the end of 2004 and 14 Chinese SOEs ranked among the top 500 enterprises of the world in 2005.\textsuperscript{295} Nonetheless, in-depth and holistic reforms focusing mainly on financial sectors, the privatization, and the establishment of a social security system are further required by SOEs.\textsuperscript{296}

3.1.2.2 Chinese Township and Village Enterprises

Collectively Owned Enterprises (COEs) can be categorized into urban and rural enterprises, as shown in the above table 3-2. The latter is also termed Town and Village Enterprises (TVEs), referring to enterprises that “are owned by towns, townships, districts and villages, or by rural household either as individuals, as partnerships, or in cooperation with their village”.\textsuperscript{297} Most TVEs are Small and Medium Enterprises (SMEs) operating in rural areas, and they can be also operated in JVs with urban COEs, SOEs and foreign enterprises.\textsuperscript{298}

Emerging firstly in rural areas of Jiangsu, Zhejiang and Shandong provinces in the 1950s, TVEs then grew rapidly in non-urban areas of China, especially during the Deng Xiaoping’s era. It is difficult to define their property rights, as they are viewed as an informal sector of Chinese economy with a distinctive characteristic which only can be understood in the special background of China’s transition from the centrally planned to the socialist market economy.

Generally, TVEs run their own course. They are not controlled directly by the government, therefore, they have more flexibility and freedom in decision-making compared with SOEs; however, they are not able to enjoy Chinese government’s protection and subsidies that SOEs can.\textsuperscript{299}

TVEs have undergone its golden development period i.e. 1985-1995, then started to decrease in output and employment with the slowdown of Chinese economic growth in the

\begin{footnotesize}
\begin{enumerate}
\item Nie, S. (2005), p. 1
\item Ibid., p. 2
\item Mcnally, C. A. (2002), pp. 6-7
\item Biggeri, M. (2001), p. 1
\item Ibid.
\item Ji, L. and Fang, Y. Q. (2004), p. 2
\end{enumerate}
\end{footnotesize}
1990s.\textsuperscript{300} Two reasons stand out: \textit{firstly}, TVEs were regarded as a transitory format and thereby their decline was an inevitable trend; \textit{secondly}, many TVEs have evolved into Private-Owned Enterprises.

In a word, with a little help of Chinese government, TVEs sector has been playing a crucial role in the processes of China’s industrialization and development.\textsuperscript{301} especially the rural areas’ economic development. Concretely, TVEs made extensive contributions to absorbing surplus agricultural labour force and redundant SOEs workers\textsuperscript{302}, boosting export, reducing regional inequality, and closing up the urban-rural income gap. Without regard to how TVEs evolve afterwards, it is affirmative that TVEs did accelerate China’s economic development during a certain period and make indelible contributions to impelling China to become a global player.

\textbf{3.1.2.3 Chinese Private-Owned Enterprises}

There was no private sector across all industries in China from 1950 to 1978, and all industries and commercial enterprises were owned by the state, provincial and local governments. Chinese non-state-owned economy is one of outcomes of the transition from the centrally planned to the socialist market economy.

Chinese non-state-owned economy emerged in the early 1980s. At that time, private economy was regarded as a necessary supplement to the state-owned economy. Under the circumstances, private economy has kept steadily growing at an annual rate of 20\% in the past two decades. Today, Chinese private sector has become a major component of the socialist market economy, contributing more than 50\% to China’s GDP in 2000; especially in China’s eastern coastal provinces such as Zhejiang, Fujian and Guangdong provinces where private economy is highly developed, the private sector contributes more than 60\% to national GDP.\textsuperscript{303}

\textsuperscript{300} Field, J. et al. (2006), p. 16
\textsuperscript{301} Wan, G. H. and Kong, R. (2004), p. 3
\textsuperscript{302} Biggeri, M. (2001), p. 9
\textsuperscript{303} China Internet Information Center (2004)
The reasons for the rapid expansion of private sector in China are multiple. A primary contribution is the favorable institutional system created by the central and local governments. For example, in order to encourage private companies to compete in the international market, Chinese government decided to lower the criterion for applicants from the private sector to do import and export business in 2001, through removing previous requirements on their sales revenue and export quota. In addition, under the influences of “go-west” strategy and China’s entry into the WTO, private enterprises have developed greatly.

Private sector of Chinese economy is composed of Privately Owned Enterprises (POEs-Siying Qiye) and individual businesses (Getihu). Both of them are wholly owned by domestic residents; however, the former refers to those with eight or more employees, and the latter refers to smaller ones with no more than seven employees. Since 1993, POEs have achieved a steady growth, whereas individual businesses encountered an apparent and sharp setback due to the increasing competition brought by larger enterprises.

Both POEs and individual business have played a significant part in boosting China’s economy and national prosperity, especially the national output and the employment. They have created numerous job opportunities and reduced the pressure of unemployment from the layoffs of SOEs. Furthermore, they also made great contributions to China’s export.

However, POEs’ continuous development has confronted some obstacles, such as an imperfect system for protecting private property, the bias toward private businesses in market access, difficulties in accessing to investment funds and technology, weak management skills, lack of talent and so forth.

In summary, the boom of POEs has yielded formidable sources of China’s continuous development. However, the scale and size of POEs are still far behind SOEs and foreign

306 Asian Development Bank (2003), pp. 5-6
companies in China. And most POEs still focus primarily on supplying consumer goods or service within Chinese domestic markets.

### 3.1.3 Major Chinese Consumer Goods Companies

From an external environment perspective, now China is the largest consumer goods market in the world. And it is not surprising that this market is becoming the most competitive and complex one all over the world. Thus, Chinese Consumer Goods Companies (CCGCs) are confronting not only tremendous opportunities but also tough challenges.

From an internal developing perspective, CCGCs including SOEs, TVEs or POEs have experienced significant reforms and impressive development. Deepening market reform and liberalization will force Chinese companies to become either profitable or die.\(^{307}\) Generally, CCGCs can offer now all range of consumer products by virtue of “not only low-cost advantages but also technical and managerial competence”\(^ {308} \). However, in face of increasing foreign incursion and expansion, these CCGCs’ fates are greatly diverse, which will be presented later in detail.

Some influential CCGCs in FMCGs sector are Nice (cosmetics), Libai (laundry-detergent), Huiyuan Juices and Wahaha Group (beverage), Guangming, Mengniu and Yili (dairy products), Wuliangye and Qingdao Beer (alcohol), Chef Kang and Tongyi (food and beverage). Besides, some influential CCGCs in DCGs sector include Haier Group Corporation and TCL International (white goods and telecommunications), Lenovo Group (PC), Gree (electronics), Chery (automobile), just to name a few. These CCGCs are regarded as the most dynamic, competitive and impressive consumer goods manufacturers in China, and their products have been widely accepted by Chinese consumers or even consumers throughout the world. Figure 3-2 below lists some logos of major Chinese consumer goods companies.

\(^{307}\) Kalish, I. (2003), p. 8
With global economic integration, China’s accession into the WTO and the introduction of modern Chinese enterprises system, there is a group of CCGCs which were no match for foreign MNCs and have already disappeared, and the remaining survivals of CCGCs can be generally classified into the following three statuses.

Some CCGCs are hardly struggling to survive as a result of deregulation and banking system reform, such as the manufacturers in mobile phone and laundry-detergent sectors. Some are striving for cooperating with foreign MNCs as they are confronting financial problems or lacking R&D innovation capability and well-recognized brands, such as those producers in cosmetics industry. And some have begun to become powerful competitors with whom global giants have to reckon. That is, today some CCGCs are changing their thought from competing negatively with foreign companies to welcoming the challenge energetically and thinking this as an opportunity to upgrade their competencies by emulating or learning from those MNCs.\textsuperscript{309} They do not only survive the onslaught of

\textsuperscript{309} PricewaterhouseCoopers (2005/2006), p. 41
foreign competition but also thrive on it at home and abroad,\(^{310}\) for instance, some producers in beverage, white goods and PC industries.

To sum up, CCGCs are working hard to improve their competencies in a variety of aspects, expecting to outmaneuver their foreign counterparts in more Chinese consumer goods sectors and further taking on them on a global basis.

An overall evaluation of CCGCs’ strengths, weaknesses, opportunities, and threats will be presented in the last section 3.4 as a conclusion of this chapter.

### 3.2 Major Macroenvironmental Forces

Nowadays, world peace and development are still two themes. From an international perspective, the current world is experiencing a profound change which is characterized by the following two aspects: a multipolar world is an inevitable tendency and globalization is unprecedentedly booming. Accordingly, competitions among countries in terms of national power, technology, human resource etc. will be getting more and more drastic. From an internal perspective, China has undergone tremendous changes and impressive development after economic reforms. These accomplishments can be illuminated by an increased total productivity level, the growing national income, the enhancement in overall national power, the raised people’s standard of living as well as an improved environment for external economic relationship. In the following sections, China’s political/legal, economic, sociocultural, and technological situations will be introduced in brief.

\(^{310}\) Boyd, M. and Cavey, P. (2005), pp. 18-19
3.2.1 Political/Legal Environment

3.2.1.1 Political Background and Current Situation

Firstly, China is a one-party state. The Chinese Communist Party (CCP), founded in 1921, has ruled the People’s Republic of China since the CCP established it in 1949. The CCP has been remaining its monopoly on political power; meanwhile, it has played a significantly important role in China’s rapid economic and social changes.

The central and supreme administrative institution is the State Council that initiates legislation and controls the civil service. The supreme authority of state power is the National People’s Congress (NPC), indirectly electing the State Council and dismissing the top officers of state. NPC is held every year to scrutinize and ratify its decisions.

Regional government comprises 23 provinces, 5 autonomous regions (Inner Mongolia, Guangxi, Tibet, Ningxia and Xinjiang), 4 municipalities (Beijing, Tianjing, Shanghai and Chongqing) and 2 Special Administrative Regions (Hong Kong and Macao) which returned to China in 1997 and 1999, respectively. And local government comprises a “three-level administrative network of prefectures, counties and cities, townships and districts”. All of them are indirectly elected by their respective People’s Congresses. Equally important, the political system in China has one decisive pillar: the People’s Liberation Army (PLA), at the head of which is the Central Military Commission (CMC).

Secondly, the introduction of the succession of Chinese leadership generations can briefly explain China’s political background.

On October 01, 1949, Mao Zedong, leader of the first generation, proclaimed the

---

311 Lunn, J. et al. (2006), p. 14
313 Lunn, J. et al. (2006), p. 16
foundation of People’s Republic of China in Beijing. At that time, Chinese communist leaders were faced with a series of severe problems: the devastated economy and the disrupt transportation and communications system. In order to rehabilitate the situation, “Chinese communist leaders quickly installed a new political and economic order modelled on the former Soviet example”\(^{314}\). Then, the First Five-Year Program for economic and social development was worked out and implemented in 1953. As a result, China has achieved remarkable growth in both economic and social systems during the early 1950s. The key achievement was that the government has gained the increasing support by curbing inflation, restoring the economy, and rebuilding many war-damaged industrial plants.\(^{315}\) Particularly, “during this period, China established more than 100 large industrial enterprises, some basic industries as well as some new industrial sectors, thus laying a preliminary foundation for socialist industrialization.”\(^{316}\) Equally important, the CCP’s authority has also been enhanced in Chinese people’s minds during this initial developing stage.

However, in 1958, Chairman Mao broke away from the former Soviet model and announced carrying out a new economic program, namely the “Great Leap Forward”, aiming at rapidly raising industrial and agricultural production. This measure resulted in a disaster: normal market mechanisms were disrupted, agricultural production fell behind, and Chinese people exhausted themselves producing what turned out to be shoddy, unsaleable goods.\(^{317}\) It is the worst thing that the unplanned Great Leap Forward and natural calamities has eventually resulted in a serious famine. In addition, the relationship between China and the former Soviet also kept exacerbating during this period. “In 1960, the Soviets and the Chinese began to have disputes openly in international forums.”\(^{318}\) However in the winter of 1960, a policy of readjusting, consolidating, filling in and raising

\(^{314}\) Anonymous (2006f), p. 1  
\(^{315}\) Ibid.  
\(^{316}\) People’s Daily Online (2006)  
\(^{317}\) Anonymous (2006f), p. 1  
\(^{318}\) Ibid.
standards for the national economy was adopted, then China’s economic construction was brought back to the right track.319

Before long, a more frightful calamity “The Cultural Revolution” took place on a national scale in 1966. This event led to a decade of social turmoil, and economic development went through the most severe setback and the biggest loss ever since China’s foundation.320 Under the circumstances, it was impossible and unpractical for any enterprise to concentrate on business activity.

It was a pivotal turning point that the Third Plenary Session of the Eleventh Communist Party of China Central Committee convened in 1978. “The central government made the strategic decision of shifting the focus of work to socialist modernization and defined the guiding policy of revitalizing the domestic economy and opening up to the outside world.”321 Subsequently, the 12th National Congress of the Communist Party of China set up an overall objective for economic reconstruction. In a word, numerous remarkable improvements have been made in almost all fields in China since 1978.

Despite Student Movement and Tiananmen Square Incident in 1989 to some extent cast shadow on China’s international image and hindered economic development, Deng Xiaoping’s, the second generation, inspection tour in Southern China in early 1992 brought back new and dramatic dynamics to the overall reforms. Subsequent to the visit, the 14th Party Congress later in the year put forward the goal of establishing the system of socialist market economy. Under the background of intensive external and internal market competition, the new market economy system requesting firms to make market research, forecast, analysis, plan and control in order to survive and develop, was different from the traditionally state-planned economic system under which firms didn’t need to do those work. Deng argued that either “socialistic” or “capitalist” measures could be adopted as

319 People’s Daily Online (2006)
320 Ibid.
321 Ibid.
long as it aimed for improving Chinese people’s standard of living. Although realizing a sound market economy needs a long-term transitional period, China has consistently placed overwhelming priority on its economy opening by means of not completely eschewing political reform.322

As the condition of Deng deteriorated, the *third generation* of leaders with Jiang Zemin as the core came into being and took over dominion gradually. They made further contributions on China’s economic reforms and opening to the outside world. Particularly, they started to reform state industries by privatizing unprofitable SOEs on a large scale.

Now, China has stepped into the period of the *fourth generation* of leaders, which primarily consists of Hu Jintao, Li Ruihuan, and Wen Jiabao. This new generation will consistently carry on not only the policies of the Jiang Zemin leadership, but also all of the characteristics of the third generation. “But what China really needs now, at a time when it must press forward with further reforms, are reformist politicians”323. Evidently, higher expectations have been given to the *fifth generation* of leaders which is supposed to be made of young and educational reformists. They will bear more weight in making impressive and noticeable reforms in both political and economic fields.

In summary, Chinese leaderships will keep on boosting peace and development. As a result, China’s role in influencing global political processes is getting more and more crucial. Most importantly, a long-run political stability has hitherto been providing a strong backup for China’s continuous economic expansion, and the living conditions of Chinese people have been improved greatly.

### 3.2.1.2 Legal and Regulatory Environment

“Even though China has no rule of law tradition, it has been making rapid progress since

---

322 Anonymous (2006f), pp. 2-3  
1978 when the policy of opening-up was adopted in setting up a legal system that is supportive of a market economy."\textsuperscript{324} These achievements are represented in the current framework for a socialist legal system with the constitution as its core and private, public and social laws as its mainstay.\textsuperscript{325} The framework and the main content of each law are illustrated in figure 3-3 below:

**Figure 3-3: The Framework of China Legal System**

<table>
<thead>
<tr>
<th>Public Law</th>
<th>Private Law</th>
<th>Social Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legislation on police, judges, administrative sanctions, administrative supervision, administrative procedure and state compensation, central banking, budget, statistics, auditing, prices, individual income tax, arbitration;</td>
<td>Civil law; Corporate law; Macro-economic control Law; Competition law; Consumer law; Labour law and the protection of labour rights; Intellectual property law; Financial law; Guarantee Law; Adoption and marriage, etc.</td>
<td>Social security law; Environmental law and natural resources law, etc.</td>
</tr>
<tr>
<td>Criminal law;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Criminal procedure, prisons, civil procedure, martial law, etc.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: adapted from Liu, J. H. (1999), pp. 1-6

Although each kind of law is indispensable to the establishment and development of market economy system, several laws closely related with this dissertation will be introduced in detail as follows:

✓ **Corporate Law**

“Establishment of a modern corporate system, which is at the core of a market economy, has been promoted by China’s progress in legislation.”\textsuperscript{326} In order to protect the interests of both companies and shareholders, the 1993’s Company Law was set up on the basis of

\textsuperscript{324} Liu, J. H. (1999), p. 2
\textsuperscript{325} Pei, M. X. (2006), p. 1
\textsuperscript{326} Liu, J. H. (1999), p. 22
defining the establishment of corporations, corporate governance structure, corporate finance, shareholders’ rights, and so on. Furthermore, this law involves setting up criterion of the main bodies of Chinese markets including SOEs, TVEs, POEs, foreign-funded firms, and Sino-foreign Joint Ventures, clarifying the responsibility of directors and managers, strengthening corporate social responsibility, accelerating the reform and restructuring of SOEs, protecting and promoting POEs, and encouraging “risk investment to cultivate and develop hi-tech enterprises”.\textsuperscript{327} Besides, with its accession to the WTO and gradual accomplishment of the WTO’s commitments, China will continue to improve the political and legal environment for foreign investment.

✓ \textbf{Competition Law}

To promote the market economy and ensure a fair competition, the Anti-Unfair Competition Law was put into effect on January 1, 1994. This law has played an important role in forming and safeguarding a unified and orderly market economy.\textsuperscript{328} However, this law together with Price Law, Foreign Trade Law and other Chinese laws and regulations are “not powerful enough to settle rampant and newly emerged deceitful competition”.\textsuperscript{329} Actually, monopoly is a serious problem existing in market competition. “The current monopoly in China usually takes two forms: administrative monopoly motivated by administrative power, which is unique to China, and economic monopoly motivated by economic power.”\textsuperscript{330} Hence, in order to guarantee a fairer and more rational market environment for competition, the enactment and implementation of anti-monopoly seem very urgent and indispensable. “Accordingly, the stated goals of the July 2004 draft PRC Anti-monopoly Law include protecting the legitimate rights and interests of consumers”.\textsuperscript{331} The enactment of this law was regarded as a major milestone in the process of China’s legal development. Although an official draft has not come out yet, a new draft surfaced in 2005. It represented many revisions compared with 2004 draft. These revisions involve monopoly agreement, abuse of dominant market positions, merger review, administrative enforcement, private litigation and intellectual property. “Ultimately, the convergence of

\textsuperscript{327} Liu, J. H. (1999), p. 34
\textsuperscript{328} Ibid., p. 36
\textsuperscript{329} Ibid.
\textsuperscript{330} Ibid.
\textsuperscript{331} Bush, N. (2005), p. 1
Chinese competition policy with international practice will depend on the competence and political stature of the enforcement authorities."332

✓ Consumer Law

Consumer Law covers the law on the Protection of Consumers’ Rights and Interests implemented in 1994 and the law on the Consumers’ Rights and Interests Protection Division in 1998. These two laws not only constituted nine aspects of rights that consumers could enjoy, but also set up the gist to handle “cases of serious infringement of consumers’ rights and interests, and cases of fake products”.333 Besides, the China Consumers Association (CCA) made great contributions to protecting consumer’ rights and interests by means of solving consumers’ complaints and retrieving consumers’ financial losses. In a word, consumer law “will help promote fair competition among enterprises and weed out the selling of fake and shoddy products, cheating in sales, and other forms of illegal business practice”.334 It is significantly vital to construct a healthy, normative market economy system and social environment.

To sum up, although the pace of Chinese political reform “which is broadly defined here as institutional changes that rationalize bureaucracy, strengthen the rule of law, expand political participation, and protect human rights”335 gets relatively slow, the current political/legal environment provides economic growth and prosperity with a long-term, stable, and balanced circumstance, and it will keep effecting Chinese society to become “more pluralistic, autonomous, and open”336.

3.2.2 Economic Environment

In comparison with other external environment factors, economic environment influences enterprises’ behaviours and activities in a more direct and broader way. In the following sections, China’s economic environment will be analyzed from historical, current, and

334 Ibid., p. 38
335 Pei, M. X. (2006), p. 1
336 Ibid., p. 5
future perspectives respectively, along with an examination of economic challenges China is confronting.

3.2.2.1 The History of Economic System

During these six decades, China’s overall economy has achieved a big forward step, though there were some fluctuations. In essence, the development background of China’s economic system can be comprehended in virtue of the transition from the former centrally planned to current socialist market economy and the future development towards a sound market economy. Hence, in order to better understand the current situation and prospects of China’s economy, it is necessary to first take a review on China’s economic development in various historical periods as well as the corresponding representative events, which can be outlined in figure 3-4 below:

**Figure 3-4: Development Stages and Historical Events**

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949---1965</td>
<td>Reconstruction and Opening up</td>
</tr>
<tr>
<td>1966---1976</td>
<td>Stagnation</td>
</tr>
<tr>
<td>1978---1992</td>
<td>Further Reform and Opening up</td>
</tr>
<tr>
<td>1993---2001</td>
<td>Overall reform and opening up</td>
</tr>
<tr>
<td>2002---2006</td>
<td>China’s accession to WTO</td>
</tr>
</tbody>
</table>


As illustrated in above figure, China’s economic history can be divided into three main stages according to the shifts of economic policy: the centrally planned economy (1949-1977), the transitional economy (1978-1992), and socialist market economy (1993-present).
After a series of communist revolutions, “the socialist state was built up.” Meantime, a centrally planned economy (1949-1977) was also established on the basis of Marxist-Leninist and Marxist-Maoist doctrines which advocated that state is the ownership of capital and land. At that time, such command economy seemed to be indispensable, as “the communists viewed central planning as a way to organize the economy’s resources rationally, to meet basic human needs, to achieve macroeconomic stability, to provide greater equality, and to end exploitation of labor by capitalists.” There are two main characteristics of such economy: one is that all land, natural resources, transportation facilities, communication networks, banking facilities as well as virtually all industries belong to Chinese government; and the other is that decisions concerning nearly all economic activities only can be made by the central government, which means economic behaviours were oriented by government’s planning directives instead of the market demand. Furthermore, the traditional socialist economic structure was also characterized by the trinity of a distorted macro-policy environment, a planned allocation system, and micro-management institutions. The above-mentioned characteristics can be further described as follows:

- Government’s policies concentrated on developing heavy industries and rural areas, “and small-scale industries were scattered throughout the rural areas.” Consumer goods industries, distribution and service sectors were completely ignored.

- Resource allocation system also placed emphasis on heavy industries and rural development. Moreover, the proportion of resources allocated among industries and firms were controlled by the central government instead of the market system.

- “Government, rather than the forces of supply and demand, set the prices of resources and products.” Meanwhile, the price remained unchangeable for a

---

337 Hayashi, T. (2003), pp. 2-3  
338 Anonymous (2005d), p. 1  
339 Lin, J. Y. F. et al. (1996)  
340 Anonymous (2005d), p. 3  
341 Ibid.
long period according to the quantity of output instead of the production cost or the market demand.

✓ An emphasis of economic self-sufficiency: China was a relatively closed nation and possessed the limited trades and relationship with Western countries. China preferred to trade with other communist countries such as the former German Democratic Republic, Poland, North Korea, and Vietnam, because other Western countries with different economic systems were regarded as hostile.

✓ As for enterprises, there exist simply no business companies in China under the centrally planned system. Local enterprises were dominated by SOEs acting as “branches and tools of the government’s planning administration, with their managers appointed by the state and paid as bureaucrats”342. Those SOEs were not meant to earn profits, but rather to fulfil production targets set by officials and to provide their workers with the so-called “iron rice bowl” which implied that “the full range of social welfare services from homes to schools to hospitals”343.

Obviously, there were many fatal problems existing under this economic system, which are represented by the following aspects: 1) a big coordination problem between inputs and outputs; 2) an incentive problem which led enterprises to refuse any innovation; and 3) market was lack of competition because of no threats among existing enterprises or from foreign companies and products. In this case, it was imperative to carry out a thorough reform in China’s economic system.

The Third Plenary Session of the 11th Central Committee of CCP held in 1978 was a representative event which marked that China didn’t only start the second stage (1978-1992) of the market reform but also gradually moved into the transitional economy by abandoning the old system and launching a preliminary reform and the opening up. In other words, China began to transit from the traditional Soviet-model planned economy to a modern market economy as well as from a rural economy to an urban economy. This transition is characterized by “a gradual, evolitional approach which is piecemeal, partial,

343 Ibid.
incremental, often experimental, and especially without large-scale privatization.”

There is a widely quoted phrase said by Deng Xiaoping, “crossing the river by groping for stones”. However, the outcome of the transition is that China has become the fastest growing country in the world. “There is no precedent for a country under the rule of a Communist Party to make a successful transition to a fully-fledged market economy. Nor is there a precedent under which a centrally planned economy reformed successfully in an incremental way before China did it in its first fifteen years of reform.”

The significance of China’s economical transition can be analyzed through comparing with what happened in the Former Soviet Union. Differences of market reforms between China and the Former Soviet Union mainly involved motivations, quomodo and results, which are illustrated in table 3-4 below:

### Table 3-4: Differences in Market Reforms between China and Former Soviet Union

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>Former Soviet Union and East Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Motivations</strong></td>
<td>➢ To improve the economic efficiency;</td>
<td>➢ To improve the economic efficiency;</td>
</tr>
<tr>
<td></td>
<td>➢ To rectify the structural imbalance;</td>
<td>➢ To replace “socialism” with “capitalism”;</td>
</tr>
<tr>
<td></td>
<td>➢ To improve incentives.</td>
<td>➢ To replicate the economic institutions of Western Europe.</td>
</tr>
<tr>
<td><strong>Quomodo</strong></td>
<td>➢ <em>Perestroika</em> (economic restructuring) without <em>glasnost</em> (political openness);</td>
<td>➢ Both perestroika and glasnost;</td>
</tr>
<tr>
<td></td>
<td>➢ A gradual, incremental and evolutionary approach;</td>
<td>➢ A big bang approach, including stabilization, price liberalization, and privatization;</td>
</tr>
<tr>
<td></td>
<td>➢ Implementation without well-founded theory or a pre-determined blueprint.</td>
<td>➢ All reforms were supposed to be achieved simultaneously and in a short time;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>➢ Implementation based on the basic principles of neoclassical economics for a well-functioning market economy, along with a comprehensive plan.</td>
</tr>
<tr>
<td><strong>Results</strong></td>
<td>➢ Transition has been remarkably successful by obtaining a rapid and stable economic growth;</td>
<td>➢ Economic collapse;</td>
</tr>
<tr>
<td></td>
<td>➢ People’s living standard was improved greatly;</td>
<td>➢ Social crisis;</td>
</tr>
<tr>
<td></td>
<td>➢ Not complete yet.</td>
<td>➢ Not complete yet.</td>
</tr>
</tbody>
</table>

Source: self-designed according to Lin, J. Y. F. (2004), pp. 2-23

Concretely, during this transitional period from the centrally planned to the market economy, China’s reforms mainly involved the following aspects:

---

345 Qian, Y. Y. and Wu, J. L. (2000), p. 4
Chinese transition started in agricultural field in 1978. And the most important change was “the replacement of collective farming with a household-based system, now known as the household responsibility system.” Under the household responsibility system, each peasant family was given a long-term lease of a piece of land. The household must deliver a certain quota of the agricultural products to the government each year, and may keep anything it produces beyond that quota. In this instance, peasants’ incentives were greatly stimulated and the link between individual effort and return was strengthened. Moreover, the increase in agricultural productivity in turn spurred the growth of rural industry, by generating a lot of saving and excess labor. Hence, we could say the achievements of agricultural transformation made a huge contribution towards China’s overall economic reforms, as nearly 70% of the Chinese labor force came from rural areas.

Price reform was famous for introducing the “dual-track” price mechanism, which refers to “prices were free up at the margin while the planned prices were maintained for planned quantities freezed for some time.” In other words, firms or farmers must sell an appointed quantity of production to government at a fixed price; whereas they could also sell the surplus in free markets at market-determined prices. This reform first started in the commodity price system. “By 1996, with the exception for a few raw materials and coal, fuel and transportation, the prices for most commodities and services have been liberalized.”

The transformation of SOEs was the process of continuously reducing government’s intervention and enlarging SOEs’ autonomy. Meanwhile, non-state enterprises such as TVEs or POEs have been promoted greatly.

As for the resource distribution system, many items which were controlled before have been de-linked from the government plan and deregulated gradually.

China began to partially open to the global economy. During the period of 1978-1986, Special Economic Zones (SEZs) was set up in coastal regions so as to attract foreign investment and encourage private ownership and international trade. Although there

348 Ibid., p. 138
349 Qian, Y. Y. and Wu, J. L. (2000), p. 6
were still some limitations, the establishment of SEZs as China’s “windows on the world” has achieved a great success. Subsequently, during the period of 1986-1992, the “twenty-two regulations” were enacted, whereby a more beneficial environment was created for foreign investors. The detailed information for foreign companies operating in China will be addressed in subsequent section 3.3.3.

In a word, achievements of China’s market transition up to 1992 were obvious and tremendous. However, the final objective of this fifteen years’ reform was not a full-fledged market system, because its “official ideology was the one of ‘combining plan and market together’”.

Accordingly, China’s market reform was expected to take a forward step and a further strategic shift.

Several turning points, such as Deng Xiaoping’s Southern inspection tour, the 14th Party Congress in 1992, and the Third Plenum of the 14th Party Congress one year later, marked that Chinese economy was redefined as a “Socialist Market Economy” and indicated the beginning of a new direction of economic reforms. It is worthy to note that in the definition of “socialist market economy”, the term “socialist” is a determiner which makes a restriction that “public ownership remained conceived as the dominant form” and “market economy” is an ultimate goal of China’s reforms. Therefore, the current market economy in China is a “socialist market economy with the Chinese characteristics”, referring to “the government regulates the market and the market guides the enterprises in their production”.

Anyhow, China has stepped into the third stage (1993-present) in order to systematically establish market-oriented economy and constantly deepen its unfinished market reforms in a fundamental way. A series of reforms involved the following aspects: 1) foreign exchange and external sector reform; 2) tax and fiscal reform; 3) financial reform; 4) SOEs reform; and 5) establishment of a social safety net.

At the beginning of 2000, China confronted rapidly increasing pressure to further its economic reforms. Two basic reasons stand out. For one thing, China’s economic growth slowed down in 1998 and 1999, partly because of the Asian financial crisis and the sluggishness of reforms in key areas. For another, China faced the coming accession to the WTO. Thus, “in order to survive in the global market place, China has no choice but to

---

351 Qian, Y. Y. and Wu, J. L. (2000), p. 8
accelerate its transition to a full-fledged market system incorporating international best practices.”

As a result, China attempted to further reform key areas which had limited and unsatisfactory results during the second stage and push its domestic reform more rapidly. A core issue required to be resolved was “establishing a system of free and competitive enterprises where the underlying key is the change of government-business relationship into the one of arm’s-length type.” Furthermore, addressing this core issue was closely connected with other three correlated tasks: “1) transforming existing SOEs; 2) promoting new POEs; and 3) establishing the rule of law.”

In conclusion, China is on the way towards a sound market economy, though there is a long way to go.

### 3.2.2.2 Present Economic Performances

After a series of market reforms, China has achieved remarkable successes and impressive accomplishments; meanwhile, China, especially as a global manufacturer and trader, has become a key driver of global economic growth. Particularly during the 10th Five-Year Plan period (2001-2005), China has made significant progress in deepening reforms. Now China has the fourth largest economy in the world, only behind the United States, Japan and Germany. The following main indicators can reveal China’s current economic performances from both international and domestic perspectives.

#### 3.2.2.2.1 Foreign Trade

Firstly, from an international perspective, one of the key economic indicators is trade balance.

Before applying economic reforms and the open door policy in 1978, China has done minimal trade with the rest of the world. At that time, the total trade value was only US$
20.6 billion. However, with the help of a series of favourable policies adopted to promote foreign trade, China’s trade has obtained a robust growth. Furthermore, with a favourable economic climate at home and abroad, especially China’s accession to the WTO in 2001 as well as world trade recovery since 2002, China’s total two-way trade was valued at US$1422.1 billion in 2005, rising by 23.17% than the previous year and bringing a large trade surplus of US$ 101.8 billion which was much higher than that in 2004. (Table 3-5)

Table 3-5: Total Value of Imports and Exports (USD 100 Million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Trade</td>
<td>206.4</td>
<td>696.0</td>
<td>1154.4</td>
<td>4742.9</td>
<td>11545.5</td>
<td>14221</td>
</tr>
<tr>
<td>Total Exports</td>
<td>97.5</td>
<td>273.5</td>
<td>620.9</td>
<td>2492.0</td>
<td>5933.2</td>
<td>7620</td>
</tr>
<tr>
<td>Total Imports</td>
<td>108.9</td>
<td>422.5</td>
<td>533.5</td>
<td>2250.9</td>
<td>5612.3</td>
<td>6601</td>
</tr>
<tr>
<td>Balance</td>
<td>-11.4</td>
<td>-149.0</td>
<td>87.4</td>
<td>241.1</td>
<td>320.9</td>
<td>1018.0</td>
</tr>
</tbody>
</table>


Today, China ranks the third-largest trading power in the world, only behind the United States and Germany, which has not only restructured the global trading system but also made tremendous political and economic impacts on the rest of world.

The augmentation of China’s trade resulted from the following reasons: firstly, Foreign Invested Enterprises (FIEs) have made a great contribution to Chinese foreign trade; secondly, China’s foreign trade system reform has created a sound environment for developing foreign trade and effectively stimulated a rapid expansion of China’s trade.

Noteworthily, in the past decades, China’s exports have grown much stronger than imports thanks to a series of export-encouraging policies. From 1978 to 2005, the volume of Chinese merchandize export has grown on average 17 percent per year,358 of which manufactured goods occupied the absolutely dominant position. Taking the situation of 2004 as an example, according to China’s customs statistics, the exports value by category of commodities in 2004 was partitioned into primary goods accounting for 6.8% of the total exports value and manufactured goods accounting for 93.2%. Only during the first half of 2006, China surpassed the United States as being the world’s largest exporter; that

---

358 World Bank (May-2006), p. 6
is, Chinese export of manufactured goods was valued at US$ 404 billion compared with US$367 in exports by the United States during the same time.\textsuperscript{359} Furthermore, the export proportion of hi-tech products was getting higher than labor-intensive ones, and in 2005 Chinese exports of hi-tech products accounted for 28.6 percent of total exports. To some extent, this shift reflected a fundamentally structural change of manufacturing in China. Besides, the increasing trade surplus as a result of stubbornly strong exports and relatively low imports became a poignant issue for China’s main trading partners such as the United States, the European Union etc. However, in order to ensure a fair trade, Chinese government attempted to simulate imports by reducing investment in domestically overheated sectors as well as keeping on reducing average import tariffs and removing import restrictions as China’s commitment to the WTO.

Exports and imports are not the only indicators of China’s openness, and the following foreign direct investment in China and China’s overseas direct investment will reveal a similar track for liberalization.

\textbf{3.2.2.2 Foreign Direct Investment and Overseas Direct Investment}

From the international perspective, another two important indicators are Foreign Direct Investment (FDI) and Overseas Direct Investment (ODI), which will be examined in subsequent sections, respectively.

\textbf{3.2.2.2.1 Foreign Direct Investment}

Over the past three decades, China has attracted tremendous inflow of FDI thanks to a stable political environment, a favourable economic climate, the high productivity, domestic low-cost resources, plenty of raw materials, a huge domestic market of 1.3 billion consumers and so on (Figure 3-5).

\textsuperscript{359} McCORMACK, R. (2006)
Since 1993 China has become the largest destination of FDI among all developing nations, and for many years it has occupied the second-largest position of FDI's in the whole world, only behind the United States. Now, China is the third-largest recipient of FDI and possesses the second-largest foreign currency reserves in the world. Expanding FDI inflow makes a strong impact not only on the foreign and regional investors but also on the process of China’s economic transition “by adding to capital formation, stimulating upgrading of total factor productivity, creating positive spillover effects to domestic enterprises, as well as creating employment opportunities”\(^{360}\).

Hongkong, the Special Administration Region of China, is the largest regional investor to China, and other main direct investors are the United States, Japan, Taiwan and Virgin Island.

Between 1980s and 1990s, FIEs were mostly made up of JVs between foreign and Chinese enterprises, especially the form of Equity Joint Ventures (EJVs). In the 1980s, FIEs were restricted to the export-oriented JVs between foreign and Chinese firms; in the early 1990s, FIEs were allowed to manufacture goods for sale in domestic market. At that time, Wholly Foreign-Owned Enterprises (WFOEs) were highly restricted. Until the mid 1990s, the form of WFOEs started to be admitted. Then they have expanded rapidly in China. (Table 3-6)

\(^{360}\) Zhang, X.Y. et al. (2005), p. 2
In contrary to those restrictions, FIEs did also enjoy lots of preferential treatment, such as numerous and substantial tax breaks and holidays. At present, FIEs enjoy an effective income tax rate of 11 percent, while local Chinese firms are faced with an effective rate of 23 percent. In this instance, the competitive advantages of domestic firms are being weakened for a long time. Hence, Chinese authority is planning to consider “unification” of the tax between FIEs and local Chinese firms.

As a result of accomplishing all the WTO regulations before 2006, the FDI inflow into China will expand further. In particular, with the help of China’s “Great Western Development Strategy” and the guideline of constructing new countryside, many larger foreign investors will be attracted by those inland cities and towns.

### 3.2.2.2.2.2 Overseas Direct Investment

It is well-known that China is a dominant destination of global FDI flows. However, recently more worldwide attention has been allured to China’s Overseas Direct Investment (ODI).

ODI refers to investing domestic assets such as structures, equipment and organizations into foreign countries. China’s ODI has undergone a steady growth over the past three

---

decades, but the latest ODI wave began in the late 2001 when China joined the WTO. By the end of 2006, China’s ODI has grown to US$73.33 billion which was distributed over 163 countries and regions in the world, and the number of local enterprises established abroad has reached 10,673. How great development of ODI has been achieved in China since 1990 can be illustrated in the figure 3-6 below. Such impressive performances represent China’s emergence as a global investor and its further integration into the world economy. In this case, the overseas investment activities of Chinese companies by means of cross-border M&As have emerged frequently and gained increasing attention worldwide.

![Figure 3-6: Stock of Chinese ODI (Billion US$)](image)

Source: China Ministry of Commerce (2007)

The surge of China’s ODI is mainly contributed by the following four motivations. *First and foremost*, Chinese government has been adopting the “Going Global” strategy to stimulate and encourage the overseas investment of Chinese companies. In this instance, Chinese government provides companies with a set of favourable industrial policies, the preferential financing system, the convenient service system, and perfect coordinating mechanisms. Moreover, guided by “Going Global” strategy, Chinese government is intending to create a number of “global champions” which refer to those “large multinational firms with globally recognised brands able to compete in the international

---

363 People’s Daily Online (2007)
364 Lunding, A. (2006), pp. 5-6
Secondly, China needs to secure its access to overseas energy resources and raw materials so as to ensure its rapid and sustainable economic growth. Thirdly, today’s Chinese companies are seriously in short of foreign advanced technology, well-known brands, and modern managerial knowledge and experience. In order to obtain these key elements that are crucial for a long-term success, Chinese companies are anxious to go outside through cross-border strategic alliances and M&As. And fourthly, the domestic market in China is becoming competitive and intensive due to the increasing new entrants, the depressed margins, and the overcapacity within many industries. Therefore, if equipped with some assets which can be transferred abroad, Chinese companies intend to seek new markets for their further growth. The reality shows that not only large SOEs are active players in China’s ODI, but also some small and medium-sized POEs are more likely to invest abroad.

By investing overseas, Chinese companies can transfer their successful experience abroad to catch new opportunities. Equally important, if they succeed abroad, in return their competitive positions in domestic market will be enhanced greatly.

In short, China’s ODI will keep booming, meanwhile, more and more local Chinese companies show their increasing interests in the overseas expansion. China’s Ministry of Commerce predicts that China’s ODI will maintain an average annual growth rate of over 22 percent during the next five years and will have exceeded US$60 billion by 2010.

### 3.2.2.2.3 Gross Domestic Product, Investment and Consumption

From a domestic perspective, a foremost economic indicator is Gross Domestic Product (GDP) growth. China’s GDP growth during the period of 1978-2005 is listed in the table below:

---

365 Lunding, A. (2006), p. 6
366 Ibid., pp. 3-5
367 Woo, Y. P. and Zhang, K. (2006), pp. 5-6
368 Beebe, A. et al. (2006), p. 2
Table 3-7: Gross Domestic Product Growth (1978-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (100 Million Yuan)</th>
<th>Annual Growth Rate (%)</th>
<th>Per Capital GDP (Yuan/Person)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>3624.1</td>
<td>11.7</td>
<td>379</td>
</tr>
<tr>
<td>1979</td>
<td>4038.0</td>
<td>7.6</td>
<td>417</td>
</tr>
<tr>
<td>1980</td>
<td>4517.8</td>
<td>7.8</td>
<td>460</td>
</tr>
<tr>
<td>1981</td>
<td>4862.0</td>
<td>5.2</td>
<td>489</td>
</tr>
<tr>
<td>1982</td>
<td>5295.0</td>
<td>9.1</td>
<td>525</td>
</tr>
<tr>
<td>1983</td>
<td>5935.0</td>
<td>10.9</td>
<td>580</td>
</tr>
<tr>
<td>1984</td>
<td>7171.0</td>
<td>15.2</td>
<td>692</td>
</tr>
<tr>
<td>1985</td>
<td>8964.4</td>
<td>13.5</td>
<td>853</td>
</tr>
<tr>
<td>1986</td>
<td>10202.0</td>
<td>8.8</td>
<td>956</td>
</tr>
<tr>
<td>1987</td>
<td>11963.0</td>
<td>11.6</td>
<td>1104</td>
</tr>
<tr>
<td>1988</td>
<td>14928.0</td>
<td>11.3</td>
<td>1355</td>
</tr>
<tr>
<td>1989</td>
<td>16909.0</td>
<td>4.1</td>
<td>1512</td>
</tr>
<tr>
<td>1990</td>
<td>18547.9</td>
<td>3.8</td>
<td>1634</td>
</tr>
<tr>
<td>1991</td>
<td>21618.0</td>
<td>9.2</td>
<td>1879</td>
</tr>
<tr>
<td>1992</td>
<td>26638.0</td>
<td>14.2</td>
<td>2287</td>
</tr>
<tr>
<td>1993</td>
<td>34634.0</td>
<td>13.5</td>
<td>2939</td>
</tr>
<tr>
<td>1994</td>
<td>46759.0</td>
<td>12.6</td>
<td>3923</td>
</tr>
<tr>
<td>1995</td>
<td>58478.1</td>
<td>10.5</td>
<td>4854</td>
</tr>
<tr>
<td>1996</td>
<td>67885.0</td>
<td>9.6</td>
<td>5576</td>
</tr>
<tr>
<td>1997</td>
<td>74463.0</td>
<td>8.8</td>
<td>6054</td>
</tr>
<tr>
<td>1998</td>
<td>8345.0</td>
<td>7.8</td>
<td>6038</td>
</tr>
<tr>
<td>1999</td>
<td>82068.0</td>
<td>7.1</td>
<td>6551</td>
</tr>
<tr>
<td>2000</td>
<td>89468.1</td>
<td>8.0</td>
<td>7086</td>
</tr>
<tr>
<td>2001</td>
<td>109655.0</td>
<td>8.3</td>
<td>7651</td>
</tr>
<tr>
<td>2002</td>
<td>120333.0</td>
<td>9.1</td>
<td>8214</td>
</tr>
<tr>
<td>2003</td>
<td>135823.0</td>
<td>10.0</td>
<td>9111</td>
</tr>
<tr>
<td>2004</td>
<td>159878.0</td>
<td>10.1</td>
<td>10561</td>
</tr>
<tr>
<td>2005</td>
<td>182321.0</td>
<td>9.9</td>
<td>13772</td>
</tr>
</tbody>
</table>


Illustrated by the above table, China’s economy has experienced profound changes over the past three decades. Since China started to transform its economy from the centrally planned to the market-driven economy in 1978, China has obtained a real economic expansion with an average annual rate of 9.6%, increasing 50 times from 362 billion yuan in 1978 to 18232 billion yuan in 2005. And GDP per capita also increased 36 times, from 379 yuan/person in 1978 to 13772 yuan/person in 2005. Today China has become one of the world’s fastest growing economies and the world’s fourth-largest economy after the United State, Japan and Germany. Although GDP per capita in China is still lagging behind developed countries, Chinese people’s standard of living has been improved greatly.

Of all economies, the growth of GDP by expenditure approach is a summation of the increase of final consumption expenditures, gross capital formation and net exports of
goods and services (Table 3-8). Besides, the development of China’s fixed assets investment and final consumption expenditure is illustrated by the table 3-9 and 3-10, respectively.

**Table 3-8: Gross Domestic Product by Expenditure Approach**

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Domestic Product by Expenditure Approach (100 million Yuan)</th>
<th>Final Consumption Expenditures</th>
<th>Gross Capital Formation</th>
<th>Net Exports of Goods and Services</th>
<th>Capital Formation Rate (%)</th>
<th>Final Consumption Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>3605.6</td>
<td>2239.1</td>
<td>1377.9</td>
<td>-11.4</td>
<td>38.2</td>
<td>62.1</td>
</tr>
<tr>
<td>1980</td>
<td>4551.3</td>
<td>2976.1</td>
<td>1590.0</td>
<td>-14.8</td>
<td>34.9</td>
<td>65.4</td>
</tr>
<tr>
<td>1985</td>
<td>8792.1</td>
<td>5773.0</td>
<td>3386.0</td>
<td>-366.9</td>
<td>38.5</td>
<td>65.7</td>
</tr>
<tr>
<td>1990</td>
<td>18319.5</td>
<td>11365.2</td>
<td>6444.0</td>
<td>510.3</td>
<td>35.2</td>
<td>62.0</td>
</tr>
<tr>
<td>1995</td>
<td>58510.5</td>
<td>33635.0</td>
<td>23877.0</td>
<td>998.5</td>
<td>40.8</td>
<td>57.5</td>
</tr>
<tr>
<td>2000</td>
<td>89340.9</td>
<td>54600.9</td>
<td>32499.8</td>
<td>2240.2</td>
<td>36.4</td>
<td>61.1</td>
</tr>
<tr>
<td>2001</td>
<td>98592.9</td>
<td>58927.4</td>
<td>37460.8</td>
<td>2204.7</td>
<td>38.0</td>
<td>59.8</td>
</tr>
<tr>
<td>2002</td>
<td>107897.6</td>
<td>62798.5</td>
<td>42304.9</td>
<td>2794.2</td>
<td>39.2</td>
<td>58.2</td>
</tr>
<tr>
<td>2003</td>
<td>121730.3</td>
<td>67493.5</td>
<td>51554.7</td>
<td>2682.1</td>
<td>42.4</td>
<td>55.4</td>
</tr>
<tr>
<td>2004</td>
<td>142394.2</td>
<td>75439.7</td>
<td>62875.3</td>
<td>4079.2</td>
<td>44.2</td>
<td>53.0</td>
</tr>
</tbody>
</table>


**Table 3-9: Fixed Assets Investment (100 Million Yuan)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets</td>
<td>1073.9</td>
<td>4339.0</td>
<td>25154.2</td>
<td>51303.9</td>
<td>62351.4</td>
</tr>
</tbody>
</table>


**Table 3-10: Final Consumption Expenditure (100 Million Yuan)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Consumption</td>
<td>2239.1</td>
<td>10565.5</td>
<td>43579.4</td>
<td>67493.5</td>
<td>75439.7</td>
</tr>
<tr>
<td>Resident Consumption</td>
<td>1759.1</td>
<td>8523.5</td>
<td>34854.6</td>
<td>52685.5</td>
<td>58994.5</td>
</tr>
<tr>
<td>Public Consumption</td>
<td>480.0</td>
<td>2033.0</td>
<td>8724.8</td>
<td>14808.0</td>
<td>16445.2</td>
</tr>
</tbody>
</table>


In comparison with the growth rate of these three indicators, it is very obvious that the soaring investment amount and the incremental net exports of goods and services are key drivers and pillars of China’s sustained economic expansion. Investment value reached about 5100 billion yuan in 2003 and 6200 billion yuan in 2004, as a share of GDP by expenditure approach accounting for 42.4% and 44.2% respectively, “a level well above
Meanwhile, during the period of 2001-2005 the total trade value and the corresponding trade surplus China achieved was also impressive, which has been introduced in the previous part. However, since 1990, although the totally final consumption has augmented with a stable rate and finally reached the amount of 7543.9 billion yuan in 2004, the consumption/GDP ratio has gradually decreased from 62% in 1990 to 53% in 2004, far below the ratios of investment/GDP and net exports/GDP. “The declining share of consumption is due to both a decline in household disposable income as a share of GDP and a decline in consumption as a share of disposable income.”

Two reasons for this issue stand out: firstly, the low domestic demand derived from excessive Chinese residents’ savings in order to afford the cost of their health insurance, housing, retirement and education. Secondly, 60% of China’s population is rural residents whose average living standard is still far lagging behind. Under the circumstances, Chinese government has realized the imbalance between consumption and investment, and put forward in 2004 that more attention would be paid to simulating economic growth by enlarging domestic consumption instead of relying on investment and export. Furthermore, Chinese government indicated in the 11th Five-Year Program of 2006 that economic policies would “focus on the creation of a knowledge-led, innovation-oriented economy supported by greater domestic consumption.” Although it is not easy to make this shift, the good news is that favourable economic policies and measures have already been on the way.

3.2.2.3 Economic Challenges

During the transitional period from a plan-oriented economy to a market-oriented one, China as a developing country still faces a number of great challenges which to some extent block its sustained growth of economy. These challenges mainly result from a widening imbalance, a conventional and rigid banking system, and Chinese currency issue.
3.2.2.3.1 Imbalance

The fact of imbalance is getting more apparent and tougher in the process of China’s economy expansion. These imbalances mainly exist in the following aspects: the income gap between the rich and the poor, regional disparities between the eastern coastal and western or central interior provinces, and differences between urban and rural areas.

Consider firstly the rich and the poor, poor people now in China mainly refer to those peasants who are depending primarily on agriculture in their land. They are the poorest and at the bottom level of society in China. Besides, another group of poor people are those laid-off workers in cities who resulted from the implementation of restructuring SOEs and could not find job any more, especially those over 45 years old. Accordingly, while wealthy residents are spending their disposable income in the booming CCGM, these poor groups are still confronting some basic problems, such as the serious lack of fundamentally healthy insurance and primary education, the limited disposable income to afford most DCGs, and so on.

Secondly, today’s regional disparities are represented by the following aspects: 1) Chinese inward FDI is mostly allocated in coastal areas; 2) modern and up-to-date technological development and innovation are mostly used in the eastern areas instead of in the central or western ones;\(^{372}\) 3) the most important commercial and industrial centres as well as the activities and the targeted consumers of foreign companies are concentratively located in the western provinces; and 4) “development in the eastern provinces has focused on secondary and tertiary industries, while provinces in the interior remain dependent on agriculture and mining.”\(^{373}\)

Thirdly, there is an extreme differentiation between urban and rural areas. The most illustrative indicator is the income differences shown in table 3-11 below:

\(^{372}\) Anonymous (2005e), p. 2

\(^{373}\) Ibid.
### Table 3-11: Income Comparison of Rural and Urban Households

| Year | Rural Households | | Urban Households | | | Urban/Rural Income Ratio (Rural Household=1) |
|------|------------------|------------------|------------------|------------------|------------------|
|      | Per Capita Net Income (yuan) | Engle coefficient (%) | Per Capita Disposable Income (yuan) | Engle Coefficient (%) |  |
| 1978 | 133.6 | 67.7 | 343.4 | 57.5 | 1:2.57 |
| 1980 | 191.3 | 61.8 | 477.6 | 56.9 | 1:2.50 |
| 1985 | 397.6 | 57.8 | 739.1 | 53.3 | 1:1.86 |
| 1990 | 686.3 | 58.8 | 1510.2 | 54.2 | 1:2.20 |
| 1995 | 1577.7 | 58.6 | 4283.0 | 50.1 | 1:2.71 |
| 2000 | 2253.4 | 49.1 | 6280.0 | 39.4 | 1:2.79 |
| 2001 | 2366.4 | 47.7 | 6859.6 | 38.2 | 1:2.90 |
| 2002 | 2475.6 | 46.2 | 7702.8 | 37.7 | 1:3.11 |
| 2003 | 2622.2 | 45.6 | 8472.2 | 37.1 | 1:3.23 |
| 2004 | 2936.4 | 47.2 | 9421.6 | 37.7 | 1:3.21 |
| 2005 | 3255.0 | 47.2 | 10493.0 | 37.1 | 1:3.22 |


Although in 2004 the income level of rural households has been increased twenty times higher than that in 1978, it is still lagging far behind an international level and three times lower than that in urban households. Meanwhile, the unemployment rate in rural areas is much higher than that in urban areas. And the number of the illiteracy still accounts for a large percent in rural areas.

To sum up, these imbalances between the rich and the poor, the coastal and interior areas as well as the urban and rural areas have become a serious social problem, which has accordingly gained a great deal of attention of Chinese government. Noteworthily, these imbalances further imply that it is a big misunderstanding for the marketers who want to make profits to approach China as a single and homogenous market.

#### 3.2.2.3.2 Banking System

As china stands as one of the fastest growing economies in the world, Chinese policymakers are facing the increasing pressure to deepen its economic reforms, especially in the financial sector which has supported those unprofitable SOEs over years. Furthermore, it is significantly crucial to have an efficient banking system in place for the economy to prosper.
China has four main state-owned commercial banks, namely the Bank of China, the Agricultural Bank of China, China’s Construction Bank, and Industrial and Commercial Bank of China, which dominate the national banking system by accounting for 52.5% of the assets of the banking sector in 2006. A major problem of China’s banking system is that for many years state-owned banks have lent the capital to loss-making state-owned companies instead of those truly creditworthy companies such as POEs and foreign investors. In addition, lending decisions are made mainly on the basis of government plans or relationships rather than enterprises’ profitability.

According the commitments to the WTO, China must completely open its banking sector to foreign participation by December of 2006. Foreign participation implies that foreign banks are able to compete with Chinese state-owned banks for local deposits, and meanwhile they are also expected to help Chinese monetary policy become more effective.

Today, these four largest state-owned banks are in the process of privatization. Except for the slower step in reforming agricultural bank of China, other three banks have experienced four main steps: recapitalisation, reform of internal structure, strategic partnership and stock market listing.

In conclusion, the reform in China’s financial sector seems to be in a right direction so far, though plenty of challenges remain. Finally, “when the banking system becomes fully resolved, this avenue to survival will disappear, forcing Chinese companies to become profitable or die”.

### 3.2.2.3.3 Currency Revaluation

Recently, one of the dominant issues in China’s economic development is the revaluation of Chinese currency --- Renminbi (RMB). In 1984 China’s central bank, the People’s Bank of China, adopted a floating exchange rate system, under which the exchange rate of RMB was allowed to fluctuate near the rate of 8.27 yuan to the US dollar. However, in tandem with China’s emergence as a global economy for many years, China has been confronting the increasing pressure to revalue RMB from both international and domestic sides.

---

375 Ibid., p. 3
376 Deloitte (2005), p. 2
From an international perspective, RMB revaluation is expected to reduce the growth of China’s export as China holds an enormous and increasing trade surplus, especially with Japan and the United States; from a domestic perspective, RMB revaluation is supposed to dramatically increase the purchasing power of Chinese consumers, thereby stimulating growth of the domestic sector.  

In July 2005, Chinese government adopted a new system, under which the old system of US dollar peg was abandoned, RMB is pegged against a basket of currencies, and a revaluation of 2.1% against the dollar was announced. Subsequently, RMB has further appreciated by 1.2% against the dollar. “Since the revaluation China has worked on building a functioning foreign exchange market, with indications that any further revaluations or adjustments will be made on a gradual basis.”

The economic significance and effects of RMB revaluation are highly argued. On the one hand, the revaluation did reflect that China intended to embark on the exchange rate reform by introducing more flexibility. On the other hand, it is too early to make conclusion whether RMB appreciation would have an effect on China’s exports and current account surplus or whether it could make a notable impact on boosting domestic consumption. However, how RMB revaluation will influence the CCGM becomes the most concerned issue of foreign and local companies. Noteworthily, “a revaluation would quickly lead to a reduction in the prices that Chinese consumers and businesses pay for imported goods.” As a result, for one thing, domestic consumer goods manufacturers would face tougher price competition from abroad; for another, in most cases lower prices would bring the increased demand. In a word, RMB revaluation is expected to stimulate consumer spending.

In addition to three main issues mentioned above, there exist some other economic challenges in China now, for instance, continuing restructuring of SOEs, civil service, increasing unemployment, insufficient protection of Intellectual Property Rights (IPR), counterfeit issue, environmental pollution, absence of infrastructures, energy issue and so

377 Kalish, I. (2003), pp. 17-18
378 Lunn, J. et al. (2006), p. 49
379 Ibid.
380 Ibid., p. 50
381 Kalish, I. (2005), p. 17
382 Ibid., pp. 17-18
on. As China is not a highly industrialized or nationalized economy, it is much easier to restructure while developing. In other words, with the help of government policies, China is expected to “realize growth while problems exist, solving them in the process of growth”.

### 3.2.2.4 Prospects

Broadly speaking, the prospects of China’s economy are promising. The national economy has “displayed a good momentum featuring fairly rapid growth, good return, stable price, and good dynamics”. China’s economic growth is expected to maintain this favourable path based on the stable macroeconomic environment internationally and domestically.

*Firstly*, in 2006 China stepped into the period of the 11th Five-Year Program (2006-2010). Many proposals were put forward in this program, encompassing “1) stabilizing macroeconomic policy; 2) constructing a ‘Socialist New countryside’; 3) strengthening capacity of innovation to promote structural adjustment; 4) saving energy, resources and promoting environmental friendly society; 5) promoting beneficial interactions among eastern, central and western regions; 6) speeding up reform to remove institutional obstacles so as to the implementation of the ‘Scientific Development Concept’; 7) implementing a win-win strategy of opening up; 8) promoting a harmonious society”.

Directed by the economic policies mentioned above, China’s GDP is expected to grow at an annual rate of 8 percent. On the one hand, “the nation’s future economic development will continue to be fuelled by the rapid growth of fixed asset investment, backed by the high saving rate and a major inflow of foreign direct investment.” On the other hand, China’s economic growth can be also sustained in virtue of accelerating industrialization and urbanization processes, upgrading consumption structure, and deepening reforms in SOEs, banking system, exchange rate system, technology, and so forth.

*Secondly*, according to China’s commitments to the WTO, the year 2006 is the deadline of transitional period, thereby indicating that all regulations and commitments in accordance

---

384 Ibid.  
386 World Bank (February-2006), p. 18  
387 Xu, D. S. (2005), p. 1
with the WTO must be fulfilled completely. In this instance, it is expected that foreign trade and FDI will keep dramatically growing.

In summary, China’s future is promising, although there are many challenges and issues to be overcome in order to smoothly accomplish its transition from planned economy to a sound market economy and to successfully integrate itself into the world’s system. What China has achieved so far, to a great extent, can reveal that those brilliant futures will not be impossible, though it still has a long way to go.

### 3.2.3 Sociocultural Environment

#### 3.2.3.1 Demographic Environment

One of the key sociocultural factors is demographic environment, encompassing national gross population, geographic distribution and density, household size and structure, age group, and population growth rate. Entrepreneurs and managers are very interested in these factors, as these factors influence manufacturing and marketing significantly and directly.

*First of all*, China is the most populous country in the world by possessing a population of 1.3 billion, the one-fifth of the world’s population. During the past six decades, the mortality in China has decreased due to the increasing political and social stability, especially the expansion of public health system and medical care system after economic reforms. Meanwhile, the birthrate in China has also fallen, mainly because China has been enforcing “one-child policy”, the strictest one of national birth planning policies. Although an average annual growth rate has declined to the current 0.60%, national gross population will keep rapidly increasing unquestionably, due to the increase of world gross population and the tremendous population base in China.

*Secondly*, the geographic distribution of Chinese population is grossly imbalanced. For instance, two-thirds of the population is in the eastern and central parts of China. The population density of Shanghai was 2690 persons per square kilometre; however, there were only 2 persons per square kilometre in Tibet. In 2005, resident structure is 43% in urban areas and 47% in rural areas respectively. 388 However, this proportion is rapidly

---

388 Liang, Y. G and Arcilla, M. S. (2006), p. 6
changing because of the massive and rapid urbanization. With the change of China’s large population, the increasing inequalities between the rich and the poor, between urban and rural areas as well as among different regions are getting more and more visible. Under the circumstances, internal migration from the rural to the urban areas is another serious issue China encounters. Lately, in order to promote China’s long-term development and create a harmonious society, Chinese government has formulated some strategies for population development by achieving five “balances”: balance in urban and rural development, balance in regional development, balance in economic and social development, balance in harmonious development between human and nature, and balance in domestic development and opening-up.389

Thirdly, during the past several decades, the average size and the structure of Chinese households have also changed in both urban and rural areas, not only because of the country’s family planning policy, but also the availability of housing, increases in per capita living space, social services, social pressures, and changes in the economy. A major characteristic of the change is that the size of Chinese household has constantly decreased. Meantime, the household structure is characterized by the following trends: one couple with one child or without child, the increased single families, the ascending divorce rate in urban areas, and so on.

Lastly, similar to other developing countries, the majority of the population in China is young.390 However, the proportion of elderly in China is estimated to increase from 8% to 24% between 2006 and 2050,391 because of better living conditions and great improvements in health.

3.2.3.2 Physical Environment

Physical environment is another important sociocultural factor, which has a close relationship with enterprises’ business activities. As a result of rapid industrialization and a long-run neglect of environment protection, China’s physical environment has been destroyed tremendously in the past several decades.

390 Polsa, P. S. et al. (2005), p. 13
Concretely, the physical environment in China is now characterized by 1) lands are overloaded, and the area of arable land keeps decreasing sharply; 2) forest resources are in the deficit; 3) fresh water is in shortage; 4) irreproducible limited mineral and oil resources are in shortage; and 5) China is now facing many severe environmental problems such as air and water pollution.

3.2.3.3 Cultural Environment

There are 56 nationalities within China’s border. The majority is Han Chinese, with 91 percent of Chinese population, and 55 minorities with 9 percent of Chinese population. The Han Chinese has eight distinct linguistic groups, encompassing Mandarin, Cantonese, Hokkien-Taiwanese etc. Besides, the minorities have their own diverse dialects and languages.

Although some characters of Chinese culture are in common with other countries particularly Asian countries, there still exist unique cultural characteristics in China. The concept of Chinese culture was derived from the Confucianism as well as the ideas from Taoism and Buddhism, which makes a fundamental impact on people’s modes of thinking and ways of behaving. With these traditional philosophies, Chinese culture values are characterized by 1) moral cultivation; 2) importance of interpersonal relationships; 3) family and group orientation; 4) respect for age and hierarchy; 5) avoidance of conflict and need for harmony; and 6) importance of the concept of “Chinese face”.

As a result of the above-mentioned aspects, Guanxi becomes a significantly important element in identifying Chinese culture system and also a critical business determinant of a company’s performance in Chinese markets. The term Guanxi refers to interpersonal relationships, further characterized by 1) it involves reciprocal obligation; 2) it doesn’t exist simply between two persons, but spreads into an entire Guanxi network; 3) it acts as an important resource; and 4) Guanxi results in the importance of “face-work”, which can be interpreted as honour of a person.

393 Ibid., p. 15
395 Ibid., pp. 7-8
396 In this research the word “Guanxi” refers to interpersonal relationship or connection
397 Polsa, P. S. et al. (2005), pp. 16-19
In a word, cultural backdrop and ethnic identification play a critical role in China’s business activities, as no enterprise strategies will succeed without taking the unique features of Chinese culture into consideration.398

3.2.4 Technological Environment

Similar to economic environment, the technological environment also plays a key role in directly affecting enterprises’ manufacturing and marketing activities. The general tendency of technological environment in today’s world can be represented by the following three aspects: 1) the range of new technology and invention is getting broader, covering information technologies, biology technologies, new material, space technologies etc.; 2) the periods of transformation from theoretical results to actual production as well as production update are greatly shortened; and 3) expenditures on R&D increase sharply.

Under the former centrally planned economy, Chinese companies hardly had any fund to do R&D because of lacking the remained benefit. Additionally, there was little connection between firms’ R&D department and the actual market, which resulted in lots of new technologies were left unused because those technologies could not keep up with rapidly changing market requirements. However, the previous situation has been changed greatly since China’s economic reforms. As the deepened reform in R&D sector and the increasing competition among firms, China has made efforts to cultivate its own technology industries and to reduce its reliance on foreign technology by developing indigenous standards in various fields.399 Today, China is not only leading the world in producing many types of consumer electronics and appliances but also becoming a major player in software production.400

Furthermore, the technological environment is expected to be more favourable for China’s sustainable development in the future because of increasing pressures and a lot of support of Chinese government. The increasing pressures mainly come from two aspects. For one thing, China is facing the shortage of energy, water and land resources. Only by promoting Science and Technology (S&T) can China solve these problems. For another, in the face of

398 Polsa, P. S. et al. (2005), p. 16
400 Myers, J. (2004), p. 3
intensive competition brought by foreign counterparts, Chinese enterprises have gradually
realized that their long-term survival and prosperity can be maintained by developing their
own core technologies instead of purely purchasing from outside. Noteworthily, the most
important stimulation comes from Chinese government’s support. Firstly, the budget for
S&T in 2006 will reach 71.6 billion yuan (US$8.9 billion), up 19.2% year-on-year, and
Chinese government will ensure that expenditures on R&D grow at a faster pace than fiscal
revenues in the next five years.401 Further, China plan to put roughly 900 billion yuan
(US$111.8 billion) into R&D in 2020, accounting for 2.5% of the expected GDP.402
Secondly, new tax policies will be of benefit to innovative business and research-oriented
companies by offering tax allowance. Thirdly, China Development Bank is allowed to
issue loans with low interests to high-tech companies as an investor. Fourthly, “China
already has the second largest share of science and engineering researchers in the world,
and between 2005 and 2010, the country will graduate some 3 million engineers, nearly
nine times the number that will graduate in the United States”.403

All in all, China aims to become an “innovation-oriented society” and world’s top five
science powers by the year 2020, finally a world leader in S&T by the year 2050.

3.3 Microenvironment Characteristics and Actors

Following the analysis of macroenvironment, this section focuses on microenvironment
characteristics and domestic actors, mainly involving the Chinese Consumer Goods Market
(CCGM), Chinese consumers, foreign competitors, and distributors in China.

3.3.1 The Chinese Consumer Goods Market

3.3.1.1 The Significance of the CCGM

With a population of 1.3 billion and their heightened disposable income, the significance of
the CCGM is obviously undeniable in China. For instance, every year more mobile phones
are sold in China than in any other country, and China is the world’s fifth-largest market

401 Anonymous (2006g)
402 Anonymous (2006h), p. 2
for cars.404

Under the background of China’s gradual emergence as a global player and its quickened pace of two themes: reform and development, the CCGM has achieved significant development since 1980s and is expected to keep booming in the years to come.

Today, the role of the emerging CCGM in Chinese economy is no longer defined as a simply domestic market featured with the imperfect legal system, inferior and small-sized manufacturers, low-price and low-quality products, the out-of-order competition mainly on low costs, and consumers who are sensitively price-oriented and possess limited disposable incomes. Rather, in today’s CCGM, a favourable regulatory environment has gradually been constructed; many foreign consumer goods giants have entered into this market and are operating profitable business there; a group of local Chinese manufacturers are growing up at home and abroad; consumer electric appliances, technological products, luxury goods, or auto sector are getting more and more popular and becoming new consumption hotspots, and so forth.

The booming CCGM has contributed greatly to China’s stable political environment, prosperous economy, the sustainability of social stability, and the improvement of people’s standard of living. Moreover, the size and scope of the CCGM are now having a significant effect on other country’s economies and the way that MNCs do business. Some MNCs believe that their new products are successful in China will be regarded as a good indicator for those new products’ to succeed in other markets around the world, as Chinese market is highly competitive and consists of a group of sophisticated consumers who demand quality and value.405 In turn, “as more products and services are developed and introduced in China first, successful companies realize that Chinese consumers will have a growing influence on global tastes and trends in the years to come”.406

In a word, the CCGM will go forward steadily, which is generally characterized by the following aspects: 1) this market is flourishing and stable; 2) the consumption of urban and rural inhabitants is continuously increasing; 3) the trend of consumption upgrade is getting obvious; and 4) the driving force of consumption to China’s economic development is getting enhanced further.

406 Ibid.
Due to the CCGM’s strategic position in China’s sustainable economic expansion, it is necessary first to offer an overall perception of the CCGM’s current situation in terms of sales and demand, and then the CCGM’s future prospects will be presented, finally, great attention will be given to its unique characteristics.

3.3.1.2 Current Situation of the CCGM

3.3.1.2.1 Sales Analysis

From a sale perspective, China’s total retail sales of consumer goods have increased significantly over the past decades, from 214 billion yuan in 1980 to 6,717 billion yuan in 2005, as shown in figure 3-7 below:

**Figure 3-7: Growth of Total Retail Sales of Consumer Goods (1979-2005)**

![Figure 3-7: Growth of Total Retail Sales of Consumer Goods (1979-2005)](image)


From 2001 to 2005, China’s total retail sales of consumer goods grew with the rate of 10.1%, 11.8%, 9.1%, 17.7% and 24.5% respectively, and an average growth rate reached 14.64%, exceeding the GDP growth in the corresponding period 9.6% by 5.04%. The total

---

407 Li & Fung Research Centre (2006), p. 2
retail sales of consumer goods in 2005 reached 6717.7 billion Yuan and 1.79 times than that of in 2001. Meanwhile, the total retail sales of consumer goods per capital for the first time breached 5000 yuan and reached 5153 yuan. Thereinto, retail sales of consumer goods in rural area from 2001 to 2005 also increased with growth rates of 7.7%, 7.0%, 6.8%, 10.7% and 11.5% respectively, and an average annual growth rate of 8.74%. In 2005, it reached 2208.2 billion Yuan and 1.7 times than that of in 2000.\textsuperscript{408} When being measured with current exchange rates, China had retail sales of US$785 billion in 2006, increasing by 13.7% than 2005.\textsuperscript{409}

The reasons for the tremendous and steady growth of China’ retail sales mainly involve the following aspects: 1) macroenvironment and microenvironment have created a favourable climate and condition for expanding the CCGM, and infused powerful dynamics into the augment of retail sales; 2) urban and rural markets have achieved synchronous growth; 3) catering has grown rapidly; and 4) new consumption hotspots such as private automobile, housing, tourism, and communication products have increased stably.\textsuperscript{410}

3.3.1.2.2 Demand Analysis

From a demand perspective, population growth trends, residents’ income level, consumption pattern, and consumption confidence should be addressed, respectively.

Firstly, as is commonly known China has 1.3 billion residents, accounting for 20% of the world’s population. “China has more consumers than Europe and the United States combined.”\textsuperscript{411} Therefore, China’s population growth is closely associated with the demand potential of the consumer goods market. Table 3-12 below lists the population growth in China from 1995 to 2005.

\textsuperscript{408} The Central People’s Government of the People’s Republic of China (2006)
\textsuperscript{409} Kalish, I. (2007), p. 2
\textsuperscript{410} The Central People’s Government of the People’s Republic of China (2006)
\textsuperscript{411} Yu, C. and Wong, M. (2002), p. 1
Table 3-12: China’s Population Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Population (millions)</th>
<th>Growth Rate</th>
<th>Urban Population (millions)</th>
<th>Growth Rate</th>
<th>Urbanization Rate</th>
<th>Yearly Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>1,211</td>
<td></td>
<td>352</td>
<td></td>
<td>29.0%</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>1,224</td>
<td>1.0%</td>
<td>373</td>
<td>0.8%</td>
<td>30.5%</td>
<td>1.4%</td>
</tr>
<tr>
<td>1997</td>
<td>1,236</td>
<td>1.0%</td>
<td>394</td>
<td>0.8%</td>
<td>31.9%</td>
<td>1.4%</td>
</tr>
<tr>
<td>1998</td>
<td>1,248</td>
<td>0.8%</td>
<td>416</td>
<td>0.8%</td>
<td>33.4%</td>
<td>1.4%</td>
</tr>
<tr>
<td>1999</td>
<td>1,250</td>
<td>0.8%</td>
<td>437</td>
<td>0.5%</td>
<td>34.6%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2000</td>
<td>1,267</td>
<td>0.8%</td>
<td>459</td>
<td>0.9%</td>
<td>36.2%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2001</td>
<td>1,276</td>
<td>0.7%</td>
<td>481</td>
<td>0.7%</td>
<td>37.7%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2002</td>
<td>1,285</td>
<td>0.6%</td>
<td>502</td>
<td>0.5%</td>
<td>39.1%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2003</td>
<td>1,292</td>
<td>0.6%</td>
<td>524</td>
<td>0.3%</td>
<td>40.5%</td>
<td>1.4%</td>
</tr>
<tr>
<td>2004</td>
<td>1,300</td>
<td>0.6%</td>
<td>543</td>
<td>0.3%</td>
<td>41.8%</td>
<td>1.2%</td>
</tr>
<tr>
<td>2005</td>
<td>1,308</td>
<td>0.6%</td>
<td>562</td>
<td>0.3%</td>
<td>43.0%</td>
<td>1.2%</td>
</tr>
<tr>
<td>10-Year Avg.</td>
<td>9.5 0.8%</td>
<td>21.0 0.6%</td>
<td>43.0%</td>
<td>1.4%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Although recently China’s population growth rate has slowed down to around 0.6%, it is still expected to expand continuously due to the huge base. It is forecasted that China’s population will reach 1.5 billion by 2025.412 Undoubtedly, the tremendous population base and the sustained growing population ensure a huge consumer market for manufactured goods.

The population of 1.30 billion is made up of 562 million urban residents and 738 million rural residents, accounting for 43% and 57% of China’s gross population respectively. Although the population of rural areas is dominant, that of urban areas will continue to expand greatly as a result of the intense urbanization of the rural population.413

Secondly, “if both the quantity and the quality of supply are mainly determined by the industrial standard and structure, the scale and level of demand will be influenced by the monetary income earned by urban and rural residents.”414 Thus, the residents’ annual income level of urban and rural households is very crucial to analyze the market demand.

---

413 Liang, Y. G. and Arcilla, M. S. (2006), p. 2
414 UEL Department of Economics (2000), p. 5
Illustrated by the above figure, the income level of Chinese residents has been improved significantly in the past 25 years. In 2005, per capita annual net income of urban and rural households reached 10,493 RMB and 3,255 RMB, respectively. With the implementation of the 11th Five-Year Plan (2006-2010), the income level of urban and rural residents will be further raised. By 2010, the per capita disposable incomes of urban and rural residents are expected to reach 13,390 RMB and 4,150 RMB, respectively.\(^{415}\)

Thirdly, in the context of a rapid economic growth and the increasing disposable income in pockets, Chinese residents’ consumption pattern has been experienced a structural transformation and upgrade, which is featured with a decreasing proportion of food and clothing as well as an increasing proportion of housing, automobile, communication, transportation, education etc., as shown in figure 3-9 below:

---

\[^{415}\text{Ma, K. (2006)}\]
Lastly, “income is the basis for consumption. Without the support of income, there will be no consumption increase.”\textsuperscript{416} Although Chinese residents’ income level has been raised greatly since 1978, it is still far behind the general standard compared with other Western countries. In this instance, residents’ consumption confidence presents a weakening tendency. Meanwhile, there are some other important factors which influence residents’ consumption confidence. For instance, consumers have the feeling of uncertainty for their future expenses. Since the mid 1990s, social security and welfare, such as housing, medical care and education which should be provided by the government before, now must be born by residents themselves. Besides, credit consumption level is still very low. Especially, now Chinese residents are willing to pay much more on education. According to a questionnaire survey conducted by the Central Bank in 50 large, medium and small cities in China, urban residents’ consumption intention has dropped to an all-time low after three quarters of decline in a row.\textsuperscript{417}

3.3.1.3 Future Trends of the CCGM

Generally speaking, China’s politics and economy create a sound foundation and a favourable environment for developing the CCGM. \textit{Firstly}, the central government will keep on implementing moderate macro-economic policies; the exchange rate of RMB will

\textsuperscript{416} Qiu, X. H. (2006), p. 1
\textsuperscript{417} Wei, X. (2006)
remain stable; China’s overall economy will maintain a rapid and steady development; and
domestic demand will keep strong. Secondly, Chinese government has fully realized the
effect of enlarging consumption, and accordingly the emphasis of its economic policies
will be laid on enlarging consumption in both urban and rural areas. Thirdly, residents’
income level is expected to increase continuously, particularly in rural area. With the help
of implementing the policy of constructing new rural, the income of rural residents will
increase rapidly and the purchasing power will be also getting strong. Fourthly, Chinese
government has recognized the significance of marketing channels, and therefore it will
pay more attention to improving the infrastructure and environment of consumption and
widening consumption scopes. Lastly, as Chinese government has put more control on
maintaining a stable and healthy market system, product quality is getting better, which is
of great benefit to promoting residents’ consumption confidence.

However, there still exist some unfavorable issues that might block the further
development of the CCGM. For instance, some public incidents, such as food security
issue, may impact on the market stability.

In summary, taking both positive and negative factors of China’s business environment
into account, the development trends of the CCGM in 2006, in general, will keep
promising. Concretely, these trends are reflected by:

- Domestic consumption will keep expanding rapidly and steadily, serving as a major
driving force of the country’s economic growth. The total retail sales of consumer
goods are expected to reach 7,500 billion yuan in 2006 with an anticipated growth
rate 13%. The rural consumer goods market will also expand. The retail sales of
c consumer goods in rural areas are expected to grow with 11.5% and the gap between
urban and rural areas will become narrower. According to the findings of a survey by
Credit Suisse, one of the world’s leading investment banks, the CCGM will overtake
Japan, Germany, Britain and Italy to become the world’s second biggest consumer
goods market only behind the United States by 2015.\textsuperscript{418}

- In general, residents’ consumption price remains stable. Influenced by the price reform,
the whole price level is supposed to increase by 2% or 3%.

- The relationship between demand and supply in CCGM will develop in a good
direction.

\textsuperscript{418} Hong Kong Trade Development Council (2007)
The consumption structure is being upgraded and new consumption hotspots emerge continually. In addition to the housing which will still be the consumption hotspot in urban and rural areas, automobile, information and communications, catering, travel, fitness, education, culture and sports recreation, and some culture products with special characteristics will become the main engine for the CCGM’s growth. A new consumption direction of residents will be characterized by a combined consideration of brand, environmentalism, individuation, and fashion.

The means of shopping keep evolving, for example, credit cards and the Internet will become increasingly important in residents’ daily life.

All in all, China is expected to become the world’s third largest consumer market by 2010 and the second largest by 2015.

To better understand the CCGM, the previous research is still not enough. The reality behind those numbers and indexes should be further identified through studying the unique characteristics of the CCGM.

3.3.1.4 Unique Characteristics of the CCGM

Similar to other emerging markets such as India, Russia or Central and Eastern Europe, the CCGM contains not only opportunities but also challenges and risks. On the one hand, the scope and the potential capacity of the CCGM are impressive according to the previous research. On the other hand, it would be a big misconception to view this market as a single and homogeneous one because of the considerably large differences in terms of culture, geographic conditions, and economic development degree within Chinese marketplace. Actually, this highly fragmented consumer goods market can be discerned as a complicated network with different hierarchies concerning geography, consumer goods, and consumers. What follow are hierarchies of geography and consumer goods, and the consumer hierarchy will be examined in the section 3.3.2.

---

419 Gao, Y. D. (2005)
420 Anonymous (2007c), p. 3
421 Hsu, H. et al. (2007), p. 3
3.3.1.4.1 Geographic Hierarchy

China is located in the Eastern Asia. It has a total area of 9.6 million square kilometres, ranking the second-largest country in Asia by occupying 1/4 of Asia area and the third-largest country in the world by covering 1/5 of world land. East and West, North and South of China are greatly diverse in terms of climate, landform, population, culture, and dialect.

![Map of China](source-image)

Source: Anonymous (2006i)

Referring to this map, China is divided into 31 provincial-level localities, including 22 provinces, 4 municipalities directly under the central government, and 5 autonomous regions. Below the provincial level, there are three administrative levels. They first cover 335 prefectures and municipalities at the prefectural level; second, 2,142 counties, autonomous counties, and cities at the county level; and third, tens of thousands of townships, towns and city districts.

According to different economic development, infrastructure, industrial priority, local

---

422 Polsa, P. et al. (2005), p. 3
culture, purchasing power and distribution,\textsuperscript{423} the above-mentioned geographic areas can be categorized into five tiers cities plus rural areas, which further belong to “three Chinas: prosperous China, Emerging China, and Rural China”\textsuperscript{424}, as illustrated in the table 3-13 below:

### Table 3-13: Geographic Diversification in the CCGM

<table>
<thead>
<tr>
<th></th>
<th><strong>Prosperous China (1\textsuperscript{st} and 2\textsuperscript{nd}-tier Cities)</strong></th>
<th><strong>Emerging China (3\textsuperscript{rd} to 5\textsuperscript{th}-tier Cities)</strong></th>
<th><strong>Rural China (6\textsuperscript{th}-tier and Rural)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Cities</td>
<td>25</td>
<td>305</td>
<td>324 (Tier 6 only)</td>
</tr>
<tr>
<td>Percentage of China’s total population (2004)</td>
<td>9% (119 million)</td>
<td>18% (234 million)</td>
<td>73% (947 million)</td>
</tr>
<tr>
<td>Percentage of China’s GDP (2004)</td>
<td>34%</td>
<td>43%</td>
<td>23%</td>
</tr>
<tr>
<td>Average annual GDP growth rate of cities</td>
<td>16%</td>
<td>16%</td>
<td>Not available</td>
</tr>
</tbody>
</table>


Firstly, the “

\textbf{prosperous China}” covers the 1\textsuperscript{st}- and 2\textsuperscript{nd}- tier markets:

- **1\textsuperscript{st}-tier market** includes top four cities: Beijing, Shanghai, Guangzhou, Shenzhen. These four highly developed and modern cities, located in the eastern part of China, are thought to be in possession of the highest income level, the strongest purchasing power, the advanced infrastructure, and well-connected transportations.

- **2\textsuperscript{nd}-tier market** refers to those cities at the provincial level, for instance, Wuhan and Zhengzhou in central China; Fuzhou and Xiamen across the strait from Taiwan; Chengdu and Xi’an in the west; and Harbin in the northeast;\textsuperscript{425} Nanjing, Dalian, Qingdao; Hangzhou, Ningbo and Wenzhou in Zhejiang Province; Dongwan in Guangdong province as well as two municipalities directly under the central government: Chongqing and Tianjing.

\textsuperscript{423} Luo, Y. D. (2005), p. 7
\textsuperscript{424} Beebe, A. (2007), p. 7
\textsuperscript{425} Liang, Y. G. and Arcilla, M. S. (2006), p. 8
Secondly, the “emerging China” includes the 3rd-, 4th-, and 5th-tier markets, which involve cities at prefectural level and counties in Zhejiang, Jiangsu and Guangdong provinces.

Lastly, the “rural China” involves the 6th-tier market, which consists of the hinterland of China, namely countrywide villages and towns as well as widest and dispersive rural areas.

Generally, the target markets that companies are always willing to mention refer to the “prosperous China”, namely the 1st- and 2nd-tier cities; however, the reality is that the “emerging China” and the “rural China” hold 91% of the whole population of China.

As the 1st- and 2nd-tier markets are habitats of the main purchasing power, they become the most ideal and attractive target for consumer goods manufacturers. So far for most consumer goods, particularly commodities and home appliances, foreign companies are major players in the prosperous markets and their distribution channels generally end in the 3rd-tier market. However, the 3rd-, 4th-, 5th-tier markets and even 6th-tier markets are steady citadels of most local Chinese companies. It is on the basis of these citadels that Chinese companies attain the basic survival and long-term development and meanwhile resist foreign competition to some extent. In tandem with China’s economic boom and the gradual saturation in the 1st- and 2nd-tier markets, the “emerging China” markets including the 3rd-, 4th- and 5th-tier cities start to attract more and more attention, and become a new battlefield where foreign and domestic companies compete actively against each other.

3.3.1.4.2 Consumer Goods Hierarchy

In today’s China we will be amazed at the tremendous varieties of consumer goods when walking into department store, hypermarket or supermarket. Modern and well-decorated shelves are crowded by sundry consumer goods, ranging from luxuries to daily necessities, or from hi-tech products to mass products, or from Western-style goods to Chinese traditional ones. In general, consumer goods in China can be roughly divided into three grades: high-end products, middle-end products and low-end/mass products.

- **High-End Consumer Goods** refer to products containing high-quality, high
technology, high price, superior after-sale service, and a global brand prestige, for instance, imported luxury goods. This segment of consumer goods are mainly characterized by 1) being produced by Foreign Invested Enterprises or JVs; 2) serving wealthy class and upper-middle class; and 3) covering 1st- and 2nd-tier markets where exist enough demands of affluent consumers who are able to and willing to have high-end consumer goods. High-end consumer goods are expected to provide consumers with more than quality and function of products by adding aesthetic and social value in this segment. Today, more and more Chinese consumers are interested in the high-end products due to the increase of their disposable income and the strong desire to improve their life quality, however, high-end consumer goods are still “peripheral to China’s mass market”\textsuperscript{426} for the moment.

- **Middle-End Consumer Goods** generally include directly imported foreign brands, products produced by foreign brands in China, and some domestically produced local brands. Middle-end consumer goods target mainly on Chinese middle class and the 2nd- and 3rd-tier markets. Particularly, “demand for imported consumer healthcare and personal-care products is growing among these middle- and upper-class consumers.”\textsuperscript{427} Nonetheless, the demand for imported consumer goods is still much smaller compared with those produced locally.

- **Low-End Consumer Goods** are characterized by low quality, low price and inferior after-sales service. Low-end consumer goods include most local brands which are made by middle- or small-size domestic enterprises in China, and are offered to the tremendous lower-middle class and the bottom of social stratification. Low-end consumer goods cover the widespread 4th- and 5th-tier markets which are composed of villages, counties or agricultural areas.

The classification of consumer goods in China can be illustrated in figure 3-11 below:

\textsuperscript{426} Kotler, M. (2001), p. 8
\textsuperscript{427} Zakreski, J. and He, F. (2001), p. 60
If a foreign company positions its product as low- or middle-grade consumer goods, the company will not be able to compete effectively with Chinese companies on price. The main reason is that Chinese companies have the unique advantage especially in low- and middle-grade product ranges, where they “with low cost structures excel in developing similar products offered at up to 40 percent lower prices”. Accordingly, low- and middle-grade product sectors have been occupied by Chinese companies for a long time. Now, more and more foreign players start to expand their products into medium-end range instead of previously only high-end or luxury segment. This inevitably leads to that the middle-grade consumer goods will become the fiercest sector that local Chinese enterprises and foreign companies are contending for.

### 3.3.2 Chinese Consumers

Based on the previous research on geographic hierarchy, it is obvious that neither identifying Chinese consumers as a whole nor treating them by dividing them into the 1st-tier markets and other areas is complete and comprehensive for companies to understand Chinese consumers very well. Actually, the CCGM is made up of multiple and hybrid consumer groups, involving the traditional and the modern, the urban and the rural,
millionaires and needy peasants, well-educated white-collar workers and poor-educated blue-collar ones whose disposable income, consumption structure, buying behaviour, and peculiarities are quite different.

Therefore, a thorough investigation on Chinese consumers’ evolution, hierarchy, wants and needs, buying behaviour, and cultural background is quite necessary for both foreign and Chinese companies to understand Chinese consumers, identify target segments, and accordingly make a long-term profitable business in China.

3.3.2.1 Chinese Consumer Evolution

Being isolated from the rest of the world for a long time, China was very penniless in the past. In this instance, the CCGM was featured with the serious scarcity of consumer goods, no real brands available, less media methods and nearly no advertisements, and so on. In those days, most Chinese consumers were merely concerned about their basic necessities of survival such as food and clothing. Meanwhile, most consumer goods were unnecessary, unaffordable, or unreachable for them. In short, Chinese consumers were characterized by a long-term global isolation, very limited disposable income in pockets, very price-conscious shopping, and self-restraints of personal desires. This can be regarded as the first stage of Chinese consumer evolution, namely “Wenbao” – the phase of dressing warmly and eating one’s fill.

However, China’s rapid economic development brought an increase in consumers’ disposable incomes, and meanwhile, China’s further integration into global markets and a lot of foreign companies rushing into Chinese markets brought an increase in the range of products available. With the aim of improving life quality, Chinese consumers’ consumption consciousness started to change from meeting basic needs to pursuing more contents. This signalled the second stage of Chinese consumer evolution, namely “Xiaokang” – reasonably well-off phase. Urban consumers in this stage prefer to spend their money on commercial housing, automobiles, telecommunications, advanced IT products, medical and health care, education, entertainment, and tourism. As such, consumers in wide rural areas start to buy some durable consumer goods after possessing

---

430 Zakreski, J. and He, F. (2001), p. 60
431 Taylor, R. (2003), p. 188
sufficient food and clothing.

Further, some Chinese consumers have stepped into the third stage, namely “Fuyu” – affluent phase. These consumers are represented by wealthy entrepreneurs and key management talent in both foreign and Chinese companies. Generally, they are quite aware of the luxury goods, this is the reason why some mega-brands like Louis Vuitton, Dior, Mercedes Benz, and BMW are flourishing in China.

In a word, these three evolutionary stages are not regarded as a successively developing process; rather, they offer an overall and historical background, which facilitate us to understand the reasons that generate and shape unique characteristics of Chinese consumer behaviour and psychology.

3.3.2.2 Chinese Consumer Hierarchy

The diversities in geographic markets of various tiers undoubtedly result in many differences in consumers’ income level and living style. Generally speaking, Chinese consumers can be divided into two groups: urban residents and rural residents. However, this classification is insufficient to understand Chinese consumers. Therefore, it is necessary to further examine various consumer hierarchies on the basis of different social and wealth classes.

Since China’s open policy was implemented in 1978, the structure of China’s social class has experienced a fundamental change. In the earliest times of Chinese history, there were two social classes and one social estate: elite and peasantry classes as well as intelligentsia estate. Due to China’s economic growth and FDI increase, the state sector is crumbling, private enterprises are booming, and the thought that the working class leads the country is shrinking.\(^{432}\) Meanwhile, many other classes and subgroups have emerged. Finally, ten different social classes came into being based on people’s different social status, occupations and income levels, including national and social governor class, handler class, entrepreneurs in non-state corporations, professional technician class, clerk class, individual businessman class, service personnel class, industrialist class, farmworker class,

\(^{432}\) Brennan, P. (2002)
and unemployed or semi-employed class.

According to the income level and spending power, these ten social classes can be further classified into five wealth strataums or economic classes: wealthy class, upper-middle class, middle class, lower-middle class, and bottom class. Each social class is a sub-society composed of people with similar social class, cultural background, or economic status.

Due to the huge size of China and the rapid changes in Chinese society, it seems to be very difficult to find a unified and official classification of Chinese consumers according to the same criteria like occupation, income, consumption, or self-identification. Consequently, table 3-14 below only indicate a rough overview of Chinese consumer hierarchy.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Annual Income Level (RMB, per Household)</th>
<th>Proportion of Whole Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wealthy Class</td>
<td>&gt; 200,000</td>
<td>7%</td>
</tr>
<tr>
<td>Upper-middle Class</td>
<td>100,000---200,000</td>
<td>15%</td>
</tr>
<tr>
<td>Middle Class</td>
<td>40,000---100,000</td>
<td>20%</td>
</tr>
<tr>
<td>Lower-middle Class</td>
<td>25,000---40,000</td>
<td>15%</td>
</tr>
<tr>
<td>Bottom Class</td>
<td>&lt; 25,000</td>
<td>43%</td>
</tr>
</tbody>
</table>

Sources: Liang, Y. G. and Arcilla, M. S. (2006), p. 9

- **Wealthy Class**

China’s rapid economic boom and open have firstly made a group of rich people, namely wealthy class. Households in wealthy class earn annual income of minimum 200,000 RMB, accounting for 7 percent of total population.433 This class is made up of entrepreneurs of large SOEs and foreign invested enterprises, private businessmen, national governors, and famous stars as well as a group of people who benefit greatly from dealing with real estates or securities exchange. They are the owners of luxury houses and cars, and many of them have real estate under management. They can afford high-end products, durable consumer goods or fashion gadgets, dining out, travelling abroad. Noteworthily, a new group --- the knowledge wealthy class has emerged. Generally, they are young and have strong purchasing power to match their special life quality and style.

433 Konomoto, S. (2004), pp. 5-6
• **Upper-Middle Class**

The upper-middle class earns an annual income of 100,000 to 200,000 yuan per household, accounting for roughly 15 percent of the whole population. This class is made up of “scientific development entrepreneurs, high-level managers in foreign invested enterprises, JVs, or SOEs and financial institutions; professional technicians in various fields especially in information technology industry; high-level government officials; and some self-employed private entrepreneurs”.434

In general, they are better educated and cultured, and can consume most durable consumer goods such as colour televisions, mobile phones, personal computers, digital cameras and so on. Furthermore, most of them can afford ordinary cars and nice private houses. Additionally, they pay much attention on educational investment, especially for their children. “Wealthy and upper-middle class households are projected to grow from 19 million in 2005 to 74 million in 2015, a yearly rise of 5.5 million, at an annual rate of 14.6%.”435

• **Middle Class**

Particular attention has been paid to the middle class. The emergence and rapid expansion of middle class is the consequence of China’s rapid economic development and urbanization.

Middle class firstly emerged in the 1st-tier markets of the eastern part of China and coastal areas where the economy was booming, and then spread rapidly to the central and western China. Middle class is defined as those households with an annual income ranging from RMB 40,000 to 100,000, accounting for 20% of China’s population of 1.3 billion. It is a major social group, consisting of office managers, lower-level cadres or employees in FIEs, JVs, SOEs or POEs, technical personnel and office workers in various fields. In mainland China the middle class is a group of people with stable incomes and the capacities of purchasing either private houses or ordinary cars, or both but with the help of bank loan and affording education and holidays. “They are better educated, are marrying later and having fewer children. The young, urban middle

---

434 China Internet Information Center (2002)
435 Liang, Y. G. and Arcilla, M. S. (2006), p. 10
classes of Asia are as sophisticated as any in the world. They lead sophisticated lifestyles and want sophisticated products and services. They are looking for quality as part of a self-conscious search for quality of life.\footnote{Naisbitt, J. (1996), p. 36}

Middle class plays a significant role in China’s society, as it is “both a vanguard in consumption and a rearguard in politics.”\footnote{Zhou, X. H. (2005), p. 2} On the one hand, this stratum is a dominating group leading social consumption. When this class becomes the majority of national gross population, their life and consumption style will guarantee a huge and sustained consumption market. On the other hand, middle class is a major force to ensure social stability, since it acts as a glacis between the rich and the poor and tries to abate their conflicts. In view of the importance of China’s middle class in maintaining stable political and economic conditions, building up a more reasonable and modern social class structure, and creating a good social order and a harmonious society,\footnote{China Internet Information Center (2005)} China is planning to raise the proportion of middle-class earners to reach 40% of total population by boosting reforms in terms of registered residents, employment, personnel, social guarantee. Finally, “total middle class (lower middle class and above) households are projected to increase by 166 million households, or 16.6 million, at 17.1% per year, reaching 209 million households by 2015.”\footnote{Liang, Y. G. and Arcilla, M. S. (2006), p. 10}

- **Lower-Middle Class**

Lower-middle class refers to the households with annual income ranging from RMB 25,000 to 40,000, accounting for about 15% of whole population. This class is represented by intellective working force, and most of them are armed with the basic education. Precisely, this group includes skilled workers, general managerial staff, office clerks, sales men and individual businessmen. Generally, this class gets the access to preliminary social system for unemployment, illness and retirement. Besides, “this segment is less eager to pay for brands or foreign products and the ownership rates of consumer durables are the lowest”.

- **Bottom Class**
Bottom class is the lowest social class in China, referring to those households whose annual income is below RMB 25,000. Bottom class is comprised of two different socioeconomic groups.

One group consists of people who are struggling around the poverty line and whose lives are absolutely needy and miserable. In rural areas, this stratum refers to those households lacking sufficient labour forces in depressed area where natural condition is atrocious. In urban areas, this stratum covers aged and unskilled laid-off workers, retirees without pensions, underprivileged rural migrants, and the new urban poor consisting of inactive unemployed and partially unemployed people. Their annual income is around RMB3000 to 4000 or even less. What they are mainly concerned about are basic necessities of life --- clothing, food, and house. This social group totally lacks social welfare provisions for illness, unemployment and retirement.

The other group is made up of people who can only meet their basic needs for living. Generally, they are living on physical force, such as industrial workers, service workers, builders, small individual businessmen, autarkic peasants, surplus farmers who moved to cities and the like. Their annual income ranges from RMB 5000 to 25,000. Although they have already lived above the absolute poverty line, they will be very weak once facing illness, unemployment or retirement.

3.3.2.3 Chinese Consumer Behavior

Based on the previous research on the evolution of Chinese consumers and the diversities of geography, culture, economic development in the CCGM, it is more paramount for companies to identify the unique and sophisticated consumer behaviours in mainland China, which are summarized as follows:

- In principle, Chinese consumers’ requirements of product quality continue increasing due to their bulging pockets with money and their rising expectations of better life quality. Additionally, more and more Chinese consumers are pursuing aesthetic feeling and approved social value, rather than concentrating only on the basic functions of products.

---

440 Li, Y. Y. (2004), p. 10
Traditional Chinese consumers are very sensitive to price. Most consumers prefer to buy what they really need rather than to buy impulsively. When shopping in small stores, especially in private sellers, they bargain actively till the price is lowered to a suitable level that they can afford or can accept from a psychological perspective. However, such bargaining behavior is seldom applied in buying durable consumer goods or brand products.

Advertising is always playing the leading role in China. Advertising was allowed again since the early 1980s.\textsuperscript{441} It includes different forms such as television, radio, newspaper, or billboard. Among the mass media, television plays a vital role in affecting consumers’ buying decision, as Chinese spend a lot of time watching TV. Due to available options of recreation are increasing, now some consumers start to relax by taking other ways, like going for sports or playing bowling, instead of only focusing on TV after work. Nonetheless, advertisements through television programmes, broadcast, and newspaper still work effectively on the mass consumers who can not afford other new and modern entertainment.

Another important element influencing consumers’ buying behavior is oriented by strong characteristics of Chinese collective culture, group orientation and hierarchically social relations.\textsuperscript{442} In other words, Chinese people have close relationships and frequent contacts with their neighbors, friends, relatives and colleagues. They share and exchange a mass of information through an informal way namely “word-of-mouth”, which makes their positive or negative information and experiences on a given product spread very quickly. Furthermore, such communication in network makes Chinese consumers feel neither to be a pioneer trying new products nor to be far behind in their group. When some consumers find that they have less experience or knowledge in their network, they will try to catch up.

Chinese consumers spend much time browsing in hypermarkets or supermarkets as a necessarily recreative means, even if some of them have nothing to buy. At least they

\textsuperscript{441} Polsa, P. et al. (2005), p. 48
\textsuperscript{442} Ibid., p. 47
feast their eyes on product availability, variety, and price range, and enjoy modern shopping environment such as air conditioner, interesting promotion shows offered by retailers. With all collected information on products in their minds, generally, Chinese consumer will adopt a “wait-and-see” attitude before they make any serious buying decision.

- With the increase of middle class, there is another emerging consumer group: the female consumers. In China, woman are said to hold up half of the sky. These modern Chinese women are paying much more attention to taking care of themselves by bringing fashionable thought and practice into their life. “Women’s increasing income with an annual rate of 5%” will become a significant driving factor of expanding purchasing power on cosmetics, healthy products, high-priced accessories, etc.

- The one-child policy implemented in China since 1970 has made a great impact on China’s demography and accordingly consumption pattern and purchasing behavior of those single child families. These “little emperors” are dominant in their families and even in their grand-fathers’. Hence, the involved families will to some extent incline to these single children when parents consume.

- Chinese consumers prefer a free shopping environment for their browsing and they seldom express their dissatisfaction, at least not directly to salespersons in shops.

- Mass consumers in China belong to the conservative type, which can be represented by their high savings rate compared with that of developed countries. A major reason for this is that Chinese consumers have to bear the costs brought by housing, medical treatment, and education reforms, as well as the deposit for retirement or inexpectant unemployment.

---

443 Li & Fung Research Centre (2006), p. 9
444 Anonymous (2005f), p. 4
445 Ibid.
446 Li, Y. Y. (2004), p. 10
Last but not least is the brand effect on Chinese consumer behavior, especially the influence of foreign brands. Some matured consumers start to pay attention not only to brands or superficial elements, but some integrated factors related to products, such as quality, price, and service. Even so, it doesn’t mean that brand effect becomes weak. On the contrary, this situation creates a good chance to those successful brands which provide consumers more with a series of matching value-added elements. For instance, in 2005, 66 percent of purchasing power was given to the top 10 popular brands of consumer goods in China.447

Besides, in the past, foreign brands were always connected with premium price, high quality, good image and better lifestyle, especially for some durable consumer goods such as electronic appliances or home improvement. However, as domestic brands are catching up, Chinese consumers don’t blindly adore imported brands any more, but make suitable selections between foreign and local brands. In some product categories, local brands even overtake foreign brands in consumers’ preferences. In a word, local brands try to improve themselves by continuously updating product quality, whereas foreign brands try to localize themselves by reducing their product price and tailoring product to approach local preferences as close as possible. In order to seize consumers’ pockets, the competition between foreign and domestic players will be getting fiercer and more head-on in the CCGM.

3.3.3 Foreign Competitors

There are two major players in China: domestic Chinese companies and foreign companies. For domestic Chinese companies, regardless of SOEs in transitional stage or POEs, foreign companies are their major and strong competitors.

Foreign Investment Enterprises (FIEs) or Foreign-funded Enterprises (FFEs) refer to

---

447 The Central People’s Government of The People’s Republic of China (2006)- (a)
foreign entities which set up enterprises in China in accordance with Chinese law and engage in direct investment jointly or independently.448 Only between 2004 and 2006, the number of FIEs in China has soared from about 470,000 to more than 500,000.449 FIEs, an important subgroup of enterprises in China, are playing a significant role in boosting China’s economy by creating about one-third of Chinese industrial output, representing nearly ninety of China’s 200 largest exporters, making up over one-fifth of Chinese tax revenue, dominating numerous market segments such as cosmetics, and employing over 24 million people.450

Two major types of FIEs have emerged in China: one is Multinational Corporations (MNCs) from Western developed countries such as Europe, America, and Japan; and the other is mid-sized Asian manufacturers from Singapore, Thailand, Malaysia, as well as Taiwan, Hongkong and Macao areas.

Thereinto, MNC refers to “a firm with branches and subsidiaries in several countries from which it derives at least 25 percent of its annual sales income.”451 The number of MNCs worldwide has increased from 7,000 in 1970 to more than 60,000 in 2000.452 These full-fledged MNCs always keep dominant positions in the CCGM, and thus they belong to the first-tier investors in China, which are characterized by possessing globally known brands, advanced technology, and great financial strength.

Other foreign competitors belong to the second-tier investors in the CCGM, with weaker positions if compared with MNCs, but much stronger or equally matched positions if compared with local Chinese firms.453 Although Chinese companies are confronting considerable competition pressures from both first- and second-tier foreign competitors, in this research the emphasis will be put on analyzing Chinese companies’ competition

---

448 Mallesons, S. J. (2002)
against foreign MNCs, as the competition between local Chinese companies and foreign MNCs is more typical to exhibit Chinese companies’ strategic options and competitive responses.

To well understand the emergence and development of foreign MNCs in China, it is necessary first to examine the evolution of China’s relevant policies towards FDI in terms of regulatory, geographic restriction, and legal operating forms. Then foreign companies’ three major developing stages in China and the evolution of their China strategies will be addressed. Subsequently, major foreign consumer goods MNCs operating in China will be introduced briefly. Finally, an overall evaluation of foreign consumer goods MNCs’ strengths, weaknesses, opportunities, and threats in the CCGM will be summarized.

3.3.3.1 The Evolution of China’s Regulatory Environment toward Foreign Investment

In order to create a favorable investment environment and encourage overseas firms to invest in China, the Chinese government has gradually set up a series of foreign investment policy system since 1979, which mainly involves industrial, regional, tax and financial policies as well as the operating formats of foreign investment.454

Firstly, China’s policies on foreign investors have experienced a gradual evolution over time. It is clear, however, that the Chinese government has taken and will continue to take significant steps towards making the law and policy changes necessary to liberalize foreign investment. That is, this evolution is characterized by a process of increasingly opening. Relevant dates and representative achievements are summarized in table 3-15 below. Moreover, it is worthy of note that all related laws and regulations are also applicative to those investments into mainland China from Hong Kong, Macao and Taiwan areas.

454 The Central People’s Government of The People’s Republic of China (2005)- (b)
Table 3-15: China’s Institutional Changes to Foreign Investment

<table>
<thead>
<tr>
<th>Time</th>
<th>Representative Laws, Regulations and Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949 --- 1977</td>
<td>Due to the previous bitter experiences with foreigners and ideological distance with capitalism, the new China sought to reconstruct the national economy by nationalizing the industry. Foreign investment was expelled in the context of China’s establishment of a socialist planned economy.</td>
</tr>
<tr>
<td>1978</td>
<td>To catch up with the developed countries, China started to open door to absorb more capital.</td>
</tr>
<tr>
<td>1979</td>
<td>- China established the Foreign Investment Control Commission to attract and coordinate foreign investment, &lt;br&gt; - The Equity Joint Venture (EJV) Law was promulgated, which authorizes the acceptance of foreign equity capital.</td>
</tr>
<tr>
<td>1980s</td>
<td>Foreign investment was restricted to export-oriented businesses, and foreign investors were required to enter into joint ventures (JVs) with Chinese counterparts in order to enter the market.</td>
</tr>
<tr>
<td>1983</td>
<td>Regulations for the implementation of the Joint Venture Law</td>
</tr>
<tr>
<td>1986</td>
<td>A national Wholly Foreign Owned Enterprise (WFOE) law was promulgated, which permits foreign investors to set up exclusively wholly foreign-owned enterprises in China under certain conditions.</td>
</tr>
<tr>
<td>1988</td>
<td>The National People’s Congress passed the Contracted Joint Venture (CJV) Law.</td>
</tr>
<tr>
<td>Early 1990s</td>
<td>Government began allowing foreign investors to manufacture and sell an increasingly wide variety of goods in the domestic market.</td>
</tr>
<tr>
<td>Mid 1990s</td>
<td>WFOEs have been allowed to operate in China</td>
</tr>
<tr>
<td>2001</td>
<td>China’s accession to the WTO implied more open fields for foreign investment on schedule, for example, foreign investment opportunities were further expanded with the removal of financial and distribution services from the restricted list.</td>
</tr>
</tbody>
</table>

Source: Anonymous (2007d); The Central People’s Government of the People’s Republic of China (2005) – (b)

With institutional changes toward foreign investors in a liberalizing way, Chinese government has also given foreign investors more liberty on geographic scope by granting various regions a special status which is favorable for foreign investment, as shown in the table 3-16 below. They are Special Economic Zones (SEZs), open coastal cities, economic and technological development zones, free trade zones, border economic cooperative zones,
and export processing zones.455

Table 3-16: The Geographic Expansion toward Foreign Investors

<table>
<thead>
<tr>
<th>Phase</th>
<th>Accessible Locations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>Four Special Economic Zones (SEZs) were established in southern China: Shenzhen, Shantou, and Zhuhai in Guangdong province, and Xiamen in Fujian province.</td>
</tr>
<tr>
<td>1984</td>
<td>14 open coastal cities: Shanghai, Guangzhou, Tianjin, Fuzhou, Dalian, Qinhuangdao, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Zhanjiang, and Beihai were open to foreign investors and provided them with the same preferential treatment as those available in the four SEZs.</td>
</tr>
<tr>
<td>1985</td>
<td>Three delta regions: Yangtze River Delta, Pearl River Delta and the Golden Triangle Delta were open to foreign investors.</td>
</tr>
</tbody>
</table>
| 1988  | ➢ The fifth SEZ was established on Hainan Island  
       ➢ Liaodong and Shandong peninsulas were granted as coastal economic open areas. |
| 1990  | Pudong New Area was established in Shanghai and afterwards Shanghai was granted greater autonomy over foreign trade and investment. |
| 1992  | 21 cities along the Yangtze River and in the Northeast offered special incentives to foreign investors. Since then, more provinces, regions, and major municipalities have had their own international and trust investment corporations. |
| 1999  | “Go-west” strategy was announced by the central government to encourage foreign investors’ operations in the western and inland regions. |

Source: Anonymous (2007d); The Central People’s Government of the People’s Republic of China (2005)-(b)

Generally speaking, while going to the international stage, MNCs can choose from a spectrum of options including Export Trade, Licensing, Franchising, Joint Venture and Wholly Foreign-owned Enterprise (WFOE).456 Specially speaking, FIEs in China are mainly structured by the following legal entities and forms (Table 3-17).

Table 3-17: The Forms of Foreign Invested Enterprises in China

<table>
<thead>
<tr>
<th>Various Forms</th>
<th>Definitions/Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chinese-Foreign Equity Joint Ventures (EJVs)</strong></td>
<td>Namely Share Company with Foreign Investment, referring to enterprises jointly established within Chinese territory by foreign companies, enterprises, other economic entities or individuals on one side and Chinese companies, enterprises or other economic entities on the other side, on the principle of equality and mutual benefit, and the ratification of the Chinese government. Principle: the involved parties share benefits, risks and losses in proportion to their respective contributions to the registered share capital. And generally, the proportion of the investment contributed by the foreign party shall not be less than 25% of the total. They are viewed as Chinese legal persons in Chinese law.</td>
</tr>
<tr>
<td><strong>Chinese-Foreign Contractual Joint Ventures (CJVs)</strong></td>
<td>Namely Cooperative Joint Venture, referring to enterprises jointly established within Chinese territory by foreign companies, enterprises, other economic entities or individuals and Chinese companies, enterprises or other economic entities, according to their cooperative conditions. The concerned parties don’t need to calculate the shares in the form of currency and distribute profit in proportion to their share, but share profit according to the form of investment and the ration of profit sharing as per the contract. In this instance, generally, the foreign investor offers all or major part of capital, while the Chinese side contributes the land, factory buildings, existing equipment and labor, and in some cases a certain amount of capital as well.</td>
</tr>
<tr>
<td><strong>Wholly-owned Foreign Enterprises (WFOEs)</strong></td>
<td>Refer to enterprises established in the territory of China with all capital exclusively invested by foreign investors in accordance with relevant Chinese laws.</td>
</tr>
</tbody>
</table>

Sources: Anonymous (2001b); The Central People’s Government of the People’s Republic of China (2005)-(b); Anonymous (2007d)

China’s economic development has benefited greatly from FDI, focusing on the activities of FIEs. FDI does not only involve the introduction of foreign capital and facilities, but the comprehensive introduction of production technology, production systems and business expertise, and sometime even the complete transplantation of different business models. In short, FDI influences China’s economic development impressively in production, fixed asset investment, trade, trade structure, and especially in R&D. The most important

---

457 Hayashi, T. (2003), p. 38
458 Ibid.
459 Ibid., pp. 38-49
thing is that Chinese government gradually released the restrictions on foreign activities in China has provided local Chinese companies with a breathing space and a key opportunity to grow up before suffering from foreign competition.

### 3.3.3.2 Foreign MNCs’ Three Developing Stages in China

As a consequence of the improvement of institutional environment and geographic expansion of accessible locations, more and more foreign investors have been allured into China’s the biggest potential domestic market in the world. In general, with increasingly liberalized regulations, MNCs in China have experienced three major developing stages as outlined in table 3-18 below:

**Table 3-18: Three Developing Stages of Foreign MNCs in China**

<table>
<thead>
<tr>
<th>Stage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-----1992</td>
<td>Most pioneering companies invested to simply establish themselves in China:</td>
</tr>
<tr>
<td></td>
<td>• Limited domestic sales;</td>
</tr>
<tr>
<td></td>
<td>• Limited operational control;</td>
</tr>
<tr>
<td></td>
<td>• Low growth and profitability;</td>
</tr>
<tr>
<td></td>
<td>• Low competition pressure.</td>
</tr>
<tr>
<td><strong>Market Entry</strong></td>
<td><strong>Summary: Test Phase</strong></td>
</tr>
<tr>
<td>1992-----2001</td>
<td>Most foreign MNCs chose conservative strategies:</td>
</tr>
<tr>
<td></td>
<td>• High-end segment, e.g. imported goods or global designs;</td>
</tr>
<tr>
<td></td>
<td>• Increasing operational control;</td>
</tr>
<tr>
<td></td>
<td>• Moderate growth and profitability;</td>
</tr>
<tr>
<td></td>
<td>• Medium competition pressure.</td>
</tr>
<tr>
<td><strong>Market Skimming</strong></td>
<td><strong>Summary: Strategic Arrangement Phase</strong></td>
</tr>
<tr>
<td>2002-----present</td>
<td>With the help of China’s entry into the WTO:</td>
</tr>
<tr>
<td></td>
<td>• Diverse product portfolio;</td>
</tr>
<tr>
<td></td>
<td>• Significant operational control and flexibility;</td>
</tr>
<tr>
<td></td>
<td>• Strong growth and profitability;</td>
</tr>
<tr>
<td></td>
<td>• Strong competition pressure.</td>
</tr>
<tr>
<td><strong>Market Penetration</strong></td>
<td><strong>Summary: Overall Strategic Aggression Phase</strong></td>
</tr>
</tbody>
</table>

Source: Beebe, A. and Cheng, L. (2007), pp. 3-4
3.3.3.3 The Evolution of Foreign MNCs’ China Strategies

Since the first emergence of foreign MNC in China, MNCs’ China strategies have evolved greatly over the past two decades in accordance with China’s ever-changing environment concerning economic development, liberalizing regulations towards FDI, the rapidly expanding CCGM and infrastructure development.

Generally speaking, most foreign MNCs have undergone three phases, i.e. test, strategic arrangement, and holistic strategic aggression shown in the above table 3-18. Moreover, the strategies of foreign MNCs operating in China have experienced a significant shift from “foreign investors” (prior to the late 1990s) to “strategic insiders” (since the late 1990s).

“Foreign investors” operate in a single or few projects, often using the low risk entry mode to test the water, being located in a major coastal city, and mainly targeting wealthy class and upper-middle class customers in the 1st- or 2nd-tier markets by offering high-end products. However, “strategic insiders conduct multiple businesses in multiple locations, operate on an extremely large scale with various entry modes including high risk ones, coordinate these operations through their China centres, and maintain both organizational control and strategic flexibility”. The below figure 3-12 illustrates foreign MNCs’ strategic shift from “foreign investors” to “strategic insiders”, in terms of shifting competitive parameters, shifting regulatory parameters, and shifting dominant China strategies.

---

460 The following content comes mainly from Luo, Y. D. (2005), p. 2
461 Ibid.
462 Ibid.
As regulatory environment towards MNCs has already been examined in the previous part, MNCs’ shifting competitive landscape and dominant strategies will be explained as follows.

In detail, that foreign MNCs have gradually shifted their competitive landscape *from weak to strong competition* means that they have been facing incremental competition not only from mid-sized Asian manufacturers of Singapore, Taiwan, Thailand and Malaysia, but especially from local Chinese rivals who have grown up rapidly and occupied some unique competitive advantages that foreign MNCs can not simply imitate; foreign MNCs’ shift *from niche to massive competition* refers to that they have started to pay attention to the
middle-class consumers or even the lower-middle class segments by offering middle-end products, instead of previously targeting only Chinese wealthy or upper-middle consumers by supplying high-end products; moreover, the shift from single to multi-market implies that besides developing the 1st- and 2nd-tier growth markets, they consider expanding to 3rd-tier or even 4th-, 5th-tier markets which are emerging and untapped markets for foreign MNCs; the last shift from structural similarity to structural multiplicity indicates new generation MNCs are facing totally different opportunities and threats across different industries.463

In terms of foreign MNCs’ shifting their dominant strategies in China, firstly, the shift from parent to national integration refers to that foreign MNCs build their China centers as local headquarters to consolidate common functions and integrate nationwide subunits to improve efficiency; the shift from production relocation to value chain localization indicates that now foreign MNCs are actively involved in building local supply base or distribution networks and localizing their product development as well as even undertaking educational investment; and MNCs’ shift from competence transfer to competence building by, for instance, building brand tailored to local or localizing R&D; the shift from competition to coopetition with local government or with local and foreign rivals along both upstream and downstream activities makes foreign MNCs’ performance more effectively and efficiently. Coopetition presents an integrative theoretical bridge which stretches to join two contrasting perspectives: competition and cooperation;464 besides, the shift from repetition to adaptive diversification implies that foreign MNCs try to offer different products tailored to different class consumers in different tier markets, instead of offering their core products to China’s multi-markets without adaptation; lastly, MNCs reconstruct their alliance to keep fit with actual environment and their global strategies.465

463 Luo, Y. D. (2005), pp. 5-8
In conclusion, analyzing and monitoring foreign MNCs’ shift on China strategies are significantly crucial for local Chinese companies to formulate their own strategic countermeasures and to take competitive reaction in time.

3.3.3.4 Major Foreign Consumer Goods Companies in China

By November 2004, there have been 500,479 foreign enterprises in China, with a total worth of US$62.1 billion contractual foreign capital. Of the Fortune 500 firms, about 400 foreign companies have had the presence in one form or another on the ground in China.466

Fast Moving Consumer Goods (FMCGs) industry has been deregulated in China since the late 1980s. In the early 1990s, this industry became one of the first sectors in which foreign MNCs had a large presence in China.467 A lot of leading global MNCs have entered in this market, such as Procter & Gamble, Unilever, Gillette, Colgate-Palmolive, SC Johnson, Henkel, Revlon, Shiseido, Kao, Maybelline, Estee Lauder, etc.468

Subsequently, more and more foreign MNCs have set foot in China, including Toshiba, Adidas, Amway, Avon, Coca-Cola, General Electric, General Motors, IBM, Microsoft, Johnson & Johnson, Kraft, L’Oreal, Philips, Emerson Electric, Electrolux, Nabisco, NEC, Nestle, Pepsi, Heinz, Sony, Motorola Inc., Nokia, Panasonic, Samsung, Siemens, and Volkswagen, just to name a few.469 They are widely regarded as the most influential ones in China and their products have been well accepted by Chinese consumers. Several major foreign consumer goods manufacturers and their dominant characteristics are summarized in table 3-19 below:

468 Ibid., p. 101
Table 3-19: Foreign Consumer Goods Suppliers in China

<table>
<thead>
<tr>
<th>Foreign Suppliers</th>
<th>Main Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Toshiba</td>
<td>Owns 37 wholly-funded enterprises and joint ventures in China with investment about $1 billion</td>
</tr>
<tr>
<td>Amway</td>
<td>Owns 80 direct sales outlets in China, and invested totally $125 million in the manufacturing base, its largest outside the United States</td>
</tr>
<tr>
<td>Motorola</td>
<td>One of the leading foreign investors in China, has invested around $3.4 billion and purchased $4 billion in goods and services from 17 local suppliers</td>
</tr>
<tr>
<td>Philips</td>
<td>Has 17 joint ventures and about a dozen wholly owned subsidiaries in China and has invested around $2.5 billion</td>
</tr>
<tr>
<td>Nestle</td>
<td>Has established 21 plants in China and total investments in manufacturing plants are around $807.22 million</td>
</tr>
<tr>
<td>P&amp;G</td>
<td>Started with a joint venture in Guangzhou in 1988, then set up 11 joint ventures and wholly owned companies in cities such as Beijing, Chengdu, and Tianjing, and has invested more than $300 million</td>
</tr>
<tr>
<td>Unilever</td>
<td>Has invested around $1 billion</td>
</tr>
<tr>
<td>Danone</td>
<td>Has a controlling interest in Robust Corp., and a 51% stake in Wahaha and a minority stake in Shanghai Bright Dairy and Food Co.; acquired a 50% stake in Shanghai Aquarius Drinking Water Co.</td>
</tr>
<tr>
<td>Coca-Cola</td>
<td>Has invested more than $1 billion and has 28 bottling plants in China</td>
</tr>
<tr>
<td>Pepsi</td>
<td>Has invested more than $800 million and has 14 bottling facilities in China</td>
</tr>
<tr>
<td>Electrolux</td>
<td>Entered China in 1995 and views China as a large home electric appliance market and an important production base</td>
</tr>
<tr>
<td>Whirlpool</td>
<td>Started with a joint venture in 1995</td>
</tr>
<tr>
<td>Emerson Electric</td>
<td>Made its first investment in 1978 and has close links with Haier</td>
</tr>
</tbody>
</table>

Source: Kalish, I. (2003), pp. 4-5

In the FMCG sector, Procter & Gamble, the world’s top maker of household products, has
widely been regarded as one of the most successful foreign companies in the CCGM. Particularly, its hair care and cosmetics products have been well recognized by Chinese consumers over the past decades. P&G’s China revenue exceeded $1.8 billion at the end of 2003. Today, China is the sixth largest market for P&G in revenue terms and it is forecasted that China will become the second largest one after the U.S. in a few years. In the passenger car sector, Volkswagen is an impressive winner in spite of some frustrations. Now China is the largest market for Volkswagen, outside of Germany. In the PC industry, AST and Compaq have achieved significant performances in China at the beginning, however, now they are underperforming Dell who is a relatively late mover.

In addition to those successful foreign companies, of course, there are some unsuccessful players such as Peugeot, Calsberg, Kreisler, Whirlpool etc. Peugeot entered Chinese markets in the mid 1980s and finally made its decision to withdraw from China in 1997 after great financial losses over years. In China, foreign competition generally roots in two possibilities: one is the products imported from outside, and the other is products produced by foreign companies. Precisely, some foreign MNCs offer Chinese consumers standardized consumer goods which are the same as those in developed markets but produced in China; some adapt their products to local preferences by acquiring leading domestic brands, and some of them create new, local brands to cater to Chinese markets, for instance, Shiseido introduced its Aupres series to adjust its prices according to the buying power of Chinese consumers.

Some foreign MNCs have spent more than 20 years in China. According to a survey, some foreign MNCs have spent more than 20 years in China. According to a survey

470 The following cases come from Tse, E. and Haddock, R. (2005), p. 4
471 Ibid.
474 A survey conducted by KPMG and market research firm Taylor Nelson Sofres by questioning 136 foreign consumer goods companies
percent of foreign consumer goods companies in mainland China are making profits or breaking even and 93 percent of them are optimistic about their business in the future. Generally speaking, they benefit a lot from the wave of China’s economic integration with world. According to another survey conducted by IBM Global Business Services in 2006, China already contributes on average nearly 10 percent of the global revenues of the 180 MNCs. Of course, these foreign companies have also undergone a hard development process. Nonetheless, many corporate success stories can reveal that China is not an impossible place to build profitable businesses in. In a word, the key success factors for foreign MNCs are to grasp opportunities and overcome actual and potential challenges, and constantly readjust their strategic models and operations to coordinate with China’s ever-evolving competitive landscape.

3.3.3.5 Overall Evaluation of Foreign MNCs’ Strengths, Weaknesses, Opportunities, and Threats in China

Foreign MNCs differ from Chinese companies completely, as they have their own unique strengths and weaknesses when operating in the CCGM. Meanwhile, China’s rapid-changing and uncertain competitive environment provides these foreign consumer goods giants with special opportunities and challenges. “MNCs operate in emerging markets that, to some extent differ from one other, but still have many common characteristics.” Therefore, what follows is an overall evaluation of foreign consumer goods companies’ main strengths, weaknesses, opportunities, and threats in China, as listed in table 3-20 below:

---

### Table 3-20: Strengths, Weaknesses, Opportunities, and Threats of Foreign Consumer Goods Companies in China

<table>
<thead>
<tr>
<th>Strengths:</th>
<th>Weaknesses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Massive financial resources;                                            • Limited understanding of Chinese consumers’ tastes, preferences and cultural background;</td>
<td></td>
</tr>
<tr>
<td>• Well-recognized brands;                                                 • limited capabilities of understanding the subtle arts of managing relationships;</td>
<td></td>
</tr>
<tr>
<td>• Superior products tailored closer to local preferences, and with good quality;</td>
<td>• limited ability to deal with institutional voids, immature infrastructure and distribution networks;</td>
</tr>
<tr>
<td>• Strong capabilities of innovation, R&amp;D, superior technology and know-how;</td>
<td>• Organization is not flexible enough and lack of flexibly strategic arrangement;</td>
</tr>
<tr>
<td>• Access to cheaper labour force and manufacturing resources;</td>
<td>in a ever-changing business environment, etc.</td>
</tr>
<tr>
<td>• Advanced marketing methods;</td>
<td></td>
</tr>
<tr>
<td>• Seasoned management talent;</td>
<td></td>
</tr>
<tr>
<td>• Abundant management experience, etc.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities:</th>
<th>Threats:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• China’s unprecedented economic development and consumer goods markets expansion;</td>
<td>• Increasingly stiff competition from local Chinese players;</td>
</tr>
<tr>
<td>• Increasing consumers’ disposable income, gradually changing consumption consciousness, and a rising middle class;</td>
<td>• Insufficient market research concerning clear, overall, and actual information on markets, economic trends, and other matters;</td>
</tr>
<tr>
<td>• Liberalized regulations on their activities after accession into the WTO and fully implementing commitments before 2007, etc.</td>
<td>• Inefficient distribution channels, inadequate infrastructure and supply chains;</td>
</tr>
<tr>
<td></td>
<td>• Increasing nationalism and protectionism;</td>
</tr>
<tr>
<td></td>
<td>• IPR Protection and counterfeiter issues;</td>
</tr>
<tr>
<td></td>
<td>• Higher costs derived from integrating operations in China with global organizations;</td>
</tr>
<tr>
<td></td>
<td>• Higher costs for targeting mass market;</td>
</tr>
<tr>
<td></td>
<td>• Difficulties in recruiting and retaining qualified and skilled staff etc.</td>
</tr>
</tbody>
</table>


To sum up, the developing process of foreign MNCs in China can be concluded by the old adage: “Everything is possible, but nothing is easy.”[^477] On the one hand, the competition to serve consumer needs is intense, thus, foreign MNCs have to battle for market share.

against one another and especially taking on increasingly sophisticated Chinese players. Most foreign MNCs express that now their local rivals are much more numerous and aggressive than before.\footnote{Boyd, M. and Cavey, P. (2005), p. 12} Since no foreign MNCs can ever assume that their good positions are unassailable, they have to reconsider and re-devise their strategies to address the tough competition in a fast-moving environment constantly. On the other hand, foreign MNCs are also full of confidence for the future and none of them will move back easily in the face of China’s complex and uncertain competition environment. Since foreign MNCs are doing so, how will Chinese companies consider and respond on their home turf accordingly?

### 3.3.4 Distributors

On the surface, the CCGM is regarded as a huge and single market; but look closer, the CCGM in essence consists of a series of fragmented markets, which widely vary by climate conditions, geographic locations, consumer characteristics, and available consumer goods options. Such complexity and uncertainty of the CCGM determine a sophisticated and hybrid environment of distribution and retail sectors in China. Another reason for the fragmented distribution system in China “comes from a past in which state policy favoured autarchic local economies, where every city and province produced and distributed it own goods.”\footnote{Kotler, M. (2001), p. 4} Accordingly, the complexities of China’s distribution and retail systems require each product to be allocated a suitable distribution network.

In the following two sections, a general introduction will be given to China’s retailers and logistics players, respectively.

### 3.3.4.1 Retailers

With China’s economic prosperity, China’s retail sector has undergone a great development shown in figure 3-13 below, and this sector is expected to grow between 12-13% in 2006, reaching RMB 7.6 trillion (US$ 0.95 trillion).\footnote{Ernst & Young (2006), p. 1} Now China keeps its position as one of the world’s most attractive retail markets, thanks to a massive population base, a rapidly
rising middle class with increasing disposable incomes, and a high rate of urbanization.

**Figure 3-13: China Retail Sales Value and Growth Rate (2000—2010)**

On the one hand, with a rapid increase of China’s retail sales, the formats of retailing have become multifarious. Until the mid-1990s, retailing mostly consisted of state-run department stores, small independent shops such as mom and pop stores, kiosks, and many traditional street markets. However, the forms of retailing industry today are composed of hypermarkets, supermarkets, convenience stores and so on. These new, modern retailers have greatly influenced the previous retailing forms and are expected to overtake them gradually, as modern ones can provide consumers with a wide variety of products, cheaper price, comfortable shopping environment, and convenient transportation. And these retailers are dealing with not only food but also apparel, electronics, furniture and others related to home improvement. Although these retailing forms have become very common in the 1st-, 2nd-, and 3rd-tier Chinese markets where shopping through these retailers is thought to be necessary in daily life, they are still new for consumers in the 4th-, 5th-tier and widely rural markets. Fortunately, now those modern retailing forms are on the way to expand further into some undeveloped areas in China, as the economy in those areas keeps developing in a rapid way.

---

481 Kalish, I. (2005), p. 16
On the other hand, tremendous retail sales value with an increasing growth rate has not only created many emerging local retailer players, but also has allured many foreign giants. According to the Ministry of Commerce, China approved the establishment of 187 foreign-funded retail enterprises in 2005 alone, which is six times the number approved in 2004.\textsuperscript{482} Table 3-21 below presents some major foreign and Chinese retailers who are actively operating in the CCGM.

\begin{table}[h]
\centering
\begin{tabular}{|l|l|}
\hline
Major Foreign Retailers & Major Chinese Retailers \\
\hline
Carrefour (France) & Shanghai Brilliance Group (Bailian) \\
YUM! (United States) & Beijing Gome Electronic Appliances \\
Ito-Yokado (Japan) & Su Ning Electronic Appliances \\
RT-Mart (Taiwan) & CR Vanguard (Hua Run Wan Jia) \\
Metro (Germany) & Dalian Dashang Group \\
Wal-Mart (United States) & Beijing Hualian \\
Auchan (France) & Beijing Wumart Group \\
Ikea (Sweden) & Nonggongshang Supermarket Group \\
B&Q (United Kingdom) & Chongqing General Trading Group \\
OBI (Germany), etc. & Jiangsu Five-star Electronic Appliances, etc. \\
\hline
\end{tabular}
\caption{Major Foreign and Chinese Retailers in the CCGM}
\end{table}


In the past, under the planned economy wholesale and retail services in China were a state monopoly, which seriously hindered the development of a nationwide market.\textsuperscript{483} Meanwhile, foreign participation in wholesale and retail industries was strictly restrained because of China’s protection on domestic industries against foreign competition, for instance, restricted import and export rights, high tariff rates, required import license and quota, and restrictions on foreign ownership.\textsuperscript{484} Particularly, foreign investments in distribution network, wholesale and retail were highly restricted by setting up a series of stringent regulations and restrictive practices. Under the circumstances, Chinese retailers have enjoyed some competitive advantages over foreign competitors. However, according to China’s commitments to the WTO, FIEs began to be allowed to enter the wholesale, retail and distribution sectors after December 11, 2004.\textsuperscript{485} In this instance, foreign retailers obtained tremendous opportunities for their further involvement; meanwhile, Chinese

\textsuperscript{482} Ernst & Young (2006), p. 1
\textsuperscript{483} Taylor, R. (2003), p. 187
\textsuperscript{484} Yu, C. and Wong, M. (2002), pp. 6-7
\textsuperscript{485} PricewaterhouseCoopers (2005), p. 1
companies have started to learn how to compete against foreign rivals in a more efficient way. Accordingly, this situation would result in a stiffer competition between foreign and Chinese retailers as both of them intend to expand business volume and improve market share in the CCGM.

Therefore, facing drastic competition, most Chinese retailers consider that they should grow up quickly to confront challenges and gain a long-term success. An efficient measure available to them is M&A. It seems that adopting traditional organic growth alone is not sufficient for Chinese retailers to deal with increasing competition and complex environment, however, M&As facilitate to ease price competition or pressures on retailers, and enable retailers to obtain an immediate presence in markets where they do not currently operate.\textsuperscript{486} Now both Chinese state-owned and private retailers are rushing to consolidate in a range of retail sectors, from home appliances and food retailing to sports and fashion.\textsuperscript{487}

In a word, both foreign and domestic retailers who intend to succeed in China have to understand the uncertainty and unique characteristics of the CCGM, the nuances of its retail markets and the complexities of its ever-changing economy.\textsuperscript{488} And the wave of M&A activity will remain prominent. However, only depending on the rapid growth in size will not be sufficient for Chinese retailers to outperform foreign rivals in the long term; rather, they need to invest heavily in developing their own retail competencies.\textsuperscript{489}

Meanwhile, if M&As do not work effectively, Chinese retailers should consider forming alliances by combining customer base, integrating suppliers, agents and consumers in order to best manoeuvre the competitive climate.\textsuperscript{490}

\subsection*{3.3.4.2 Logistics Players}

With China’s unprecedented economic expansion, accession into the WTO, tremendous retail sale growth, and vast infrastructure investments, logistics industry in China has experienced dramatic developments in the past decades.

\textsuperscript{486} Ernst &Young (2006), p. 4
\textsuperscript{487} PricewaterhouseCoopers (2006), p. 2
\textsuperscript{488} Ernst &Young (2005), p. 1
\textsuperscript{489} Ernst &Young (2006), p. 5
\textsuperscript{490} Ibid.
Firstly, compared with 1978 when there was no logistics needed at all, the total amount of social logistics during the 10th Five-Year Plan period (2001-2005) reached RMB 158.7 trillion, increasing 1.4 times that of the 9th Five-Year Program, with an average annual growth of 23%, which is much higher than the GDP growth rate of 9.5%.\textsuperscript{491} In 2005, the amount of China’s logistics reached US$423 billion, increasing 12.7% to previous year; meanwhile, the GDP proportion of logistics dropped from 19.4% in 2000 to 18.6% in 2005.\textsuperscript{492} Now logistics has become a business hotspot, alluring more and more attention from China’s government, foreign and domestic manufacturers who want to be successful in the CCGM. Secondly, today’s players in logistics industry include various formats, namely SOEs, FIEs and small-scale POEs instead of a monopoly by a few large SOEs in the past. Thirdly, tremendous capital has been invested in developing hardware and software. Lastly, transportation infrastructures have been significantly developed by constructing many modern ports, airports, highways and warehouses. Now there are four logistics centres in China: Beijing, Shanghai, Shenzhen, and Hong Kong. And the major modes of transportation include shipping, airfreight, parcel post, rail, and trucking. Of them, railways and highways are the most frequently used in transporting finished consumer goods. And recently, road system has greatly developed through extensively building modern highways and interstate highways.

However, China’s logistics industry is still a growing and undeveloped industry compared with those Western developed nations’. Firstly, China has an unfavorable geography which is made up of a lot of provinces and districts, each of which has different geographic conditions or weather situation. Secondly, local protectionism in the form of implementing own regulations and rules of local governments makes transportation networks very hard to integrate and connect. Thirdly, capabilities related to logistics are still far behind developed countries. These lagging capabilities involve inferior equipment, underdeveloped infrastructure, less-trained workers, and shortage of qualified management staff. These problems have led to that the logistics within Chinese marketplaces is unusually complex, highly fragmented, as well as time- and cost-consuming. The GDP proportion of logistics in China, including costs of both outsourcing spending and corporate in-house logistics

\textsuperscript{491} Research and Markets (2006a)
\textsuperscript{492} Yang, Z. R. (2006), p. 11
expenditures, is much higher than that in developed countries.\textsuperscript{493}

Nevertheless, China’s logistics industry will keep developing, and two reasons stand out. On the one hand, as China emerges as a vast manufacturing base, market demand will expand rapidly thanks to increasing foreign investment and significant trade position in the world. On the other hand, the increased pressure is being placed on China to push development of its logistics and the related service. \textit{Firstly}, as laid out in China’s five-year programme, “the Chinese government has designated logistics as a strategic industry and has committed to promoting investment in number of logistic centres across the country.”\textsuperscript{494} Central government will try to catch the next ten or twenty years as a golden age for developing logistics industry and to reduce overall logistics cost of society to less than 15\% of the national GDP.\textsuperscript{495} \textit{Secondly}, with the help of accession into the WTO, distribution and logistics sectors will be more open and liberated to foreign operators. Increased foreign participation will hopefully help lower costs, meanwhile, increased foreign competition is expected to improve consolidation within the industry and will to some extent work to reduce the above-mentioned operating obstacles.\textsuperscript{496}

In today’s China, several formats\textsuperscript{497} of logistics players operating actively in CCGM are listed as follows:

- **Large SOEs**  
  (E.g. China Shipping, COSCO, China Rail, China Post)
- **Foreign Transportations and Logistics Groups**  
  (E.g. DHL, UPS, FedEx, APL, Maersk)
- **Joint Venture Logistics Firms**
- **Private Enterprises**
- **New players operated by domestic or foreign manufacturing firms**  
  (E.g. Haier, P&G, Coca-Cola, GM, Walls)

In the final phase of the transition period of China’s accession to the WTO, these groups “have all established niches in the market, each having its own customers and territories”.\textsuperscript{498} As increasing new logistics players enter the market, stiffer competition

\textsuperscript{493} Fu, Y. N. (2003), p. 2  
\textsuperscript{494} Hertzell, S. (2001), p. 3  
\textsuperscript{495} Liu, C. Z. (2004)  
\textsuperscript{496} Wu, C. (2003), pp. 11-12  
\textsuperscript{497} Hertzell, S. (2001), p. 3  
\textsuperscript{498} Liu, C. Z. (2004)
among them will emerge in the near future and “merger, restructuring and a complete overhaul will become unavoidable”.

In summary, the logistics industry will continue to improve fundamentally and grow rapidly in the next years. On the one hand, according to China’s commitments to the WTO, the market of logistics industry should be totally opened to outside world since December, 2005. Hence, the year 2006 is the first year when logistics is liberated totally. On the other hand, the year 2006 is the first year of China’s 11th Five-Year Program. These elements will take significant impact on China’s logistics industry. “Mastering the supply chain and executing a proven China-specific logistics strategy is vitally important to success.” Future development in logistics industry will reply more on the supply chain theory, hi-tech support and investment capital.

3.4 Overall Evaluation of Chinese Consumer Goods Companies’ Strengths, Weaknesses, Opportunities, and Threats

In previous section 3.3.3.4, an overview of foreign MNCs’ strengths, weaknesses, opportunities, and threats has been presented to offer an understanding of the general situation of foreign consumer goods companies operating in China. In this section, the strengths, weaknesses, opportunities, and threats of local Chinese companies will be also examined in detail, as these strategic situations offer a background to identify their possible strategic options in competition. Essentially, the following analysis is expected to outline overall and ubiquitous situations contemporary Chinese Consumer Goods Companies (CCGCs) are facing, rather than to describe one or two specific Chinese companies.

3.4.1 Strengths

Strength 1: Low-Cost Resources

One of the main strengths for CCGCs is low-cost access to key resources in terms of labor, property and equipment, raw materials, and capital.

---

500 Anonymous (2005g), p. 3
Firstly, China’s tremendous population base and annually steady growth clearly ensure its status as a source of low-cost labor.\textsuperscript{503} Further, wages of Chinese labor are much lower than those in Western countries, and typically Chinese employees always work harder than usual, that is, they generally work more than five days per week and more than ten hours per day.\textsuperscript{504}

Secondly, low-cost strength also roots in cheap land, equipment, building, construction labor and materials, engineering, and architectural services, which finally results in a lower cost for Chinese companies to set up manufacturing sites.\textsuperscript{505}

Thirdly, many CCGCs have access to equity markets both domestically and internationally. In mainland China, there are two bourses available for Chinese companies, namely Shanghai and Shenzhen stock exchanges where many CCGCs regardless of the ownership structures have set foot in. Further, many CCGCs can also go to be listed in Hong Kong, London, New York, Singapore, and Tokyo stock markets.\textsuperscript{506}

In summary, CCGCs benefit significantly from low-cost access to key resources, however, this strength seems not to be translated into companies’ competitive advantage completely and efficiently. Meanwhile, foreign MNCs also can gradually benefit from these key low cost resources by locating manufacturing and even non-manufacturing facilities in China.

**Strength 2: Home-Market Familiarity**

Home-market familiarity is a typical and predominant strength that Chinese companies occupy to outperform their foreign counterparts, if it can be fully exploited and adopted. This strength is difficult for foreign MNCs to copy or imitate in a short term; at least, it will be very time- and cost-consuming for them to learn.

Precisely, home-market familiarity includes the following aspects: firstly, CCGCs are equipped with abundant awareness of Chinese consumers’ language, preferences, buying habits, cultural tradition, and value cognition, etc. On the basis of this knowledge, they can tailor products for target consumers accordingly and grasp consumers’ eyes and minds easier than their foreign rivals. Secondly, CCGCs are familiar with an especial operational

\textsuperscript{503} Raskin, A. and Lindenbaum, B. (2004), p. 9
\textsuperscript{504} Liu, D. Y. et al. (2006), p. 72
\textsuperscript{505} Aguiar, M. et al. (2006), p. 20
\textsuperscript{506} Boyd, M. and Cavey, P. (2005), p. 31
environment in the CCGM, which encompasses institutional voids, incomplete infrastructure, immature distribution networks, and geographical differences. Thirdly, Chinese companies are well aware of dealing with a sophisticated and extensive network of relationships, so-called “Guanxi”, which is very crucial for operating business in Chinese markets. Noteworthily, “these relationships, with state and local governments, buyers, suppliers and those that control access to infrastructure, are seldom transparent”\textsuperscript{507}.

**Strength 3: Established Distribution Channels**

Often CCGCs can deliver their products to customers more effectively and efficiently than their foreign competitors by accessing to established extensive distribution networks in the CCGM and maintaining a closer relationship with wholesalers and retailers. For instance, some leading CCGCs such as TCL, Lenovo, Mengniu Dairy and Haier are armed with entrenched and effective distribution networks composed of thousands of individual outlets in different provinces and 2\textsuperscript{nd} - and 3\textsuperscript{rd}-tier cities.\textsuperscript{508}

**Strength 4: Improved Capabilities of Innovation and R&D**

According to 2006 projections from the Organization for Economic Cooperation and Development, China, for the first time, will spend more on R&D than Japan to become the second highest investor in R&D behind the United States.\textsuperscript{509} Therefore, the increasing investment on R&D will inject strong dynamics to CCGCs, especially to those Chinese consumer electronics companies, which is very likely to make them introduce new differentiated (not just “me too”) products in both domestic and international markets.\textsuperscript{510}

**Strength 5: New Generation of Entrepreneurs and Management Talent**

An increasingly important source of competitive advantage for CCGCs is that the managers now are equipped with better education, more smartness and more abundant experience. This new generation of managers, regardless of in SOEs or POEs, is further characterized by a lower average age, a good awareness of Chinese domestic markets and a quick absorbability of new knowledge and ideas. They guide their companies to try to win

\textsuperscript{507} Williamson, P. and Zeng, M. (2004), p. 87
\textsuperscript{509} Bailey, G. et al. (2007), p. 6
\textsuperscript{510} Ibid.
over the huge and growing Chinese markets actively; however, they might need to learn more about how to compete on the global stage.\textsuperscript{511}

\subsection*{3.4.2 Weaknesses}

\textbf{Weakness 1: Unsatisfied Product Quality and Weak Brand Image}

Although benefiting from low costs, CCGCs are widely known in both domestic and international markets for their inferior or unstable product quality compared with those Western producers', often involving much higher defect rates.\textsuperscript{512} Meanwhile, the consciousness and importance of building and maintaining well-recognized and credible brands at home and abroad have been long ignored by CCGCs. Hitherto there have been few brands which can be the real global brands. Even in the CCGM, there are few nationwide brands which are highly recognized by Chinese consumers.

\textbf{Weakness 2: Competing Primarily On Low Price}

Regional protectionism and geographic diversity of the CCGM lead to inefficient distribution channels. Fragmentation of sales and distribution in turn makes CCGCs extremely difficult to build a brand. As a consequence of weak brand power, CCGCs, regardless of product area, are characterized by a group of relatively small-scale, short history firms producing standardized products and competing largely on costs and price, which can be represented by those large-scale “television wars”, “refrigerator wars”, “air conditioner wars” etc.\textsuperscript{513} By doing so, CCGCs have “stuck in basic manufacturing”, thereby “eroding their profit margins and further inhibiting efforts to upgrade”.\textsuperscript{514} Moreover, this situation “has driven them to practices that would be considered out of bounds by Western standards”.\textsuperscript{515}

\textbf{Weakness 3: Weak Indigenous Innovation Capability}

On the one hand, most CCGCs have weak indigenous innovation capacity. Most of them still remain acting as an imitator or adaptor of foreign technologies, with innovation mostly occurring in process rather than in products. On the other hand, although expenditures,

\begin{thebibliography}{9}
\bibitem{511} This strength is summarized from Wharton School of the University of Pennsylvania (2006), pp. 1-6
\bibitem{512} Kalish, I. (2003), p. 9
\bibitem{513} Steinfeld, E. S. (2002), pp. 2-3
\bibitem{514} Ibid., p. 3
\bibitem{515} Wharton School of the University of Pennsylvania (2006), p. 2
\end{thebibliography}
involved R&D persons, and technical publications and patents have increased, the increased output of technical patents was not in proportion with the increased inputs, and the output per unit of R&D input compared unfavourably with the relative output in other countries.

**Weakness 4: Lack of Core Competences**

One of the most important strategic thinking of a Chinese company is to identify and nurture its own core competence, as the competition between enterprises primarily equals to the competition of core competence in the context of rapidly changing operation environment and increasingly furious competition. Core competence can be nurtured by a company itself instead of being simply duplicated, imitated, and purchased by a company’s counterparts.516 Therefore, core competence offers a CCGC the ability to outmaneuver its rivals through distinguishing the CCGC itself from others. For instance, Chinese Haier and Lenovo are doing very well in this regard in that they are equipped with real core competences such as novelty and technological know-how. However, in contemporary China most Chinese companies are lacking of core competence. Two reasons stand out. For one thing, most CCGCs still follow the traditional competition principle such as price wars; alternatively, they have to imitate and follow the foreign counterparts, thereby it is difficult for them to form their own core competences because of their lack of advanced techniques.517 For another, some CCGCs desire to adopt diversified strategies to realize further development, and these companies lose their core competences accordingly.518

In short, in order to achieve long-term survival and development, Chinese companies should adequately capitalize on their unique characteristics, on the basis of which these companies explore and form their own core competences.

**Weakness 5: Lack of Consciousness and Capability of Strategic Management**

Strategic management is significantly crucial for companies’ long-term survival and development, especially in the face of a turbulent and uncertain business environment in China. However, most CCGCs have been long lacking the consciousness of strategic management and the ability of implementing strategic decisions. In principle, Chinese

---

516  Liu, D. Y. et al. (2006), p. 71
517  Ibid., p. 73
518  Ibid., p. 74
Marketing Environment of Domestic Actors in the CCGM

companies have experienced three developing stages of strategic management learning. At the first stage, Chinese companies blindly copied all Western management thoughts; however, they did not realize that Western management thoughts were associated closely with a series of factors such as history, culture, philosophy, and precondition. Thus, they might not be suitable for Chinese companies’ unique situation. At the second stage, Chinese companies started to learn a mass of advanced and modern management knowledge while copying, and consider how to make an effective combination with their reality.\textsuperscript{519} At the current stage, the best status is that Chinese companies are applying strategies which are established on both Western modern and Chinese traditional management thoughts and experiences.

To achieve the above-mentioned several leaps in strategy cognition and learning, managers in Chinese companies and other management staff will be required to have far more consciousness of innovation and capabilities of strategic management.

In tandem with the unprecedented globalization trend, China’s success of economic reforms and open up policy as well as the access into the WTO, CCGCs have the great opportunities to use their strengths to enhance overall competitiveness and rank themselves into the leading players not only domestically but also globally.

3.4.3 Opportunities

**Opportunity 1: Globalization Context**

Globally economic integration provides a number of opportunities for Chinese companies’ long-term success.

*Firstly*, more open global markets not only imply that foreign MNCs have access to key resources through presenting in Chinese markets, but also indicate that Chinese companies in many industries can simply buy the technology and expertise they need urgently to catch up, and meanwhile, CCGCs can also present in foreign markets if they have strong and transferable assets.

*Secondly*, under the background of globalization and China’s entry into the WTO, CCGCs

can benefit a lot from emulating or learning from their foreign counterparts.

On the one hand, CCGCs, regardless of large or small ones, are confronted with intensified foreign competition on their home bases; on the other hand, CCGCs are offered a good opportunity to stand in the same stage with foreign giants and compete against each other closely. In other words, many CCGCs have gradually changed their thoughts from competing negatively with foreign companies to welcoming the challenge with confidence, with a final objective of upgrading their operations through emulating their more matured and experienced foreign counterparts. Precisely, CCGCs can analyze foreign companies’ strategic thinking, decisions and activities, and learn their multiple marketing mix etc.

Furthermore, in today’s tendency featuring the growing wave of M&As by Chinese and foreign investors, CCGCs are expected to realize their transition from adolescence to mature by obtaining new capital and new skills contributed by foreign investors.

Surely, such emulation doesn’t refer to that Chinese companies copy everything from foreign rivals blindly; but, they should integrate Western thoughts and experiences into Chinese traditional strategic thoughts and the actual business environment.

**Opportunity 2: Government Policy**

Chinese government are continuously strengthening the institutional regime and improving governance so as to ensure a fairer, more transparent and more rational investment and competition environment.

Hitherto, with the help of China’s favorable policies, Chinese companies have been provided with many opportunities, especially when they confront tough competition brought by foreign counterparts.

On the one hand, in a number of industries, government policies have nurtured foreign companies to move manufacturing to China and transfer know-how to Chinese companies, often through restricting foreign firms’ operating activities in Chinese markets unless forming JVs with Chinese partners.

---

On the other hand, Chinese government has applied traditional trade barriers such as tariffs to help Chinese companies, or some other means such as hidden subsidies and unequal tax treatment with the same objective of fending off foreign competition and thereby protecting domestic companies.523

Furthermore, gradually liberated restrictions on FDI have offered CCGCs an important breathing space, whereby CCGCs have a certain time period to grow up and avoid being suffered from competing against foreign MNCs when they are still immature.

**Opportunity 3: An Ascent of Patriotic Sentiment**

In today’s China, there is a revival of localism in consumption: consumers are expressing a return to their roots. Two reasons stand out. One is that the trend of a heightened patriotic sentiment and affection of supporting Chinese traditional national industry and brands through buying domestic brands are getting predominant. And the other is that many national brands are gradually dying out after experiencing stiff competition against foreign rivals or forming JVs with those foreign partners. Especially recently, many previous national leading manufacturers are acquired by foreign MNCs. This situation re-evokes the sentiment of protecting Chinese national industries and brands. Consequently, such circumstance provides Chinese companies with numerous superexcellent opportunities to develop further.

While enjoying those tremendous opportunities, CCGCs also face many challenges or threats at both domestic and global dimensions, which needs to be taken into serious consideration for their long-run survival and development.

### 3.4.4 Threats

**Threat 1: Complex and Uncertain Environment**

Ever-changing global circumstances, rapid economic development, society change, and constantly updating information technology have led CCGCs to be in an increasingly complex and dynamic competitive environment all the time. In the face of intensifying competition and pricing pressure, CCGCs have to maintain adequate flexibility and adapt

---

their strategies continuously in response to rapidly evolving circumstances and the shifting nature of foreign competition.

**Threat 2: Financial Issue**

Financing is a major barrier for many CCGCs, especially for POEs, because cash shortage makes it very difficult for any company to sustain production or marketing effort.\(^{524}\) However, this issue is expected to be weakening due to the deregulation of China’s banking system. As a result, there are many new commercial banks and numerous foreign players which can be involved in commercial lending of local currency.\(^{525}\)

**Threat 3: Tax Policy Issue**

For many years, to some extent, CCGCs have been faced an unfair competition environment, which primarily roots in a different tax treatment for domestic and foreign enterprises. Generally, the preferential tax policies for foreign investors involve that foreign investors pay an average of 15% of their income in enterprise income tax, along with tax holidays for a certain time period, and further concessions are available in specific sectors and locations.\(^{526}\) However, “domestic companies are subject to a standard enterprise tax rate of 33%”.\(^{527}\) This issue is expected to be solved according to China’s commitment to the WTO, which means the investment climate will be improved by setting a single tax rate for both domestic and foreign-invested enterprises.

In conclusion, the above-mentioned strengths, weaknesses, opportunities, and threats are outlined as an overall evaluation to all CCGCs instead of a special firm. Most importantly, as the internal and external environment of CCGCs are keep fast evolving, CCGCs should become more flexible, more effective and faster to adapt to new competitive landscape. That is, their strategic decisions and operations should accord with internal and external elements of today and future. Only by doing so, can CCGCs achieve a sustained survival and development, further be ready to take on the world.

Precisely, the options for resistance strategy adopted by CCGCs to resist foreign competition will be analyzed in detail in the next chapter by virtue of conducting several in-depth and cross-sectional case studies.

\(^{525}\) Ibid.
\(^{526}\) Organisation for Economic Co-operation and Development (2007), p. 1
\(^{527}\) Ibid.
4 Applied Options for Resistance Strategies of Local Chinese Companies against Foreign Competition in the CCGM --- A Case Study Approach

Based on the previous research, resistance strategy at a corporate level is significantly crucial for local companies to compete against foreign incursion and expansion on their home turf. The objective of this chapter is, by conducting in-depth study of five cases and cross-sectional data, to examine what resistance strategies employed by local Chinese companies and what actions taken in reality to compete against foreign MNCs to achieve a long-term survival and prosperity.

First of all, the chapter will provide reasons for use of case study methodology and expose criteria of case selection. Much attention will be paid to the analysis of five cases. Each case study contains an industry overview, a short description of the case company’s background, its choice of resistance strategies, corresponding reaction, and a summary. Finally, major findings and synthesis of these empirical case studies will be indicated.

4.1 Research Methodology and Case Selection

4.1.1 Case Study as a Research Methodology

First and foremost, research design requires a decision on choosing a suitable research strategy. Generally speaking, several strategies of doing social science research include experiments, surveys, histories, archival analysis, and case studies. Each research strategy represents one way of collecting and analyzing empirical evidence and accordingly has its own merits and demerits; however, there are also some areas of overlap among them.

Firstly, adopting experiment research strategy is unsuitable in this research, as the experiment approach divorces a phenomenon from its context and accordingly attention will be concentrated on a few variables. Accordingly, experiments are adopted when an

---

528 Schnell, C. (1992), p. 3
530 Ibid., pp. 15-16
investor can manipulate behavior directly, precisely, and systematically.531

Secondly, Survey research strategy is not practicable, as it would be hard to answer the question of “how many”. Considering the situation in China, conducting survey will be extremely cost and time consuming for a single investigator.

Thirdly, historical method is dealing with non-contemporary events, that is, when no relevant persons are alive to report what occurred and when an investigator must rely on primary documents, secondary documents, and cultural and physical artifacts as the main sources of evidence.532 In the case of historical research strategy is applied to analyze contemporary events, case study approach is the preferred research strategy as it is able to deal with a full variety of evidence: documents, artifacts, interviews, and observations.533 Thus, historical research strategy is obviously not appropriate here.

Fourthly, the analysis of archival records is unpractical especially in analyzing Chinese companies. On the one hand, archival information about Chinese companies is generally far insufficient and outdated. On the other hand, local Chinese companies are very sensitive to expose themselves in a turbulent environment; therefore, key information about their enterprise strategies are considered highly confidential issue and in most cases very difficult to get.

Finally, case study is adopted when a “how” or “why” question is being asked about a contemporary set of events, over which the investigator has little or no control.534 Although there is a number of definitions of case study, Yin (1984) contributed a predominant one, which defined the case study as “an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used”.535

Therefore, case study as a research methodology will be employed to analyze applied options for resistance strategies of local Chinese companies against foreign competition in the CCGM and link their strategic features to the theoretical framework.

531 The content of experiments comes from Yin, R. K. (1984), p. 20-23
532 Ibid., pp. 19-23
533 Ibid., p. 20
534 Ibid.
535 Ibid., p. 23
Moreover, compared with other research methods, the case study approach represents some unique characteristics which are outlined as follows: 536

• Case studies are dealing with in-depth, detailed, and holistic investigations.
• Data can be collected from multiple methods such as survey, interviews, document review, and observation to provide a complete story; 537 meanwhile, data can be collected over a period of time.
• Data is contextual. That is, a case study involves a progress of a company or industry.
• A case study focuses on competitive environment and strategic/operational changes. In other words, “a case study presents an account of what happened to a business or industry over a number of years. It chronicles the events that managers had to deal with, such as changes in the competitive environment, and charts the managers’ response, which usually involved changing the business- or corporate-level strategy” 538.

In addition to those distinct characteristics, there are a number of advantages in applying case study approach, as outlined below: 539

• Case study allows investigators to use small data set such as one or several companies;
• Case study contains a “real life” context and an empirical feature. Case study method is expected to empirically investigate a contemporary phenomenon within its real life context and to present an actual process or problem which he, she or a company has experienced or been able to observe, measure, and analyze. 540
• Variations concerning intrinsic, instrumental and collective approaches to case studies allow for both quantitative and qualitative analysis of the data. 541

After deciding case study as the research methodology, another concern comes in to choose single- or multiple-case studies here. A single-case study is concentrated on one case only and may form the basis of research on typical or critical cases; whereas a multiple-case study may have two or more cases in the same study and may be applied to gain replication of a single type of incident in different settings, or to compare and contrast different

537 Neale, P. et al.(2006), p. 4
538 Seperich, G. J. et al. (1996), p. 2
539 These advantages are summarized from Davies, M. (2005), pp. 9-10
540 Ibid., p. 3
541 Zainal, Z. (2007), p. 4
In order to present the insight as rich as possible, this research is designed as a multiple-case study comprising of five purposely-selected local Chinese companies competing against foreign competition on their home turf.

Another issue to be raised is, whether single or multiple, case studies can be categorized into three main formats depending on various research proposes, which are exploratory, descriptive and explanatory methodology.  

**Exploratory case studies** refer to exploring any phenomenon in the data which serves as a point of interest to the research. In exploratory case studies, fieldwork and data collection may be undertaken prior to proposition of the research questions and hypotheses. In this instance, this type of study is regarded as a prelude which facilitates to create a framework of the study. **Descriptive case studies** are concerned with describing the natural phenomena which occur within the data in question. According to Yin (1993), a descriptive case study presents a complete description of a phenomenon within its context. Descriptive case studies require that the investigator begins with a descriptive theory to support the description of the phenomenon. **Explanatory case studies** are devoted to examining the data intimately both at a surface and deep level in order to explain the phenomena in the data. Moreover, explanatory case study is suitable for doing causal studies where pattern-matching can be used to investigate certain phenomena in very complex and multivariate cases and test a theory.

Therefore, descriptive case studies are deployed in this research to describe what resistance strategies are adopted by local Chinese companies against foreign competition and how Chinese companies use them in the context of a proposed theoretical framework.

In addition, case studies generally combine at least six data collection methods, documentation, archival records, interviews, direct observations, participant-observation, and physical artifacts. In view of the difficulties of performing organized interviews of key managers of a Chinese firm by a single investigator, this method will not be considered here. The major source of case study information here is documentations, which include.

\* Schell, C. (1992), p. 6  
\* The content of exploratory case studies comes from Zainal, Z. (2007), p. 3  
\* The content of exploratory case studies comes from Zainal, Z. (2007), p. 3  
literatures, monography, academic articles, newspaper articles, firms’ homepages, and official websites. Documentations are already available and for a single investigator, therefore, they are inexpensive, “stable, exact, and broad coverage”\textsuperscript{548} and can be used efficiently and repeatedly. In brief, all collected data and information are expected to be cross-sectional and longitudinal, and are able to represent actual strategic options and competitive response of case companies over a certain time period.

All in all, the above-mentioned distinct characteristics and advantages of case study method as well as the fundamentals of multiple-case studies and descriptive methodology underpin the motivations for choosing multiple and descriptive case studies in the research. The five cases are five local Chinese companies selected purposefully from various Chinese consumer goods industries. Subsequently, the criteria for selecting target industry and case company will be addressed in the following two sections.

4.1.2 Case Selection

4.1.2.1 Selection in Chinese Consumer Goods Industries

Chinese consumer goods sector has become one of the country’s fastest-growing industries during the past three decades. The long-term success of this industry has a significant impact on the Chinese economic development. Chinese consumer goods industry includes a number of different sub-industries: household appliances industry, automobile industry, cigarette industry, food industry, medicine industry, cosmetics industry, toy industry, Personal Computer (PC) industry, communication products, etc.

Three fundamental criteria for choosing target industry are:

- The sub-industry with significant foreign capital;
- The sub-industry with intensive competition between local and foreign companies;
- Local Chinese firms in selected industries have typical strategic decisions and reactions towards companies with foreign capital.\textsuperscript{549}

According to these criteria, four sub-industries will be chosen:

\textsuperscript{548} Anonymous (2006j), p. 33
\textsuperscript{549} Gorynia, M. et al. (2005), p. 52
These four consumer goods industries are regarded as dynamic and active in the CCGM. Meanwhile, these industries have innovative markets where competitive environment, corporate strategy, and reaction speed become key elements to a firm’s long-term survival and prosperity.

4.1.2.2 Selection in Chinese Consumer Goods Companies

After selecting target industries, corresponding Chinese Consumer Goods Companies (CCGCs) will be chosen.

In tandem with China’s rapidly growing consumer goods industries, a number of large and booming CCGCs have emerged, competing actively in both domestic and global markets.

Two fundamental criteria for choosing CCGCs are:

- The competition intensity between CCGCs and foreign MNCs;
- With representative resistance strategies adopted to compete against foreign counterparts.

Furthermore, to investigate the differences of resistance strategies in diverse CCGCs and various consumer goods industries, there are some important criteria listed below:

1) these companies were born and home-grown in mainland China. They produce consumer goods in beverage, cosmetics, PCs and household appliance industries as these industries are regarded as over-competition between CCGCs and foreign MNCs, the resistance strategies of Chinese firms become a crucial element to their survival, sustainability, and competitiveness;

2) Case companies here show both successful and unsuccessful situations;

3) The ownerships of targeted Chinese firms cover both Chinese SOEs and POEs;

4) Selected CCGCs have a series of representative resistance strategies which can be classified into one, or a combination of, or all of those four roles: defender, dodger, extender, and contender over a certain time period.
According to the above-mentioned criteria, five Chinese companies are chosen:

- China beverage Industry: Hangzhou Wahaha Group
- China Cosmetics Industry: Shanghai Jahwa Beijing DaBao Cosmetics Co., Ltd.
- China Personal Computer Industry: Lenovo Group Ltd.
- China Home Appliance Industry: Haier Group Co., Ltd.

These five cases are expected to provide a general overview and comparison of the company performance of different resistance strategies when competing against foreign MNCs in the CCGM.

In the following sections, each case study will be presented by an analysis of target consumer good industry, research on Chinese companies’ resistance strategies and a summary.

4.2 Case Studies

4.2.1 Case Study One: Hangzhou Wahaha Group Co., Ltd.

The case of Hangzhou Wahaha Group Co., Ltd (hereinafter Wahaha) is very notable for its product named “Future Cola” competing successfully with two foreign coke giants: Coca-Cola and Pepsi at home. In the context of fierce foreign competition and many failed experiences of Chinese beverage companies, Wahaha has achieved a brilliant success on “Future Cola” by a series of resistance strategies against foreign competition, and has impressively threatened Coca and Pepsi’s market positions in China. In 2004, “Future Cola” became the first Chinese Business case that Harvard Business School used in its MBA program.550

4.2.1.1 Chinese Beverage Industry Overview

After China’s economic modernization, the Chinese beverage industry has experienced an
unprecedented growth in both output and sales revenues. In 2005, China’s annual average beverage output reached 27 million tons with a growth rate of 14% and sales revenue reached RMB 70 billion with an annual growth rate of 13.3%. These progresses are mainly contributed by a mass of foreign investment and the raised average level of consumer spending in China as a result of economic reform policies of the government.  

In China, soft drinks generally include carbonated soft drinks, fruit juices, mineral water, sports drinks, and concentrates/dilatable, of which carbonated beverages hold a 50% market share. As carbonated beverage market has become saturated in the past few years, some large carbonated drink enterprises have accelerated expanding towards the non-carbonated drink field. In 2005, China’s total production of carbonated beverage was 7,71 million tons and sales revenue reached 31.9 billion yuan, increasing by 20.82% and 21, 63% respectively than that in 2004. However, its dominant position has been challenged by mineral water and fruit juices.

In this tremendous beverage market, two dominant players are Wahaha and Mengniu. Some other major domestic players are Huiyuan, Huabang, Nongfu, Jingjing, Xurisheng, Qianshou, and Robust. Foreign competitors mainly encompass Coca-Cola (US), Nestle (Switzerland), Danone (France), Kraft (US), Lipton (France), Berri (Australia), and Zhenghua (Singapore). Compared with these foreign players, Chinese manufacturers are small-scale in terms of fund, product varieties, sales revenues, etc.

In a word, although China’s annual per capita beverage consumption reached 20 liters in 2006, soft drink consumption still lags behind that of Western countries. By and large, the Chinese beverage industry is characterized by small-scale, geographically dispersed, relatively low market concentration, weak international competitiveness, and low quality perception. “Mergers and acquisitions in the industry served the purpose of industry integration”:  

Under the circumstances, there exists a great potential for the development of beverage markets and manufacturers in China.

---

551 Anonymous (2007e)
552 Anonymous (2006k)
553 Enterprise Management Consulting Co., Ltd. (2006)
4.2.1.2 Enterprise Background

Wahaha, originally a Hangzhou Shangcheng District School-run Enterprise Sales Department, was founded in 1987 with the help of government loan. Initially, its founders intended to sell milk products and popsicles to students through a school store. Considering further students’ health, this company started to produce nutritional drinks and then has gained a big success. On the basis of the initial achievement along with Hangzhou government support, this company took a further step to acquire a large, 30-year-old State-Owned Enterprise --- the Hangzhou Canned Food Product Co. in 1991. In the same year, it was renamed the Hangzhou Wahaha Group Co., Ltd. The word “Wahaha” is meant to mimic the sound of a baby laughing and is taken from a folk song for children.\(^{554}\)

After experiencing a series of developments over the past two decades, today’s Wahaha has grown to be China’s largest beverage manufacturer and the top 5 beverage producer in the world,\(^{555}\) producing more than 30 varieties such as milk drinks, drinking water, carbonated drinks, tea, canning food, fruit and vegetable juices, health care products.\(^{556}\) With almost 20,000 employees, 36 subsidiary companies covering 16 provinces and cities, 40 manufacturing bases distributed across China, and extensive sales networks, Wahaha has total assets of RMB 12.1 billion.\(^{557}\) It is also expanding into Europe, the United States and Southeast Asian markets, and into different product lines.\(^{558}\)

4.2.1.3 Wahaha’s Defender Strategies

Wahaha’s “Future Cola” is a very representative case indicating that local Chinese companies dances with two foreign giants: Coca-Cola and Pepsi Co. in Chinese carbonated drinks market.

With less pressure for Chinese beverage industry to globalize and Wahaha’s assets such as local knowledge and sales channels which are only customized to home market, Wahaha resist foreign competition at home as a defender. Its resistance strategies mainly involve

\(^{554}\) Chen, E. (2005), p. 15  
\(^{555}\) Chan, S. and Liu, J. Y. (2005), p. 1  
\(^{556}\) Wahaha Official Website (2007)  
\(^{557}\) Miller, P. M. (2004), pp. 59-62  
\(^{558}\) Humad, A. (2005), p. 1
defence with and without strategic alliances, which will be examined further in the following two sections.

4.2.1.3.1 Defending with Strategic Alliances

According to Dawar and Frost, an alliance can help defenders enhance their positions. Wahaha’s alliance with Danone is a good example. When a number of foreign players crushed into Chinese market, Wahaha adopted a crucial corporate strategy --- forming strategic alliances with one of its major foreign opponents: French giant Danone Group (hereinafter Danone). A series of strategic alliances did enhance Wahaha’s competitive position and lay steady foundation for launching Future Cola.

Danone is one of the most famous food and beverage groups in the world with its headquarters in Paris and 90,000 staff member worldwide. It is a Global Fortune 500 company, developing its business across over 120 countries and focusing on three core categories: fresh dairy products, biscuits and beverages. In 1987, Danone entered China and purchased 40 competitors to achieve access to the distribution and market share. As a result, Danone has rapidly become the number-one player in the Chinese beverage market and has seriously challenged Wahaha’s competitive position at home. In order to avoid head-on competition with Danone, Wahaha quick decided to set up five JVs with it in 1996.

In these JVs, Danone contributed advanced production line, production expertise, capital resource, and R&D capabilities; meanwhile, it owned a full range of water products targeting China and got 51% profit from these JVs. Wahaha contributed management team, nationwide distribution networks, production facility, and workforce; however, it obtained capital for upgrading and expanding production capacity and enjoyed autonomic local management in these JVs. Noteworthily, although Danone owned 51% of the stake, these JVs were run under the Wahaha brand and all operations were controlled by Wahaha. As the results of strategic alliances, Wahaha has become the number one bottled water producer and leading brand in China, laying a solid foundation for further business.

561 Ibid.
562 The following information about Danone comes from Thakur, S. et al. (2006), pp. 9-10
To sum up, these strategic alliances have reached the anticipative purposes of Danone and Wahaha based on both contributions. These JVs accounted for 5% of Danone’s profit with sales of more than US$ 1, 3 billion in 2006; meanwhile, Wahaha has become the leading market brand, laying a steady foundation for further development and fending off foreign competition successfully at its immature stage.

4.2.1.3.2 Defending Autonomically

Wahaha’s most impressive achievement is that Future Cola marches on Coca-Cola and Pepsi in the CCGM.

After gaining a stable brand and market position in the CCGM, Wahaha surprisingly launched its own Cola in 1998 to take on two strongest counterparts: Coca-Cola and Pepsi which completely occupied Chinese Cola market at that time.

Coca-Cola is the world’s largest cola producer and the fifth-largest food and beverage MNC. It opened bottling plants in China in 1927, but was shut down after the communist revolution in 1949. Then, Coca-Cola returned to China in 1979 as the first returnee of the American consumer goods companies. It set up 28 bottling plants with a total investment of US$ 1.1 billion, and its soft-drink national total was 16% and of which carbonated drink market share reached 35% in China. Another cola giant --- Pepsi Co. Ltd. is also one of the earliest MNCs setting up shops in China, though it arrived after Coca-Cola. Pepsi set up its first bottling plant in 1982 in Shenzhen and started expanding aggressively after the establishment of Pepsi (China) Investment Co. in 1994. Although inferior to the performance of Coca-Cola, Pepsi is still a beverage giant today in China with 40 wholly-owned and JVs including 15 bottling plants and four snack-food factories, and employs 10,000 people. Pepsi not only markets almost its all global brands in China, but also has some popular local brands.

Under the circumstances, the presence of “Future Cola” with the concept of “Chinese own

---

564 Anonymous (2007f), p. 10
565 The following case comes from Zhu, G. X. (1999), pp. 34-38
566 The information about Coca-Cola comes from Thakur, S. et al. (2006), pp. 14-15
567 Much of Pepsi’s enterprise background is taken from Anonymous (2002)
Cola!” resulted in great wonder and question.

Actually, it is happy to see that finally local Chinese manufacturer could wield a competitive banner towards foreign rivals in the CCGM; however, people wondered how Future Cola could strive for market share in the shadow of two Cola giants. After all, Coca-Cola is the giant with a history of more than 110 years, whereas Wahaha with only 11 years. Although Wahaha has established a dominant position in domestic market, it is the first time for Wahaha to deal with carbonated drinks.

Actually, the cola wars between Chinese and foreign players happened first in the mid of 1980s in China. In order to resist Coca-Cola and Pepsi Cola’s drastic impact on Chinese beverage sector, some domestic players started producing Chinese Colas under different brand names, the result of which unfortunately was miserable to Chinese companies. For instance, Chongqing’s “Tianfu Cola” ever impressed customers with rapidly spreading and actively competing against foreign rivals, however, now it has been controlled by Pepsi. Beijing’s “Changping Cola” was impressively promoted by hiring people riding bicycles with ribbons and Cola and promoting on the streets, yet, it disappeared long time ago. Henan’s “Shaolin Cola” was famous at one time, which eventually became the memory in Chinese minds. Similar situation also happened in many other cola brands such as “Tiantian Cola”, “Tianran Cola”, “Laoshan Cola” and so on, all of which finally either went bankrupt or were bought out by Coca-Cola or Pepsi Co. Chinese companies’ failures in cola wars resulted in a reconstruction of Chinese beverage industry and implied that Coca-Cola and Pepsi Cola are unconquerable under any circumstances. Accordingly, two foreign Colas were getting more and more popular in the CCGM.

Therefore, the re-emergence of “Chinese own Cola” would leave people the sign of “!” or “?” has allured both national and international attention.

CEO Zhong’s confidence revealed that Wahaha would pull a “?” to a “!” . He believed that Wahaha was able to participate in the fierce competition because firstly, Wahaha has already been a well-know brand nationwide; secondly, in order to launch this product Wahaha has already made over 2 years preparations encompassing the introduction of bottling and canning production lines that are even better than Coca-Cola’s, and thousands of experiments and taste adjustments; last but not least, there is tremendous market potential for carbonated drinks in the CCGM.
Reality proves that Wahaha’s Future Cola has achieved an impressive success in China. In addition to the above-mentioned favorable backgrounds, the success is closely related with resistance strategies that Wahaha adopted to defend itself against foreign counterparts. Some major strategic decisions and competitive countermeasures are introduced as follows:

✓ **Homegrown advantages**

According to Dawar and Frost (1999), it is critical for defenders to gain success by concentrating on the advantages local companies enjoy in their home market. According to Dawar and Frost (1999), it is critical for defenders to gain success by concentrating on the advantages local companies enjoy in their home market. 568 Accordingly, Wahaha capitalized fully on its abundant awareness of Chinese consumers, in terms of taste, cultural background, rising patriotic passion and so on.

*Firstly*, Wahaha is aware that Chinese like changes. Chinese consumers have already drunk foreign colas over years and it is time to change the taste. Thus Future Cola emerged after experienced thousands of tests according to Chinese preferable tastes and a mass of market research. As a result, Future Cola is characterized by a preservative-free carbonated drink similar to Cola but modified especially to fit Chinese tastes. In doing so, Future Cola intended to grasp consumers appreciating the local touch, but ignore those favoring foreign brands.

*Secondly*, with the help of the familiarity with Chinese traditional culture, Future Cola focuses on Chinese consumers enjoying national culture instead of American culture. CEO Zhong expressed ever that there was over 5000 years’ Chinese culture needing to be dug. “Future Cola” is pronounced “Feichang Kele” in Chinese. Thereinto, “Feichang” means pretty, special, or extreme and “Kele” means joy and happy. Future Cola thus refers to pretty happy or extreme joy. In particular, the advertisements of Future Cola are full of Chinese ethical characteristics featuring red color, classical music, along with a proud message “The Cola owned by Chinese!” Furthermore, Future Cola tries to create an image that Chinese traditional festival can’t be done without Future Cola. 569 Such promotions especially work on people living in rural areas.

569 Chan, S. and Liu, J. Y. (2005), p. 6
Thirdly, Future Cola is targeting consumers in possession of strong patriotism in minds. Future Cola passes on the idea that Chinese national pride can be represented by drinking Chinese own Cola: Future Cola. Meanwhile, Wahaha ignored those consumers who favor global brands and do not have such intrinsic appeal.

Avoiding Head-on competition with two Cola giants

Wahaha clearly knew that at its initial stage, Future Cola would be beaten in head-on competition against Coca-Cola and Pepsi for the Chinese urban consumers. Meanwhile, Wahaha also knew that foreign MNCs’ strategic decisions relied mainly on analyzing data model which is time-consuming. Further, sample or information offered by some international research companies can’t reveal a complete status of China’s expansive rural areas. Therefore, foreign MNCs have no idea about Chinese rural market, but Wahaha is very familiar with it. Wahaha has focused Future Cola on tremendous 3rd- or 4th-tier markets. That is, while Coca-Cola and Pepsi Cola were competing for market share in large or middle cities, Future Cola has stealthily and selectively entered immense rural areas and gained significant market share by establishing stable and colossal distribution networks. Further, Wahaha’s operation in lower-tier markets costs less. In doing so, Wahaha has successfully avoided tough competition in the 1st- and 2nd-tier markets where Coca-Cola occupied the dominant positions, and penetrated the 3rd- or 4th-tier markets and even remote rural areas which foreign MNCs ignored for the time being and where other local competitors are weak. In short, Wahaha has achieved enough space for survival and further development by Future Cola’s “villages besiege city” strategy which avoided two giants’ frontal assaults as this strategy did not threaten their positions.

Distribution network extending in all directions

Enhancing distribution networks is employed as another efficient measure by Future Cola to defend itself against foreign competition. Wahaha clearly realized that business to some extent was equal to organizing sales channels. Wahaha’s extensive distribution network is composed of 35 provincial sales offices, 2,500 sales team employees, more than 2,000 first-level dealers that need to meet distribution targets and manage large networks and capital, over 12,000 second-level dealers, much more third-level dealers and more than 2
Applied Options for Resistance Strategies of Local Chinese Companies against Foreign Competition in the CCGM --- A Case Study Approach

These networks aim to ensure a reasonable benefit allocation and motivate different levels by strictly implementing a price difference at different levels. The success of Future Cola has proved that these sales networks expanding intensively across the whole China work effectively, particularly in town and village markets. As a result, Wahaha maintains its sustainable market penetration and market domination.

Distribution channels in China’s rural areas are totally diverse from those in urban areas. It is nearly impossible for Coca and Pepsi Colas to build their own nationwide sales channels in a short time. Therefore, the distribution network becomes a key and indispensable element for Future Cola to compete against foreign rivals.

✔ Competing on price

Wahaha has found that Future Cola can compete on price against two foreign Colas as most consumers in the 3rd-, 4th-tier, and rural markets are extremely sensitive to price. Generally, Future Cola’s price is about 10-20% cheaper than Coca-Cola’s and Pepsi’s. Coca-Cola costs consumers 2.6-2.7 Yuan (about $0.34) per bottle; whereas, Future Cola costs 2.1-2.2 Yuan ($0.27). Thus, with the help of effective sales channels in tremendous rural areas, Wahaha made its Future Cola not only available but also affordable for numerous low-income peasants living in Chinese countryside. However, Coca-Cola and Pepsi Cola as premium brands were unable to lower their prices when facing challenge from a domestic brand, which might destroy their global brand image. Therefore, Future Cola has penetrated rural areas and has gained dominant position there successfully.

In addition to the above-mentioned advantages, Wahaha also took advantage of the Chinese government’s poverty alleviation program and state funds to set up bottling facilities in poor regions, which could not be copied by foreign competitors.

4.2.1.4 Summary

Future Cola marches on Coca and Pepsi at home successfully. Although this is still not a

570 Miller, P. M. (2004)
real one-to-one and decisive battle at present, it marks that Chinese beverage companies have started to compete with global giants on the same arena, which has greatly encouraged other domestic Chinese manufacturers to fight against foreign rivals in the asymmetric competition.

On the one hand, the reality testifies that Future Cola is successful and the dynamics to Wahaha’s success are exploiting Chinese national pride, adapting Cola to local preferences, capitalizing fully on its distribution channels and so forth. The success further reflects Wahaha’s integrated strengths in terms of high quality, modern equipment and management as well as technological innovation, all of which are the essential elements for an enterprise to achieve a long-run survival and development in domestic and international arenas.

On the other hand, Wahaha started to concern about how to sustain Future Cola’s success in a turbulent environment. Therefore, Wahaha decided to expand Future Cola to the 1st- and 2nd-tier markets; whereas Coca-Cola and Pepsi also intended to adjust their China strategies by penetrating the 3rd- or 4th-tier markets. This situation will result in a tougher head-on competition between Wahaha and Coca-Cola and Pepsi nationwide.

In conclusion, Wahaha’s success in challenging two Cola giants reveals that it is possible for Chinese companies to exceed foreign giants who seem to be unconquerable by capitalizing on the trend of global industry transformation and the extensity and growth of domestic market, designing and implementing resistance strategies based on their homegrown competitive advantages.

What really matters to Chinese companies is not their currently lagging positions and small-scale operation, but their attitudes towards foreign competition. In other words, some Chinese companies still dare not to counterwork global giants; or they are not able to find appropriate resistance strategies to compete; or they rely simply on copying foreign competitors, which will accordingly limit their own imagination and innovation. Wahaha should clearly identify its competitive advantages in local markets and consolidate itself by protecting the established territory and preventing to compete with foreign giants in the areas where foreign MNCs are good at. Wahaha’s success stresses again that foreign MNCs are just ordinary competitors with their own advantages and disadvantages. That is, foreign MNCs can be a wolf or a paper tiger when competing in the CCGM.
companies become more powerful, they are able to reoccupy the lost territory step by step.

4.2.2 Case Study Two and Three: Shanghai Jahwa and Beijing DaBao

4.2.2.1 Chinese Cosmetics Industry Overview

Chinese cosmetics industry mainly includes skin care, hair care, color cosmetics, fragrances, and personal care (bath and shower, men’s grooming products, and oral hygiene). Generally speaking, China’s cosmetics industry has experienced great developments over the past 30 years, which can be reflected by the following aspects: cosmetics production is stable; manufacturers have increased their effectiveness; new products have sprung up; product quality has improved; new marketing strategies have been deployed; more R&D centers have been set up, and so on. Specially speaking, Chinese cosmetics market is featured with huge market potential and intensive competition, which will be examined in subsequent sections.

4.2.2.1.1 Huge Market Potential

China is now “the second largest cosmetics market in Asia Pacific after Japan and the eighth largest in the world”. The total market size for cosmetics has increased dramatically from annual sales of RMB 200 million in 1982 to approximately RMB 70 billion in 2006. And this market will continue to expand at an annual rate of about 10%. It is expected that the total revenue from this industry will exceed 300 billion yuan (about 36.15 billion US dollars) by 2010. Additionally, cosmetics have become the fifth largest consumption hotspot on the China mainland, behind real estate, automobile, telecommunication products, education and tourism.

Although this sector has been impressively developed for the past three decades, China’s

572 Hong Kong Trade Development Council (2004)
573 Li & Fung Research Centre (2007), p. 1
574 Li, S. Q. (2004)
575 People’s Daily Online (2004)
576 Li & Fung Research Centre (2005), p. 1
cosmetics market is still an underdeveloped and far from saturation.\textsuperscript{577} In other words, there still exist enormous market potential and considerable business opportunities.

Three reasons for the existence of potential stand out. \textit{Firstly,} rural market’s demand for cosmetics is expanding rapidly. The increasing farmers’ disposable income and developing rural distribution channels will stimulate rural consumption and unleash the huge potential of the tremendous rural market.\textsuperscript{578} \textit{Secondly,} China’s middle class is rapidly increasing. This class is characterized by possessing the stable income, the capability to afford private-owned houses and cars, and the aspiration for a better life quality such as the consumption of beauty products.\textsuperscript{579} Therefore, the middle class “is becoming one of the most active consumer groups for cosmetics in the next 10-20 years”.\textsuperscript{580} \textit{Thirdly,} some new market hotspots have been emerged gradually in cosmetics sector, such as cosmetics for babies, children and men.

\textbf{4.2.2.1.2 Intensive Competition}

Due to Chinese tremendous market base and potential as well as cosmetics industry’s low entrance and high return, Chinese cosmetics market has undoubtedly attracted both local and global players. With increasing foreign entrants and their aggressive competitive activities in China, the competition among foreign and domestic companies in cosmetics sectors from generally personal care products to multi-functional care products is becoming tougher.

At present, there are more than 4000 cosmetics players with over 20,000 cosmetic brands in China. Of them, about 3,000 are small- to medium-sized local private enterprises, a small number of them are relatively larger state-owned companies, and the remaining 600-700 are foreign-invested enterprises. Some major domestic and foreign players are listed below in table 4-1:

\textsuperscript{577} Li & Fung Research Centre (2005), p. 2
\textsuperscript{578} Ibid., p. 5
\textsuperscript{579} Ibid., p. 6
\textsuperscript{580} Ibid.
Generally speaking, the cosmetics market is one of a few consumer goods sectors where foreign MNCs are outperforming domestic Chinese companies because of their greatly diverse in competitive advantages and enterprise strategies in China.

Concretely, foreign MNCs exceed Chinese companies in terms of scale of operation, financial strength, technological level, management know-how, brand influence and experience in brand building.\(^{581}\) Foreign competitors generally sell two kinds of products on China mainland: imported self-manufactured by foreign brand owners, and produced by local OEM factories, both of which are impressive for their good quality, reliability and reputation in most Chinese consumers’ minds.\(^{582}\) Generally, foreign-branded cosmetics target the premium market or wealthy and up-middle classes. Noteworthily, foreign players constantly change their China strategies and attempt to tap mass market and numerous middle class with the help of “price wars” and “advertisement wars”. They are further planning to acquire established Chinese companies in order to gain rapid access to local connection and distribution channels.\(^{583}\) Recently, increasing acquisitions of Chinese companies clearly reveal foreign MNCs’ intention of wiping out major Chinese counterparts.

Compared with foreign MNCs, Chinese companies are armed with advantages in local knowledge, customers’ preferences, sales channels and low-cost resources; however, they are far behind foreign giants in brand management and R&D. Generally, domestic players

---

Table 4-1: Major Domestic and Foreign Cosmetics Makers in China

<table>
<thead>
<tr>
<th>Domestic Players</th>
<th>Foreign MNCs Players</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai Jahwa Co., Ltd.</td>
<td>Johnson &amp; Johnson (J &amp; J)</td>
</tr>
<tr>
<td>Beijing Dabao Cosmetics Co. Ltd. (Beijing Sanlu Factory)</td>
<td>Avon</td>
</tr>
<tr>
<td>C-Bons Group</td>
<td>Estee Lauder</td>
</tr>
<tr>
<td>Jiangsu Longliqi Group Co., Ltd.</td>
<td>L’Oreal</td>
</tr>
<tr>
<td>Sichuan Cortry Industrial Co., Ltd.</td>
<td>Kao</td>
</tr>
<tr>
<td>Guangdong Arche Cosmetics Co., Ltd.</td>
<td>Kose</td>
</tr>
<tr>
<td>Zhuhai Sunrana Cosmetics Co., Ltd.</td>
<td>Revlon</td>
</tr>
</tbody>
</table>

Source: Li & Fung Research Centre (2007), pp. 8-11

---

\(^{581}\) Li & Fung Research Centre (2005), p. 13

\(^{582}\) Li & Fung Research Centre (2005), p. 13 and Li & Fung Research Centre (2007), p. 7

\(^{583}\) Li & Fung Research Centre (2007), p. 10
struggle in the middle- and low-end segments for limited margins. Since foreign counterparts crowded into this sector, a number of Chinese producers have given way by length or have been faced with acquisitions by foreign MNCs, for instance, Yue-Sai and Mininurse have been acquired by O’Lreal recently. It is reported that during these two years the number of domestic cosmetics producers has reduced from over 5,000 to 3,300 today.\textsuperscript{584} Under the circumstances, Chinese companies have to reconsider survival strategies, by means of which they can improve core competencies, enhance brand building and management, and employ more efficient marketing measures.

The following two case studies outline a general tendency that Chinese companies act as defenders or dodgers in the competition against foreign MNCs in cosmetics industry.

\textbf{4.2.2.2 Case Study Two: Shanghai Jahwa and its Defender Strategies}

\textbf{4.2.2.2.1 Enterprise Background}

Shanghai Jahwa (hereinafter Jahwa), established in 1992, is the oldest and largest domestically-owned Chinese manufacturer of cosmetics and personal care products. Precisely, Jahwa’s products include skin care, hair care, baby care, bath and shower, and household cleaning products.\textsuperscript{585} Now Jahwa manufactures about 350 products sold under different brands including Liushen, Maxam, SoftSence, Jiaan, Herborist, Yashuang, Chinfie, Friendship, Chunlei, GF, Cocool, and Beilei,\textsuperscript{586} some of which have received significant recognition in Chinese mass market.

\textbf{4.2.2.2.2 Jahwa’s Defender Strategies}

Jahwa adopted diverse growth strategies for its different product series, and therefore, the consequences of these products are different. It is worthy to analyze two representative brands under Jahwa, one is Maxam which had a miserable consequence, and the other is Liushen which had a brilliant result.

\textsuperscript{584} Li & Fung Research Centre (2007), p. 11
\textsuperscript{585} Li & Fung Research Centre (2005), p. 15
\textsuperscript{586} Jahwa Official Website (2007)
Firstly, Maxam is “one of the most popular domestic brands of personal care products in China. Products sold under this brand name include brand cream and lotion, suntan lotion and mousse targeted at the general public”\textsuperscript{587}. In 1990, sales revenue of Chinese cosmetics was 4 billion yuan, of which Jahwa’s products held about 10%, reaching 0.45 billion yuan and only Maxam brand reached 0.3 billion yuan. At that time, almost every foreign cosmetic giant planning to enter Chinese market wanted to cooperate with Jahwa. Finally, Jahwa chose Johnson & Johnson and accordingly Maxam became a joint brand.

However, after this JV, sales of Maxam kept declining from 300 million yuan to 60 million yuan in the 1990s. Two reasons for the regression stand out. On the one hand, 1990s was the most competitive and toughest period for domestic players, as a lot of foreign MNCs rushed into Chinese market; on the other hand, J&J did not really intend to develop Maxam brand by the JV, rather to achieve access to the established distribution channels in China or to wipe out its strong indigenous brand. After seriously considering, Jahwa decided to take Maxam back. However, as many foreign counterparts have already grown up in China, Maxam missed the best time to develop and it is very difficult for Jahwa to bring this brand into a right path.

Another leading product --- Liushen presented by Jahwa in 1991 has achieved great success. When mentioning how effectively Jahwa competes against foreign giants, “Liushen” must be considered, as it is a typical brand outperforming foreign products by targeting the large group of consumers loyal to traditional products and indigenous brands.

Liushen is “a basic personal care product, including Florida water and bath foam for the mass market”\textsuperscript{588}. Liushen, or “six spirits”, is a prescription name of six pharmic extractions from Chinese traditional medicine; it is used for remedying prickly heat and other summer ailments; and its main components are pearl powder and musk.\textsuperscript{589} According to this prescription, in 1993 Jahwa presented Liushen toilet water which is characterized by anti-prickly heat, antipruritic, and life-giving functions, particularly useful in summer. The brand has rapidly occupied 60% of the toilet water market. Two years later, Jahwa further presented Liushen bath foam, targeting to China’s personal care products in summer.

\textsuperscript{587} Jahwa Official Website (2007)  
\textsuperscript{588} Ibid.  
\textsuperscript{589} Dawar, N. and Frost, T. (1999), p. 122
Liushen bath foam was presented based on Liushen’s successful image, and most importantly, Jahwa has skillfully grasped a large group of consumers trusting Chinese traditional medicine. In this regard, foreign MNCs are not familiar with. Accordingly, Liushen bath foam rapidly gained most consumers favoring Liushen toilet water and finally became a famous brand in China.

To conclude, the key reasons why Liushen can block off foreign brands successfully are that Liushen capitalized efficiently on Chinese traditional medicine and tailored its products especially to target consumers in Chinese mass market.

Concretely, firstly, Liushen dealt with a nearly vacant sector. At the beginning of 1990s, domestic players in toilet water sector were some small factories and unknown brands whose strengths were far behind Shanghai Jahwa’s; meanwhile, foreign giants lack relevant cultural background. Secondly, cosmetic is a product category with more emotional continuation, accordingly, consumers’ needs are diversified and personalized. Further, cosmetic brand is expected to carry and reveal product’s functions, emotion, value, culture, and personality.

Although foreign giants are equipped with strong strengths and well-known brands, they are short in understanding local consumers’ needs. While considering the standardization of global business and offering products mainly for developed markets, foreign MNCs can not provide products tailored especially to local customers’ preferences. Meanwhile, when foreign players focused on Chinese young generation who are proud of using foreign products, Jahwa did not fight for this segment, but concentrated on a large group of consumers who are price-sensitive and trust traditional medicine.

Therefore, Chinese cosmetics players should concentrate on brand building by greatly devoting in advertising and R&D and offering products tailored to their target consumers, whereby distinguish their products from the others, especially from foreign players.\(^{590}\)

Later, guided by the idea of Liushen, Jahwa presented herbal products successfully. With the concept of traditional Chinese herbal beauty care and its long-term research on natural herbs, Shanghai Jahwa launched its herb-based personal care products in 1998, targeting the young adult market. This product featuring all-natural ingredients has also achieved a

\(^{590}\) Li & Fung Research Centre (2005), p. 4
big success in China.

4.2.2.3 Case Study Three: Beijing DaBao and its Dodger Strategies

“Though there is not much pressure to globalize in the fashion industry, there exists a sizable market segment that is attracted to global fashion brands.” For instance, skincare is one of the most global competition cosmetic sectors. DaBao as a national brand of skincare, therefore, confronted tough foreign competition. It is worthy to mention this impressive but unsuccessful case --- DaBao, which acts as a typical dodger.

4.2.2.3.1 Enterprises Background

Beijing DaBao Cosmetics Co., Ltd. (Hereinafter DaBao) is a famous cosmetics and personal care brand in China. Its antecedence is Beijing San Lu Factory, set up in 1985 as a large state-owned social welfare enterprise. DaBao, the leading product of this company, is the brand for herbal series of cosmetics including skincare, hair care, beauty care (makeup), perfume and clinical series.

With its impressive and memorable commercial slogan: “DaBao, see you everyday!” DaBao has become a household name and has gained its stable position in Chinese market. Further with this strong brand awareness and over 20 years experience in cosmetics sector, DaBao has achieved high prize and has positioned itself as the leading one of Chinese largest cosmetics manufacturers. In 2006, DaBao posted 676.2 million yuan of sales, with total assets of 645 million yuan.

However, during its golden time, DaBao put itself up for sale by registering with the China Beijing Equity Exchange. Finally, Johnson & Johnson (hereinafter J&J) got the bid and took over DaBao.

592 DaBao Official Website (2007)
593 All-China Women’s Federation (2007)
4.2.2.3.2 Dabao’s Dodger Strategies

Although it occupied only 4% sales revenue of Chinese cosmetics industry, Dabao had the highest market share in low-end cosmetics products and accordingly for a long time Dabao has been viewed as a banner of national cosmetics brand. Even if it has achieved brilliant performance, it was still acquired by foreign MNCs ultimately. In essence, the acquisition did not happened accidentally, but resulted from Dabao’s inappropriate strategic decisions. Therefore, it is highly worthy to analyze Dabao’s strategies in the face of the uncertain environment brought by intensive foreign competition.

Wang Wenbin, the General Manager of Dabao, explained, “It is not because of a profit bottleneck that we sold the company but to seek more growth room.” Although this acquisition may benefit both sides for a certain time, the event to some extent reflects how a leading national brand dies out.

In fact, behind J&J’s acquisition of DaBao, there exists an obvious phenomenon, that is, DaBao has reached the peak and its further growth is hindered by many long-standing issues.

From an internal perspective, firstly, Dabao was seriously short of funds, marketing experience and innovation capability. Secondly, besides Dabao’s SOD Milk Cream, there are few new products during these 20 years, not to mention new products under its other brands. In the context of advocating personality and diversification, single brand results easily in consumption tiredness. On the contrary, P&G, Dabao’s the strongest foreign rival, is armed with a strong brand consciousness, holding more than 20 different brands for its shampoo, toilet soap and toothpaste. Furthermore, P&G’s different brands are applicable for different consumer segments, which meet the unique preferences of diverse customers successfully. Thirdly, Dabao SOD Milk Cream has been stably positioned in low-end market, thus, it is very difficult for it to tap mid-end or even high-end markets dominated by foreign MNCs for a long time.

From an external perspective, Dabao is facing competition pressure from both domestic and foreign rivals. The competition among domestic players is getting fiercer. For instance,

---

594 Much of the background in this section is taken from All-China Women’s Federation (2007)
Longliqi applied special competition strategies against Dabao, that is, it introduced over 10 different products similar to SOD Milk Cream, which caused Dabao SOD Milk Cream plunged into a tough siege. In addition, with a stable position in Chinese high-end cosmetic market, foreign MNCs have started to adjust their China strategies by holistically penetrating the 3rd- or 4th-tier markets. In this case, Dabao suffered greatly from both domestic and global impact.

Therefore, facing external and internal issues Dabao needed a breakthrough to survive, which finally resulted in the acquisition and the disappearance of a national brand.

4.2.2.4 Summary

By examining two cases in Chinese cosmetics industry, two main points can be summarized as follows:

On the one hand, Chinese cosmetics sector is a booming and the most competitive market. By and large, this industry is one of Chinese consumer goods sectors in which the competition among domestic Chinese companies and foreign giants is the toughest. And generally, foreign giants outperform domestic companies in many aspects. As a result, many Chinese cosmetics companies are strongly influenced by foreign incursion and start declining, even if some of them were leading players and performed illustriously before.

Meanwhile, the current success of most local cosmetics companies results mainly from firstly, focusing on some middle or low-end products tailored to mass market, such as Dabao and Maxam, along with their proud slogan “only choose right one, not the expensive one” of Diao brand washing-powder; secondly, capitalizing on extensive distribution channels in tremendous 3rd-, 4th-tier, or even lower markets; thirdly, focusing on the idea of Chinese traditional medicine such as Liushen toilet water and bath roam, Tianqi toothpaste. However, these competitive advantages will be crippled gradually, as foreign MNCs can also learn those ideas from Chinese players. Meanwhile, foreign brands have gone beyond high-end products through adopting effective price deduction and cooperating with strong Chinese media. In doing so, foreign MNCs will further squeeze out the limited margin that Chinese companies currently possess in these markets.
Therefore, a key issue for Chinese cosmetic companies is how to become large and hold world-known brands. Generally, the quality of domestic cosmetics might not be inferior to that of foreign MNCs, but the reason why domestic players are underperforming foreign competitors as a whole is the brand value that domestic manufacturers transferred to consumers is far behind that of foreign MNCs. This is an essential gap between Chinese and foreign cosmetics players.

On the other hand, these two cases reveal that it is crucial for Chinese companies to form strategic alliance with foreign MNCs in a rapidly changing environment. In reality, many Chinese companies chose alliance strategy, because firstly, facing foreign competition, Chinese companies are afraid of being beaten by foreign counterparts, they are eager to grow up in a short term; secondly, they realize that only by strategic alliances, can they gain rapid access to foreign advanced technologies, abundant capital, intelligent personnel, and marketing experiences to enhance brand strength, maintain survival and obtain further market expansion; thirdly, when entering an uncertain and ever-changing market, foreign MNCs also need domestic partners to achieve access to local distribution channels and domestic business background in terms of regulation, tax policy and so on.

However, few Chinese companies have really benefited from their foreign partners so far. Most of them have nearly the similar fates after strategic alliances, that is, some famous national brands die out, others still hold domestic brands, but are worse than they used to be. Reasons are twofold:

From foreign MNCs’ perspective, forming strategic alliances with Chinese companies sometimes does not aim at building Chinese domestic brands and sharing profit from the successful domestic brands. Rather, foreign MNCs only want to obtain established production lines and distributions channels, cheap labor force and a large number of loyal consumers. Foreign MNCs intend to develop their own brands in Chinese market and benefit more by freezing Chinese brands. This kind of combination is doomed to fail eventually. Similar situation happens also in the acquisition of Chinese company. For instance, after its acquisition of Mini Nurse, L’Oreal Group took advantage of the former
distribution channels to serve its own three brands: Maybelline, Garnier and L’Oreal.\textsuperscript{595}

From Chinese cosmetics companies’ perspective, they transfer their own brands and equipment to foreign partners, but do not possess half shares in JV, and accordingly lose the power to make decisions. Thus, it is a crucial for Chinese companies to keep an independent position in JV. Once an established brand lost, it is very hard to get it back. Even if Chinese companies can buy the brand back with a lot of expenses, it is still very difficult for them to perform as well as before, Maxam brand is a typical example in this regard.

All in all, local Chinese companies should try to transfer specific brand value or form a kind of cultural background for consumption rather than to survive by quick sales with small margin.\textsuperscript{596} Meanwhile, they should choose a right foreign partner and reasonable alliance forms, as well as formulate an appropriate alliance strategy.

4.2.3 Case Study Four: Lenovo Group Limited

4.2.3.1 The Globalization of the Personal Computer Industry

The PC industry, one of the most global industries and also the most dynamic segment of the electronics industry since the early 1980s, refers to a complex network of companies involved in different industry segments, from microprocessors and other components to complete systems to operating systems and applications.\textsuperscript{597}

The computer industry is highly global, with measurable production in over 40 countries.\textsuperscript{598} The United States leads in computer production, followed by Japan, Singapore, China, and China Taiwan area. Intensifying globalization pressure has resulted in the demise of local PC makers in some emerging markets such as Brazil and Mexico, as foreign giants have come to dominate after economic liberalization. However, some domestic firms in Taiwan have survived by becoming suppliers of foreign MNCs and further benefited from access to the global production network. And some other emerging

\textsuperscript{595} All-China Women’s Federation (2007)
\textsuperscript{596} Ibid.
\textsuperscript{597} The following content comes from Dedrick, J. and Kraemer, K. L. (2002), pp. 2-3
\textsuperscript{598} Ibid., p. 25
market PC manufacturers are struggling actively with foreign giants worldwide.

4.2.3.2 Chinese Personal Computer Industry Overview

China has become the largest PC market in the world and the leading producer of computer hardware. “At the core of China’s computer industry strategy is the government’s desire to catch up technologically while maintaining central control over key aspects of the economy and reducing China’s dependence on foreign technologies”\(^{599}\). The reasons for a rapid development of China’s computer industry especially the PC industry are multiple: \textit{firstly}, China has achieved rapid economic growth since its transformation from a planned economy to a socialist market economy; \textit{secondly}, Chinese government has been offering manufacturers a series of favorable industrial and technology policies; and \textit{thirdly}, China has received a mass of investment from foreign MNCs and Taiwanese manufacturers. In the following two sections, main PC suppliers in China and government policies on this sector will be examined respectively.

4.2.3.1.1 Suppliers

Chinese PC market is highly competitive. There are three kinds of suppliers operating in this market, including foreign MNCs, Taiwanese manufacturers and domestic PC suppliers.

\textbf{Foreign MNCs} include Dell, IBM, HP-Compaq, Sony, Toshiba, etc., of which Dell, IBM and HP are Lenovo’s largest competitors. Their general information is listed as follows:

- **Dell Computer Corporation** (hereinafter Dell)

  Michael Dell founded Dell in 1984. In 2003, Dell with about 40,000 employees worldwide was the largest PC maker in the world. Dell’s unprecedented success is based largely on an effective direct-sales model, by which customized products are delivered to end users efficiently. Dell started to enter the CCGM at the beginning of 1990s, and in 1998 Dell established an assembly plant in Xiamen, Fujian Province, which lowered its costs for transportation and manufacturing.

Meanwhile, direct sales approach reduces its costs by bypassing retail and wholesaler and avoiding the establishment of a costly distribution network. In the CCGM Dell is Lenovo’s primary international challenger. Lenovo’s CEO Yang indicated that Lenovo paid attention to all competitors, especially to Dell. However, Dell’s Legere, the head of Asian operations announced that Dell did not have to beat Lenovo to be successful in China.

- **HP-Compaq**

  In 2002, Hewlett-Packard (hereinafter HP) merged with Compaq Computer Corporation, which made HP’s global market expand further. In 2003, HP altered its marketing from selling to China commercial market towards the consumer PC market. In order to penetrate the CCGM, HP not only adopted a blended go-to-market model including both direct sales and retail distributors, but also offered a series of digital imaging products tailored to Chinese consumers.

- **IBM**

  IBM’s Great China Group covering mainland China and Taiwan area employed 13,000 employees in 17 cities and had 12 JVs in manufacturing, IT services and software development. IBM is a leading company in China with a market share of over 6% in the software sector.

These global players have been playing a vital role in China’s PC industry by bringing advanced technologies, equipments and management skill, stepping up local purchasing, hiring local employees, and so on.

- **Taiwanese PC manufacturers** include Acer, ASUS, Compower, etc. They manufactured PCs for both foreign MNCs and domestic Chinese companies.

- **Local PCs suppliers** include Lenovo, Founder, Tsinghua Tongfang, Great Wall, Hisense, Haier, TCL, Shida Computer, Qixi, Hengshan, Boan, etc.

### 4.2.3.1.2 Government Policies

Since the mid-1980s, Chinese government has focused on promoting productions of PC, peripherals, and software, by allowing foreign firms enter the market while promoting
domestic PC makers.\textsuperscript{601}

China has attracted foreign PC makers in order to develop this industry, as foreign companies transfer their technology into China and form alliances with domestic companies. On the one hand, China has discouraged direct import of computers by imposing high tariffs and taxes. Actually, the government aims to give domestic companies time to get prepared and strengthened to compete against foreign competitors. On the other hand, to encourage exports, the government has created “export processing zones” where imported materials used in production would be free from duties and taxes when they were directly exported.\textsuperscript{602}

Chinese government’s policy played an indirect part in domestic companies. That is, it stimulated domestic manufacturers, but did not directly intervene or manage these firms.\textsuperscript{603} And the most important resource offered by the government was the access to the technologies developed by state R&D institutions.\textsuperscript{604} Meanwhile, Chinese government played an important role in promoting the use of computers and expanding computer market.

\textbf{4.2.3.3 Enterprise Background}\textsuperscript{605}

Lenovo Group Limited (hereinafter Lenovo) is the largest manufacturer of personal computers in China with annual sales of more than $24 billion dollars in 2004, holding a market share of 30 percent and providing PC products to more than 160 countries.

Lenovo, originally known as Legend Group, emerged in 1980s and was formally founded in 1984 by Liu Chuanzhi along with other ten colleagues of the Chinese Academy of Sciences (CAS). Since its establishment Lenovo was used to resell and distribute computer products of foreign companies such as AST, IBM and HP in mainland China and Hong Kong. Lenovo did not have its own brand PC until 1990.

\textsuperscript{602} Ibid., pp. 5-6
\textsuperscript{603} Ibid., p. 6
\textsuperscript{604} Ibid.
\textsuperscript{605} Much of the background in this section is taken from Lenovo Official Website (2007); Spulber, D. F. (2004), pp. 2-6; Biediger, J. et al. (2005), pp. 90-100
Now Lenovo has become the largest PC manufacturer not only in Chinese market but also in the Asia Pacific market (excluding Japan) with a steadily increasing market share to 36.2% in 2007 and more than 27,000 employees. In the world, Lenovo also grew from the eighth-largest PC maker to the third-largest after Dell and HP. Furthermore, besides the manufacturing and sale of PCs, Lenovo has begun to manufacture motherboards in Hong Kong, mobile handsets, and hand-held devices and provide IT consulting services.

4.2.3.4 Lenovo’s Three Growth Stages and its Contender Strategies

According to Dawar and Frost (1999), contenders facing strong globalization pressures and possessing transferable assets may actually be able to compete against foreign MNCs at the global level.

Lenovo has experienced three growth stages since its foundation. These three stages illustrated in figure 4-1 clearly indicate how Lenovo steadily became an aggressive contender and an emerging MNC.

![Figure 4-1: Lenovo’s Three Growth Stages](image)

In the following parts, each growth stage, and relevant strategic options and competitive responses as a contender will be examined in detail.

---

4.2.3.3.1 Stage One: Pioneering Era

During the period of 1984-1993, with few foreign PC companies in the CCGM, Lenovo was concentrating on upgrading its own capabilities and was planning to become a pioneer in Chinese PC industry. The reality proved that Lenovo did achieve a great success during this stage.

In 1987, Lenovo successfully rolled out Lenovo Chinese-character card and received the highest National Science-Technology Progress Award in the following year. Subsequently, Hongkong Legend Computer Group Co. and Beijing Lenovo Computer Group Co. were established in 1988 and in 1990, respectively. After acting as the reseller and distributor for some foreign brands, Lenovo launched its first brand PC in 1990, which signaled that Lenovo has shifted from an agent for imported computer products into a producer and a seller of its own branded computer products. Finally, Lenovo has pioneered the home PC market since 1992.

During this stage, Lenovo’s success was contributed by a series of key strategic choices and success factors listed as follows:

✓ **Technology**

One of the most important success factors for Lenovo is its pioneer position in technology by closely cooperating with the Institute of Computing Technology (ICT) which belongs to the Chinese Academy of Sciences (CAS) and has the greatest concentration of IT talent in China. 608 Strong domestic base of technological know-how enables Lenovo to capture a growing share of the Chinese domestic PC business and constantly infuses new dynamics into its sustaining growth.

✓ **Distribution Channels**

Lenovo obtained its competency in PC distribution by reselling and distributing PC products for foreign giants such as AST, HP, and IBM. Particularly from the JV with HP, Lenovo learned not only how to organize sales channels and how to market PCs, but also rich first-hand experience in understanding the needs of China’s computer market.

✓ **High Autonomy**

609 The following content in this point comes from Biediger, J. et al. (2005), p. 91
Although Lenovo was founded as a state-owned enterprise initially, it has enjoyed sufficient autonomy to operate as an independent firm. For instance, Lenovo’s leader can independently arrange personnel management training, financing, reward system, and so on.

In addition, China government set up many trade restrictions in terms of quotas, tariffs, and value added taxes on imports. For instance, government discouraged direct import of computers by imposing high tariffs and taxes with 82% in 1992 and increasing their costs by certification processes in terms of quality, local content, and export limits. In doing so, the Chinese government aimed to give domestic firms time to get prepared to compete against foreign PC giants.\(^{611}\)

By strictly controlling costs, offering reliable products tailored to local customers, and keeping updating technologies, Lenovo became China’s leading PC supplier with a domestic market share of 27% in 1992, which has laid a stable foundation for further development.

4.2.3.3.2 Stage Two: PC Brand Era

Stepping into the second stage from 1994 to 2003, on the one hand, Beijing Lenovo overtook China Great Wall Computer Co., the largest traditional State-Owned computer manufacturer, to become the largest domestic PC maker in China, with sales only behind foreign companies AST and Compaq in the Chinese PC market.\(^{612}\) This event signaled that Lenovo entered the golden era for growth. However, on the other hand, China government reduced tariffs for directly importing computers from 82% to 35% in 1993, which was expected to further reduce according to China’s commitments to the WTO. In the context of China’s fastest growing market for IT technology and a favorable investment environment, many global computer giants were aggressively entering the CCGM. In the mid-1990s, many global players such as Dell, HP, IBM, Acer, Samsung, Sony and Toshiba started to establish plants in China and participate in the booming market. Facing heightened competition at home, Lenovo’s leading position in domestic market has been threatened by foreign full-fledged opponents, especially by Dell. Lenovo’s sales and

---

\(^{610}\) Spulber, D. F. (2005), pp. 2-3
\(^{611}\) Dedrick, J. and Kraemer, K. L. (2001), p. 6
\(^{612}\) Bian, L. M. (2005), p. 64
market share began to decline rapidly. In 1994, Lenovo had only 6% of the Chinese market, but AST, Compaq, IBM and DEC held a combined market share of 66%. In this case, Lenovo quickly launched struggle with those well-heeled giants by adopting a series of resistance strategies as a contender. Besides Lenovo, a group of domestic computer companies also participated actively in the competition at home and abroad, such as Founder Electronics and Tongfang. The resistance strategies and relevant success factors which took dominant impact on Lenovo are summarized as follows:

✓ **Low Cost and Pricing**

Low cost advantage enables emerging contenders to exceed their foreign competitors at home.

Facing intensive foreign competition, Lenovo capitalized on its low-cost advantage to offer customers a package of affordable prices, technical efficacy, and strong patriotism. Lenovo positioned its product price above other domestic brands’ prices but below global brands’. Generally, Lenovo’s price is 20% or even 30% lower than imported PCs’. Compared with other domestic players, Lenovo is viewed as high quality, leading brand, but reasonable price.

“While imitating competitors and basing advantage on cheap labor or raw materials is possible in less sophisticated industries or industry segments, such advantage is rarely sustainable and cannot be the basis for economic development beyond a certain level.” Meanwhile, this advantage may be eroded by other even lower cost countries such as India and Malaysia. Therefore, a would-be contender should not compete with foreign MNCs by depending merely on low cost for a long run.

✓ **Going Public**

According to Dawar and Frost (1999), the greatest challenge for contenders is to overcome deficiencies in skills and financial resources. Lenovo successfully solved financial issue by being listed in on the Hong Kong Stock Exchange, quoted on the London Stock Exchanges’ SEAQ system, and traded in the United States through

---

613 Spulber, D. F. (2005), p. 1
614 The following content comes from Spulber, D. F. (2005), pp. 5-6
616 Biediger, J. et al. (2005), p. 98
American Depository Receipts (ADRs).\textsuperscript{618} It was a milestone for Lenovo to go public, because \textit{firstly}, Legend raised capital which is important for its further expansion; \textit{secondly}, Lenovo started to enjoy an efficient financial market which was or still is not available to most other companies based in mainland China;\textsuperscript{619} \textit{thirdly}, participating in international capital markets enabled Lenovo to deal successfully with shareholders’ pressure.\textsuperscript{620}

\textbf{Differentiation}\textsuperscript{621}

To distinguish itself from foreign MNCs and thereby obtain market share, Lenovo capitalizes effectively on domestic competitive advantages which include: \textit{first and foremost}, Lenovo has the good knowledge of Chinese market; \textit{secondly}, Lenovo has strong and broad connections with the Chinese government as the Chinese Academy of Sciences is the Lenovo’s major shareholder, and Lenovo also works closely with the Chinese Institute of Technology (CIT); \textit{thirdly}, Lenovo is able to create barriers to entry for foreign competitors by developing softwares that are more applicable for the Chinese market and can better meet Chinese standards in practice. For instance, Lenovo has focused on integrating the Chinese ideographs and symbols into their input mechanisms. All these specific elements have formed Lenovo’s unique competitive advantages which enable it to outmaneuver foreign competitors in certain areas.

In addition, Lenovo also outperformed foreign competitors in providing customers with sales assistance and tutorials on how to operate a computer and how to use the Internet. This kind of service seems very necessary to Chinese consumers at this moment. Furthermore, Lenovo was concentrating on offering specialized products for specific market segments such as state-owned enterprises, banks and small business.\textsuperscript{622} Equally important, Lenovo allured and maintained many talented professionals through a series of non-traditional Chinese reward systems.\textsuperscript{623}

It is worthy to note that due to heightened competition at home, gradually matured PC industry, and increasing indigenous competitors, Lenovo has started to diversification by

\begin{thebibliography}{9}
\bibitem{Spulber2005} Spulber, D. F. (2005), p. 6
\bibitem{Bian2005} Bian, L. M. (2005), p. 75
\bibitem{Biediger2005} Biediger, J. et al. (2005), p. 96
\footnote{The following content in this point comes from Biediger, J. et al. (2005), pp. 90-93}
\bibitem{Spulber2005a} Spulber, D. F. (2005), p. 6
\bibitem{Biediger2005a} Biediger, J. et al. (2005), p. 93
\end{thebibliography}
manufacturing other electronic products such as mobile phone and providing advanced IT services. However, the adoption of diversification strategy did not bring Lenovo a good effect, since it led to a serious decentralization of Lenovo’s limited resources.

In 2003 Legend re-branded its corporate label to “Lenovo” by taking the “Le” from Legend to honor its roots and adding “novo”, the Latin word for “new”. This represents not only Lenovo aims to expand globally, but also Lenovo has emerged with innovation at the core of the company instead of previously mere low-cost manufacturer. However, at that time, Lenovo was a brand that few people knew.

4.2.3.3.3 Stage Three: Globalization Era

Just one year after renamed from Legend to Lenovo, Lenovo announced its US$ 1.25 billion purchase of IBM’s PC business in 2004. This historic event signals that not only did Lenovo enter a completely new growth stage: globalization era by achieving a great leapfrog from a local brand to a global one overnight, but also a new era for the global PC industry. By repositioning itself as a focused, global producer, along with a desire of becoming a Fortune 500 company by 2010 and a new strategy based on what customers want: high-quality products and world-class service, Lenovo’s annual revenue reached $13 billion and became the world’s third-largest PC supplier with a 9-10% global market share, only behind Dell and HP.

While participating into global competition and defending its home base, Lenovo needs new strategies to better coordinate with its external environment and internal competences. These strategies can be outlined as abandoning diversification, reverting to core business PC, and global expansion.

✓ Abandoning Diversification

Stepping into this stage, Lenovo decidedly abandoned its non-core business, which signaled the end of its unsuccessful diversification strategy. By concentrating on its core business PC products, Lenovo realized its strategic shift and returned to the right path successfully.

---

624 Biediger, J. et al. (2005), p. 91
625 Wu, F. (2005), p. 27
Facing intensifying competition from both domestic PC manufacturers and global players, Lenovo chose to expand internationally while defending its home market. Firstly, Lenovo started to build a global brand, since Chinese products lack brand recognition and an inferior image in the global market. In order to increase the global consciousness, Lenovo became an Olympic worldwide sponsor in 2006 and 2008 as well as the National Basketball Association (NBA). Lenovo is the first Chinese company to become a computer technology equipment partner of the International Olympic Committee (IOC). Secondly, Lenovo would keep on investing more in R&D. Thirdly, Lenovo started to enter into a number of manufacturing agreements with foreign competitors, and so on.

Defending Domestic Market

Meanwhile, Lenovo would keep on defending domestic markets by developing the 4th-, 5th-, and 6th-tier of the CCGM where even Dell’s intensive direct sales can not reach. Lenovo launched the “Read a Dream (Yuanmeng)” PC series tailored especially to home users in China’s towns and villages.

“The most successful contenders --- those that have moved beyond competing solely on the basis of cost --- have learned to overcome those disadvantages by accessing resources in developed countries.” Therefore, it is equally important for Lenovo to obtain access to IBM’s international expertise especially in such areas as the management of manufacturing and distribution channels in the 160 countries where IBM had already established a presence.

4.2.3.5 Summary

Broadly speaking, Lenovo has significantly succeeded over the past 23 years. Lenovo is acting as a vanguard of Chinese companies’ global movement. Lenovo’s resistance strategies for combating foreign competitors at home and abroad are very valuable and

---

626 Spulber, D. F. (2005), pp. 11-14
628 Wu, F. (2005), p. 27
referential for other Chinese firms intending to become a global contender.

However, as Lenovo has become the third largest PC company in the world, it is undoubtedly that Lenovo will face more development opportunities and head-on struggles with Dell, IBM, Fujitsu-Siemens, Toshiba, Acer and other market players. At its initial stage of globalization, Lenovo still has a long and hard way to go.

4.2.4 Case Study Five: Haier Group

Competing actively against global giants, the Haier Group (hereinafter Haier) is admittedly regarded as a very successful case in China. Haier case has been widely applied to analyze local Chinese enterprises’ corporate strategies, especially internationalization strategies in the context of ever-changing environment and intensifying foreign competition.

4.2.4.1 Chinese Household Appliance Industry Overview

China’s household appliance industry mainly includes the following sub-sectors: refrigeration appliance, air-conditioner, cleaner appliance, kitchen appliance, electric radiator appliance, hygienical appliance, and other appliances. After experiencing almost twenty years’ development, China’s household appliance industry has become one of Chinese industries with strong global competitiveness. Today, in this industry Chinese companies are the largest global manufacturers in 28 out of 32 product categories, such as color TV, refrigerator, washing machine, home air-conditioner, VCD/DVD, etc.

4.2.4.1.1 Industry Development Background

The evolution of China’s home appliance industry can be generally outlined into three development stages:

1) Construction Stage (1981---1990)

629 People’s Daily Online (2006)
630 The following content comes from Tian, J. (2003), pp. 1-2
During this stage, local governments of different regions actively introduced advanced technologies and equipments from developed countries. At that time, there were over 100 manufacturers nationwide, mainly producing one single model of products such as televisions, washing machines, and refrigerators. Chinese manufacturers like Wanbao, Shanglin, Feilu, etc. were dominating. As a result of this stage, a fundamental platform of china’s home appliance industry was built to ensure further development.


With deepening economic reforms and open-up, the demand for home appliances has dramatically increased and some local brands started to expand their markets nationally. During this stage, industrial intensity has increased; the number of manufacturers producing single home appliances has decreased; the first wave of M&As in home appliance industry has emerged; many domestic home appliance manufacturers started transforming factories to modern enterprises; and several well-recognized Chinese home appliance brands have formed. Representative firms include Haier, Changhong, TCL, Midea, etc. From a technological perspective, this stage is characterized by introduction and absorption of foreign technologies as well as emergence of indigenous innovation; from an enterprise perspective, Chinese companies were getting more standardized and started to grow by international expansion. In addition, well-organized producers from Western developed countries began to crowd into Chinese domestic markets and many JVs were formed, which marked that foreign MNCs started to pay unprecedented attention to Chinese home appliances market.

3) Internationalization Stage (2001---Present)

After experiencing aforementioned two stages, Chinese home appliance manufacturers have been equipped with strong integrated competences. In tandem with China’s accession to the WTO and the complete performance of commitments, local Chinese manufacturers are confronting several key issues, namely how to consolidate their current competitive positions and expand markets further, how to compete against a mass of well-endowed foreign giants, and how to boost the rise of the whole industry. Beyond all doubt, this stage is the most challenging period for local Chinese firms due to continual emergence of both opportunities and threats.
4.2.4.1.2 Current Situations and Prospects

The current situations of China’s home appliance industry can be described as follows:\textsuperscript{631}

1) Basically, China’s home appliance industry is being in a hypercompetitive stage as several leading Chinese homegrown players, a number of new Chinese entrants and foreign giants competing actively in Chinese market. On the one hand, Chinese markets are crowded by a mass of domestic manufacturers, different brands, specifications, models, and categories, which results in a severe product overstock as supply is more than demand. On the other hand, foreign brands start to launch an overall counterattack against Chinese companies in the CCGM. Electrolux, Sony, Philips, Samsung, Siemens are consolidating their positions in high-end product markets, while trying to increase market share by actively and aggressively expanding into Chinese middle- or low-end markets. In spite of intense competition, Chinese consumer electronics and domestic appliances are dominated by several homegrown giants with established well-recognized brands in the CCGM.

2) Both foreign and domestic players have to adopt multiple measures in their marketing mix, such as “price wars”, “position wars”, “scale wars”, “advertisement wars” and “guerrilla wars”. Thereinto, price wars are always impressive as a) there are numerous concerned products encompassing microwaves, televisions, refrigerators and air conditioners; b) there is a big scope of price deduction; and c) price wars are very intensive.

3) Growing by expanding abroad becomes a very important and effective growth strategy for Chinese manufacturers. However, diverse Chinese firms have distinguishing directions, objectives, measures, and special emphases in practice. Generally, the nature of expansion can be classified into two categories: one is represented by Haier group intending to become a global brand; the other one is represented by export-oriented Galanz setting up production base globally through OEM and making “microwave ovens for more than 80 brands around the world”\textsuperscript{632}.

4) More and more manufacturers attempt to achieve growth through diversification.

\textsuperscript{631} The following content comes from Tian, J. (2003), pp. 2-5
\textsuperscript{632} Wu, Y. B. (2003), p. 106
By and large, the prospects of Chinese home appliance industry include: firstly, domestic market is promising. Demand in urban market will grow stably; the demand for middle- or low-end products in rural market will increase. Secondly, price will keep decreasing due to the over production and more advisable buying behavior of Chinese consumers. Thirdly, distribution channels will become more professional. Lastly, diversification will continue to augment.633

4.2.4.2 Enterprise Background and Four Growth Stages

Haier, a large Chinese enterprise originally termed the Qingdao Refrigerator Company, was founded in Qingdao in 1984.634 At that time, this company was on the verge of bankruptcy, only producing one single model of refrigerators but possessing more than 800 workers and RMB 1, 47 million net debts.635

With China’s opening up, some foreign players started to enter China market by forming cooperations with domestic partners. One of foreign entrants is Germany’s Liebherr Group, setting up an agreement with Qingdao Refrigerator Co. and offering advanced technology and equipment. And Qingdao Refrigerator Co. was an OEM for Liebherr by manufacturing refrigerators under the name of Qingdao-Liebherr and with Liebherr’s standards. More importantly, since Haier’s foundation in 1984, Zhang Ruimin as the plant director, along with a new leadership team, began to reorganize this company. In 1991, Qingdao Refrigerator Co. was renamed as Qingdao Haier Group by extracting the last two syllables “herr” from “Liebherr”. The name was further simplified as Haier Group in 1992, and has been used up to now.

After executing in a series of technological innovation, scientific management, capital operations, M&As, and multinational expansion for more than two decades, today’s Haier becomes not only the largest manufacturer of “white electric appliance” in China with 50,000 full-time employees and over RMB 100 billion annual sales, but also the fourth

633 These four prospects come from Tian, J. (2003), pp. 6-7
634 The following content comes mainly from Haier Official Website (2007); Zhang, R. M (2007), pp. 141-146
635 Wu, F. (2005), p. 22
largest in the world, as well as world-renowned brand that is popularly sold in 160 countries with an annual sales of RMB 71, 1 billion.\(^6\)

In brief, with over 15,100 different specifications under 96 categories, Haier produces household appliances such as refrigerators, refrigerating cabinets, air conditioners, washing machines, televisions, mobile phones, home theater systems, computers, water heaters, DVD players and integrated furniture.

Since its foundation in 1984, Haier has experienced “four major development stages”\(^6\) and its corporate strategies have also shifted accordingly (Figure 4-2).

**Figure 4-2: Haier’s Four Growth Stages and Strategic Shifts**

```
<table>
<thead>
<tr>
<th>Strategic shift</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global-Brand Stage</td>
</tr>
<tr>
<td>Internationalization</td>
</tr>
<tr>
<td>Diversification Stage</td>
</tr>
<tr>
<td>Branding Stage</td>
</tr>
</tbody>
</table>

```

Source: Haier Official Website (2007)

1) **1984---1991: Branding Stage/Brand Strategy**

Since Haier was founded, CEO Zhang has started to focus on developing a good reputation for its refrigerators by improving product quality greatly. The company introduced a Total Quality Management system and rigorous standards to establish a strong brand in China. And a representative event was CEO Zhang ordered workers to destroy 76 defective refrigerators after these refrigerators came out from production line, which aroused the quality consciousness of employees and signaled that quality should undoubtedly be the centre of Haier’s business forever. After gaining a series of certifications for quality

---


management such as ISO 9001, National Quality Management Award and the UL (US) certification, Haier has achieved name-brand recognition and consistency because of competitive price, excellent quality, updating innovation, and satisfying customer service in the CCGM, which accordingly ensured its dominant position and stable foundation for further development.


The second stage is characterized by a diversification strategy in China. Haier diversified itself into all kinds of household electrical appliances and electronic consumer goods through M&As across China instead of previously producing only one product. From 1984 to 1998, Haier had acquired 18 companies running at a loss and activated their assets by restructuring, recapitalizing, and recovering idle assets. In doing so, Haier’s business was expanded and strengthened successfully.

3) 1999---2005: Internationalization Stage/Internationalization Strategy

On the basis of a stable dominant market position in the CCGM, Haier started to expand internationally in order to replicate domestic achievements and sound reputation overseas. Actually, since 1990 Haier has already begun to export Haier branded products to Europe, with Germany as the first destination, and to Middle Eastern countries in 1993. In 1994 it began to export its products to the United States, initially in OEM form and then with Haier own branded products. Then, Haier started to expand to other European countries, Southeastern Asian countries, and India. Since 1999 Haier started to build overseas factories and companies, information centers and product design branches. It has also built technology alliances with 15 famous research institutes. Further, it has started to leave its footprint in life insurance, natural medicines and health foods through international diversification.638

4) 2006---Present: Global-Brand Stage/Global-Brand Strategy

In order to adapt to the trend of integrated global economy and manage its worldwide brand, Haier has stepped into the fourth strategic growth stage since 2006. With the ultimate aim of becoming Global 500, Haier replaced its former international strategy by a

global-brand strategy. International strategy was based on China, while spreading to the whole world; whereas, global brand strategy is to create localized Haier brand in every non-China target markets. In brief, the adoption of global strategy is to achieve Haier’s sustainable development through realizing win-win profits with suppliers and customers.

4.2.4.3 Haier’s Evolving Resistance Strategies in different Growth Stages

In fact, Haier’s four growth stages can be described as defender, dodger, extender, and contender respectively, as shown in figure 4-3. In this part, each strategy typology and corresponding strategic behavior to survive and develop will be examined in detail and in depth.

Figure 4-3: Haier’s Resistance Strategies in Various Growth Stages

<table>
<thead>
<tr>
<th>Pressures to Globalize in the Industry</th>
<th>Competitive Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Defender (stage 1)</td>
</tr>
<tr>
<td>High</td>
<td>Dodger (stage 2)</td>
</tr>
<tr>
<td></td>
<td>Contender (stage 4)</td>
</tr>
<tr>
<td></td>
<td>Extender (stage 2+3)</td>
</tr>
</tbody>
</table>

Source: adapted from Du, Y. P. (2003), p. 119

4.2.4.3.1 Stage One: Defender

From 1984 to 1991, on the one hand, there was relatively weak globalization pressure in the home appliance industry and foreign investors had little presence in the CCGM; on the other hand, at its initial stage, Haier did not have competitive advantages that could be transferable abroad. Therefore, Haier acted as a defender during this stage.639

---

639 Du, Y. P. (2003), pp. 119-120
Concretely, Haier concentrated on its competitive advantages in the CCGM. *Firstly*, Haier took advantage of good knowledge of China, the CCGM, and Chinese consumers. It kept up quality standards on the one hand; on the other hand, it tried to meet consumers’ special requirements more quickly than foreign competitors. For instance, Haier found most consumers who buy its compact refrigerators are college students who have very small room and want to use limited space efficiently. Haier designed a refrigerator with wooden flaps on the sides that can be folded out to make a computer table.\(^{640}\) Similarly, in 1989, Haier found that sales of the single model of refrigerator were much better in Beijing than in Shanghai. After market research, Haier realized that Shanghai residents had relatively smaller flats and accordingly there was little space for a large refrigerator. As a result, Haier manufactured a smaller refrigerator especially for the Shanghai market and sales then increased greatly.\(^{641}\) *Secondly*, it took advantage of better access to distribution networks and connections within China’s rambling bureaucracy. It worked closely with resellers who maintain close contact with end users and in return these resellers provided Haier with valuable information about consumers’ demand and future consumption trends. *Thirdly*, Haier has learned so much from its foreign MNCs during its initial stage. “In fact, the Chinese government’s favorite maxim as far as its domestic companies go is to ‘study, cooperate, and compete’ against foreign enterprises in China in order to build economic strength.”\(^{642}\)

### 4.2.4.3.2 Stage Two: Dodger

During Haier’s second development phase, the “three big buys” that Chinese consumers are concerned about have shifted from the previous bicycles, watches and sewing machines to current televisions, washing machines and refrigerators.\(^{643}\) Therefore, the home appliance market was booming during this stage. For Haier, on the one hand, it still had no sufficient competitive assets which can be transferred abroad; on the other hand, with the increasing presence of foreign giants in the CCGM, pressures to globalize in the home appliance industry were getting stronger. For instance, American home appliance giant Whirlpool entered China in the early 1990s, and then other companies like Electrolux,
Siemens, Maytag, etc., which have launched significant challenges to Haier. In this instance, Haier operated as an active dodger rather than a passive one in the CCGM.\textsuperscript{644}

\textit{Firstly}, Haier offered consumers products in dozens of categories by setting foot in other business. For instance, it expanded into new segments including washing machines and air conditioners, which to the great extent complemented the products of foreign MNCs. Meanwhile, if consumers benefit from one of products with Haier-brand, they will probably try its other products.

\textit{Secondly}, Haier offered Chinese consumers the same products with different individualities, as Chinese consumers not only demand good quality and durable products, but also expect these products to have a number of individualities which enable them to make easier decisions in the face of a body of products with diverse features, colors, contributes and styles.\textsuperscript{645} During 1990s Whirlpool and GE were establishing their market positions in the CCGM through actively acquiring Chinese manufacturers. Although they provided Chinese consumers with the products which were successful in developed countries, compared with the feature-rich products available from Haier, their products were thought to be limited by Chinese consumers. Besides, it was very difficult for these foreign competitors to meet Chinese consumers’ requirements on after-sales service.

\textit{Thirdly}, the reason why Haier was an active not a passive dodger is Haier also focused on introducing product innovations that were crucial to consumers, and taking new measures to counter growing domestic competition.\textsuperscript{646} Haier’s objective is “to avoid price wars in the domestic markets by using their integrated international competitive assets to reform the Chinese household electrical appliance industry fundamentally by leading it to a high standard and employing an innovative way towards internalization”\textsuperscript{647}.

\textit{Fourthly}, Haier focused on establishing distribution channels and after-sales service networks that covers not only urban markets on the east coast of China but also markets in semi-urban and rural China.\textsuperscript{648}

\textsuperscript{644} Du, Y. P. (2003), p. 120
\textsuperscript{645} Anonymous (2003), p. 4
\textsuperscript{646} Ibid.
\textsuperscript{647} Du, Y. P. (2003), p. 120
\textsuperscript{648} Khanna, T. and Palepu, K. G. (2006), p. 64
Lastly, during this stage, Haier has cooperated much with foreign companies. In 1993, Haier began to produce for foreign MNCs as an OEM subcontractor and set up a JV with Mitsubishi Heavy Industries to produce air conditioners in China; in 1995, Haier formed a JV in Indonesia with local producer of refrigerators and air conditioners; in 1997, Haier set up JVs in the Philippines with local companies of air conditioners; and in 1998 Haier performed a JV with Philips of the Netherlands.\footnote{Bonaglia, F. et al. (2006), p. 20}

In a word, Haier’s objectives in these two phases were to enhance its own competitive assets and avoid head-on competition with foreign MNCs. By acting as a defender and a dodger, Haier has obtained competitive advantages by adopting a series of domestic growth strategies, and has achieved dominant market position and recognized brand in the CCGM. Particularly during Haier’s immature stage, defender and dodger strategies ensured that Haier could store up strengths and avoid suffering from head-on competition with foreign counterparts. Furthermore, these two resistance strategies enable Haier to gain precious time before launching overall, large-scale development and intensive competition against foreign players both at home and abroad.

4.2.4.3.3 Stage Three: Extender

During this phase (1999-2005), Haier has gained strong and stable position in domestic markets and its competitive assets have been able to be transferred internationally. In this instance, Haier acted as a strong extender in international markets.\footnote{Du, Y. P. (2003), p. 120} Actually, Haier has started international expansion since the second growth stage in 1992; however, Haier’s large-scale expansion happened in the third stage.

The reasons for Haier’s internationalization are multiple. On the one hand, domestic competition has been intensifying, which can be reflected by more and more foreign entrants, the shift of foreign competitors’ strategies from high-end to mass products, the saturation of demand for home appliances, Chinese consumers’ sophisticated requirements
and preferences to home appliance products, and so on. If the pressure in the domestic market cannot be eased in a short term, overseas market will become the top target market for Haier. Meanwhile, CEO Zhang indicated that margins were getting thinner when every foreign MNCs had their presence in China, thus, Haier could not survive if it did not go outside.\footnote{651}

On the other hand, CEO Zhang also expressed that “without domestic market, business is rootless; without international market, business is weak”\footnote{652}. That is, if it hasn’t gained success in Chinese domestic markets, it is impossible for Haier to expand overseas; whereas, if it only gains success in Chinese domestic markets, it is impossible for Haier to achieve a long-term survival and growth. Haier has been equipped with some preconditions to expand overseas, for instance, a consolidated foundation and a reliable brand within domestic markets. Hence, it is time for Haier to spread sound success domestically into international or even global arenas.

In addition, going internationally enables Haier to benefit from the increased recognition when it backs in China. In other words, as its brand becomes successful internationally, Haier will benefit from increased awareness and reputation among Chinese consumers, which will in return bring Haier strong competitive advantage in the competition against foreign rivals at home.\footnote{653}

Finally, CEO Zhang also believed that Haier should bravely confront international challenges and the only way for this was to go internationalization through constantly learning game rules in practice.\footnote{654}

Under the circumstances, Haier has been the fastest to internationalize. It moved beyond OEM to international through acquisitions and green field investments in all regions.\footnote{655}

The path of Haier’s international expansion can be illustrated as figure 4-4 below:

\footnotesize
\begin{itemize}
\item \footnotemark[651] The Economist (2004), p. 67
\item \footnotemark[652] Haier Official Website (2007)
\item \footnotemark[653] Chan, J. (2007), p. 37
\item \footnotemark[654] Haier Official Website (2007)
\item \footnotemark[655] Bonaglia, F. et al. (2007), p. 22
\end{itemize}
Since 1995, Haier has started its international expansion from Southeast Asia, by investing in Indonesia, Philippines and Malaysia to produce refrigerators and air conditioners; in 1999, Haier established manufacturing facilities in USA; and in 2001, it entered European markets.\textsuperscript{656}

Several unique characteristics of Haier’s extender strategy distinguish itself from the majority of Chinese firms and other famous Asian firms when expanding beyond their domestic boundaries.

Firstly, unlike other Chinese firms which initially focus on entering emerging markets before they expand into tough markets in developed countries, Haier has concentrated on penetrating USA markets firstly, on the basis of which Haier continued to expand to emerging markets and other developed markets such as Europe. Two reasons for this stand out: a) Haier’s largest competitors are located in developed markets; and b) Haier believes it will be unquestionable to enter easier markets if it can first succeed in difficult ones.

Secondly, Haier adopted a niche strategy when expanding in Western markets. By avoiding the head-on fight with Western giants in the most competitive product areas such as full-sized refrigerators and washing machines, Haier has penetrated developed markets with compact refrigerators and wine storage units.

Thirdly, the strategic objective of Haier’s expansion is to produce and sell one third of its total output in China, make one third of its total output in China but export it to...
international markets, and produce and sell one third in foreign countries.657

_Fourthly_, a large majority of Chinese firms purchase resources overseas and sell their goods under foreign firms’ labels.658 However, the objective of Haier as an extender was not only to sell its products overseas and earn foreign currency as other export-oriented Chinese companies do, but also to create a sound brand reputation internationally. In addition, Haier also intended to establish itself in Western markets as a localized brand instead of an imported Chinese brand, by maximally meeting local consumers’ needs, localizing “human resources, capital and culture”659 and so on.

_Fifthly_, unlike many Chinese companies trying to offer products to foreign markets at low price as possible, Haier provides consumers with products with high technology but at a reasonable price. Haier already spent about five percent of revenues on efforts to differentiate itself through product innovation.660

_Lastly_, Haier has a unique developing background, which makes it different from other Asian firms. As China has such a tremendous geography, disparate markets, and many national and local authorities, actually Haier has dealt with many problems of globalization without leaving home.661

In conclusion, as a result of successful internationalization strategy, Haier’s products are sold in great volume to major economic regions all over the world. With well-established overseas distribution networks and reliable after-sales service networks, Haier brand has become a sound notability with good reputation and recognition.

**4.2.4.3.4 Stage Four: Contender**

Although Haier has achieved a modest success in the international markets, it is encountering increasing competitive pressure from foreign MNCs in the CCGM, especially

---

658 Hunt, L. (2005), p. 2
659 Liu, H. and Li, K. Q. (2002), p. 703
661 The Economist (2004), p. 72
After China entered the WTO in 2002 and fulfilled its commitment till 2006, globalization pressure in home appliance industry is getting higher; meanwhile, Haier’s are equipped with many transferable competitive assets. Therefore, Haier is acting as a contender in this phase. By taking a further step than extender, Haier does not view itself as a company whose base is in China and which has limited operation overseas, rather it attempts to become an emerging MNC by setting up bases in several major countries. Meanwhile, Haier’s aspiration is to make its products as localized global brand instead of an imported Chinese brand.

First of all, a very successful survival strategy Haier adopted in the United States market as a global contender is to find a distinct and defensive market niche. Haier is focusing on the niche segments of mini refrigerators and wine coolers which have already been abandoned by those strong MNCs such as Whirlpool, General Electric, and Maytag due to the low profit margins.

Furthermore, a series of “organic-growth” globalization strategies Haier are adopting aim to overcome its deficiencies in skills and financial resources, and this enables Haier to compete actively with giants on the world stage.

- **Globalization of Design**: Haier has set up 18 design centers worldwide to consolidate resources from developed countries.
- **Globalization of Manufacture**: Haier established 10 industrial parks worldwide and 22 plants overseas, which makes Haier a global manufacturer, enables its prompt reaction to satisfy local users for quality Haier products, and in turn provides great support for Haier to achieve its goal of world-class brand.
- **Globalization of Marketing**: Haier has 5,000 overseas retail outlets and over 10,000 service centers all over the world.
- **Globalization of Purchase**: public bidding and online purchase are carried out via Internet.
- **Globalization of Capital Operation**: one of the greatest challenges for contenders is to overcome deficiencies in financial resources. Haier has started to set foot in

---

662 Wu, F. (2005), p. 22
663 Wu, Y. B. (2005), p. 107
664 Wu, F. (2005), p. 22
665 The following five strategies come from Haier Official Website (2007)
finance industry through investing in Qingdao Commerce Bank and Chang Jiang Securities, running an insurance agency, a life insurance JV and a finance firm, and taking 50% of Haier Electronics Group which is listed in Hong Kong Stock Exchange.

As Haier intends to shift from niche to mainstream product lines in the U.S. markets, organic globalization can not meet this trend and thus Haier has to find a new way to realize further development. Under the circumstances, Haier tried to acquire the third-largest U.S. home appliance producer Maytag by offering $1.28 billion to Maytag shareholders with the help of the partnership with Bain Capital and the Black Stone Group. The purpose of Haier’s takeover is to capitalize on Maytag’s prestigious brand and established sales channels in the U.S. markets. Although this program failed, at least at that time the new company launched an impressive threat to Whirlpool and General Electric, which signaled that Haier would accelerate its global presence through pursuing more JVs, strategic partnerships, or M&As.

4.2.4.4 Summary

On the one hand, the competition pattern of Chinese home appliance industry has changed greatly because of the penetration of foreign MNCs in Chinese market; on the other hand, the rising costs of energy resources and raw materials have led some underperforming enterprises to withdraw from the market. In the circumstances, the concentration of home appliance industry has been promoted to be upgraded and competitiveness of superior leading enterprises to get full plays. Generally, Chinese manufacturers are outperforming their foreign counterparts in China’s home appliance industry. Thanks to low-cost production, improved product quality, individualized functions and catching-up technical innovation, Chinese companies gain brand recognition among consumers and dominant market share. Facing challenges from Chinese companies, foreign giants are trying to obtain competitive advantages through acquisition of Chinese players.

In addition, by this longitudinal and comparative perspective within one Chinese company, Haier case offers special attention on the evolution of resistance strategies in response to

---

668 Research and Markets (2006b)
the company’s external and internal contexts.

Haier’s case clearly indicates how resistance strategies of a company evolve over time according to the relationship between the company’s assets and the special characters of its located industry. Essentially, Haier’s success is mainly contributed by being flexible in response to market opportunities. When it was immature, Haier was concentrating on enhancing its own competitive advantages and preventing frontal battle with foreign giants at home through acting as a defender and a dodger. In doing so, Haier has obtained surviving space and saved power to leap forward in the future. After becoming mature, Haier started to fight back foreign giants at home and abroad. In consequence, Haier has repositioned itself as an emerging global contender by launching an overall competition against other giants on the global basis.

In conclusion, not every Chinese company can achieve such a successful leap. Most Chinese companies will keep focusing on their local markets by strengthening their homegrown competitive advantages; whereas others will defend their home markets while keeping an eye on oversea markets.

4.3 Results and Synthesis of the Empirical Cases

Generally speaking, the previous five representative case studies illuminate that in the context of intensifying competition and decreased profit margins, Chinese companies intend to compete effectively against foreign competition in their home markets in order to achieve a long-term survival and development, by adopting different resistance strategies according to the globalization pressures on the industry and their own transferable competences.

Specifically speaking, four strategies available to Chinese firms when facing the entry and expansion of foreign MNCs into their markets are 1) defending with the home field advantages; 2) dodging the onslaught; 3) extending local advantages abroad; and 4) contending on a global level. These four corporate strategies can be realized independently

---

or interdependently. That is, strategic alliances make contribution to any company regardless of what alternative strategies it employs. Moreover, these resistance strategies can be employed as one or a combination.

This section draws together the four options of resistance strategies along with those four strategies in the context of strategic alliance for local companies competing against foreign giants in the CCGM. Each strategy in the context of China and local Chinese companies will be identified respectively as a conclusion of this chapter.

4.3.1 Defending with the Home Field Advantages

If globalization pressures are weak and companies’ own assets are not transferable, like above-mentioned Shanghai Jahwa and Hangzhou Wahaha, Chinese companies should defend their existing territories against foreign aggressions through capitalizing on their “home field advantages”\(^670\) and avoid head-on rivalry with foreign opponents. Precisely, defender strategies involve the following aspects:

Firstly, despite competitive advantages of Chinese companies in terms of financing, technology, and talent storage are far behind foreign MNCs, we can’t ignore the fact that those well-organized foreign giants cannot have all the advantages at one time, particularly in the emerging CCGM with fast-moving, turbulent and distinct business environment. Thus, Chinese companies should constantly exploit unique advantages in their own marketplace and concentrate on using them to outperform foreign counterparts. Generally, these distinct advantages should not be easy for foreign MNCs to copy or imitate, or at least it will be time- and cost-consuming. To summarize, the unique advantages many foreign MNCs not prepared for are outlined as follows:

- Chinese companies are deeply knowledgeable about the unique local tastes, customer preferences, and cultural sentiments, which can yield formidable sources of competitive advantages. Chinese companies can improve their positions by building upon their cultural competencies and resources, can rely on cultural capital to construct

\(^{670}\) Dawar, N. and Frost, T. (1999), pp. 121-123
a sustainable, unique value and offer the symbolism of authenticity and prestige.\textsuperscript{671} Thus, the most important thing for Chinese companies is to find out and focus on those customers who favor the local taste and style, ignoring ones who appreciate foreign brands.

For instance, Chinese laundry-detergent producer Nice had a very successful advertisement showing its deep understanding of Chinese consumers. The advertisement describes that a young girl is helping her mother, who has just been laid off, wash the family’s laundry. Its success is contributed by representing that child take on his or her responsibilities to the family and society — a very important part of growing up concept in Chinese minds. And another successful example of better understanding of local consumers is Haier’s mini washing machine named “Little Prince”. Compared with those large, impressive-looking machine offered by foreign producers, this “Little Prince” not only related to China’s unique situation of “one child” policy, but also offer consumers with a convenient, light and energy-saving machine which meet the needs of consumer’s daily washing during the hottest summers.\textsuperscript{672}

In this regard, foreign MNCs used to target on developed countries through standardizing product characteristics, which makes them difficult to meet consumers’ changing and unique needs. It is also difficult for foreign MNCs to produce products at the price that are optimal for Chinese consumers.\textsuperscript{673} Even if they can reduce price, it might damage their global brand image in turn. Liushen of Shanghai Jahwa is a representative case. There is another case fully reflecting how Chinese firm applied defensive strategy by capitalizing on “Guanxi” — the typical relationship network within Chinese. Kingsoft, a well-known software company in China, was founded in 1988. It developed software called WPS Office that competes directly against Microsoft Office in the Chinese office applications software market. Confronting tough competition from Microsoft, Kingsoft decided to focus on governmental agencies as its main customer base. After a series of extensive interactions with the government, especially several central government leveled branches, Kingsoft made significant

\begin{itemize}
\item \textsuperscript{671} Ger, G. (1999), p. 70
\item \textsuperscript{672} These two cases come from Williamson, P. and Zeng, M. (2004), p. 87
\item \textsuperscript{673} Khanna, T. and Palepu, K. (2004), p. 4
\end{itemize}
inroads in the market. The key to success of Kingsoft is derived from its knowledge and understanding of the government’s needs. In other words, Kingsoft viewed government as a special kind of customer they can reply; meanwhile, the government is also interested in supporting local company’s development.674

- Chinese companies are familiar with tackling immature local market infrastructure such as distribution channels and logistics networks. And they are armed with better access to distribution networks and connections with wholesalers and retailers at different levels.

- Chinese entrepreneurs are more flexible by dealing with local institutional voids and China’s rambling bureaucracy, as they have abundant experience and cultural familiarity.675

- Chinese companies’ after-sales service is expected to be more reliable and effective.

Secondly, Chinese companies enjoy a considerable cost advantage which enable them outperform foreign MNCs. This implies that Chinese companies are able to compete effectively on price against foreign MNCs. One successful case is Changhong Corporation, the largest color TV producer in China. Before foreign brands entered into Chinese TV markets, many domestic manufacturers have already competed brutally against each other. In the context of aggressive onsets of foreign giants, many Chinese TV producers have gradually lost encourage and capability to take on stiff competition. Their ultimate results are acquisitions by foreign MNCs, or leave this industry, or trying to maintain small overlord in certain limited areas. Under the circumstances, in order to sustain a long-term survival, Changhong urgently needed to find a way to increase its market share in a short time. By virtue of careful market research, Changhong made decision that a price war would be the most effective weapon. Guided by this strategy, Changhong launched a rushing competition against foreign MNCs by reducing price 8% to 18% for all of its 17-inch to 29-inch color TVs. In doing so, Changhong’s overall market share has increased from 16.6% to 31% and accordingly occupied the dominant position in this industry. Meanwhile, sales of foreign brands in China were restrained impressively. The first-ever large-scale price war in China drastically changed the competitive landscape in this industry in favor of Chinese companies.676

675 Khanna, T. and Palepu, K. (2004), p. 4
676 Case comes from Wharton School of the University of Pennsylvania (2006)
In this regards, foreign MNCs are not able to reduce their price merely to attract Chinese consumers, since they have higher costs. In Chinese mind foreign products are always connected with high price and high quality, reducing price might destroy their global brand images.

Thirdly, Chinese defenders are able to benefit a lot from learning from their foreign counterparts, as the sheer visibility of the MNCs’ China strategies in terms of product formulations, brand positioning, and pricing. Chinese companies can anticipate foreign rivals’ purpose and measure, and accordingly gain time to prepare for their resistance strategies against foreign incursions.

Lastly, Chinese defender understands very well that in the face of a stronger counterpart, head-on fight implies throwing egg against stone, which might results to a failure. Therefore, Chinese companies should defend themselves by preventing head-on battles and try to minimize foreign rivals’ impact. For instance, foreign MNCs focus on high-end products and wealthy consumers, while Chinese defenders focus on low-end products and those consumers with limited incomes. When foreign players target on the 1st- or 2nd-tier markets, Chinese defenders start to penetrate tremendous rural markets by building extensive distribution networks.

In summary, Chinese defenders are able to withstand tough competition and defend their domestic turfs against foreign MNCs by means of capitalizing on aforementioned home field advantages and avoiding frontal competition with rivals from the developed world.

### 4.3.2 Dodging the Onslaught

If globalization pressures are strong and companies’ own assets are not transferable, Chinese companies seem to have no other choices but to dodge the onslaught from foreign MNCs by reconsidering their business models.

---

678 Ibid., p. 125
One of the options available to Chinese companies dodging foreign competition is to enter into JVs with, or selling out their entire equity to foreign MNCs, which happened frequently in some consumer goods industries such as cosmetics and automobile.

The second option is dodging the global threat by focusing on links in the value chain where Chinese companies still have competitive advantages, such as distribution and service.\(^{679}\) Undoubtedly, dodger must keep away from head-on competition. Accordingly, Chinese companies can realize dodge strategy through the third strategic option, that is, to supply products that either complement foreign MNCs’ offerings or adapt them to local tastes.\(^{680}\) Additionally, in order to achieve certain profitability, Chinese dodgers can also move to the other end of the value chain by acting as a sub-contractor for foreign MNCs.\(^{681}\)

Lenovo, well-known as an emerging global contender, began as a manufacturing platform to build keyboards and other simple devices for large MNCs at its initial stage.\(^{682}\) And it also acted as a distributor for foreign MNCs’ computers at that time. Haier, another emerging global contender, was an OEM at its initial stage, producing refrigerators for a Germany company.

Another example is a famous Chinese food chain store, named “Honggaoliang (Red Broomcorn)”, which sell Chinese snacks in the same way as McDonalds or KFC. Most Chinese consumers virtually don’t like the food and the prices in McDonalds or KFC or some other foreign food chain stores. They go there mainly because they like the ambience featuring with a clean, bright hall, satisfying food quality, orderly operating model and so on. However, most Chinese consumers prefer Chinese snacks with reasonable prices, but they don’t like the place provided. With deep understanding that it is hard to change Chinese eating habits, “Honggaoliang” chose to meet global standards and dining atmosphere.\(^{683}\) Accordingly, the emergence and rapid expansion of “Honggaoliang” food chain store has impressively challenged foreign snack chain stores by offering Chinese foods at the reasonable and affordable prices and an enjoyable ambience. By virtue of

\(^{680}\) Ibid.
\(^{681}\) Ibid., p. 126
\(^{682}\) Biediger, J. et al. (2005), p. 91
\(^{683}\) Based on Prahalad, C. K. and Lieberthal, K. (2003), pp. 111-112
applying advanced business model and complementing foreign MNCs’ offerings with local
tastes, “Honggaoliang” has achieved a great success in China in a short time.

4.3.3 Extending Local Advantages Abroad

If globalization pressures are weak and companies’ own assets are transferable, Chinese
companies are qualified to extend their local advantages abroad.684 And the aims for
extending abroad are to achieve profit through economy of scale and to learn business
experience in foreign markets. Compared with global players, extenders may be regarded
as companies at an initial stage of globalization and with ambitions so far been more
regional than global.685

Firstly, Chinese extenders are able to target the markets with similar conditions in
institutional and regulatory environment, geographic proximity, consumer preferences,
distribution channels etc. as their home turf. These similar markets are generally other
emerging markets, such as Central Asia, Latin America, the Central and East Europe,
Middle East, and Africa.

Secondly, there are many motivations leading Chinese companies to extend abroad
selectively.

From an internal perspective, based on a successful performance in domestic market,
Chinese companies have been qualified to transfer their homegrown advantages abroad,
these advantages ever made great contribution on their success at home. That is, 1) they are
familiar with how to deal with immature logistics and distribution networks, navigate
ambiguous legal environments, handle rapid external change, and manage firms despite
shortage of management talent;686 2) they can capitalize on low cost resources in these
emerging markets; and 3) they understand very well the characters of consumers under a
transitioning economic system. In a word, a company that has addressed these issues at

686 Ibid., p. 6
home market will have an advantage when seeking to grow in similar markets abroad.\footnote{Aguiar, M. et al. (2006), p. 6} Furthermore, these Chinese companies need new technology, new export markets, raw materials and natural resources, and most importantly, influential brands.

From an external perspective, 1) China’s domestic market is becoming more crowded and competitive as both Chinese and foreign players want to share the most populous consumer market in the world,\footnote{Egan, H. et al. (2007), p. 5} particularly since China’s accession to the WTO. For instance, household appliances and PC industries are two oversaturated sectors in China. Formerly, Chinese companies enjoyed dominant positions in their own markets, but now they find themselves under accelerating competitive pressure from foreign counterparts, with margins being squeezed and profits trimmed.\footnote{Ibid.} In this instance, local Chinese companies are forced to expand outwards. 2) Expanding overseas has been encouraged and supported by the Chinese government.

In short, when facing increasing competition, thinner profit margins and overcapacity within many consumer goods industries in the CCGM, Chinese companies have started to expand to other markets with similar conditions through reproducing their domestic strengths and power. More importantly, success in those emerging markets not only let Chinese companies benefit from the increased recognition back in China, but also provide them with a strong guarantee to move into those Western markets in the future.

Extender strategy has been widely applied by branded Chinese consumer-electronics manufacturers, such as Skyworth Multimedia International Company which penetrated smaller emerging markets with rapidly developing economies in Asia and the Middle East before launching a broader rollout.\footnote{Ibid., p. 19} Besides, Chinese automakers such as Geely and Chery are exporting and assembling low-end models in Latin America and the Middle East.

By 2006, more than 10,000 Chinese companies had invested in 170 countries, according to state figures, and a small but growing group of them are trying to establish themselves as
major global players.691 This group of Chinese companies is the contender which will be examined in the next section.

4.3.4 Contending on a Global Level

If globalization pressures are strong and companies’ own assets are transferable, Chinese companies are able to contend on a global level.692

“The rise of a nation is always accompanied by its companies becoming world-class and competing in international market.”693 As China’s emergence as an active global player, a number of domestic Chinese companies have in turn emerged as active challengers on the world stage or at the initial stage to be global. These emerging contenders are capitalizing effectively on their strong firm-specific advantages as domestic leaders to build global brands.

The emergence of contenders in China and their rising global aspiration did not take place accidentally. Firstly, China’s macroenvironment with a stable political context and a rapid economic growth provides them with the most opportune time to become strong on their home turf and even on a global stage. Secondly, after experiencing fierce competition over decades, some Chinese companies’ competitive advantages and overall strengths have been enhanced greatly. Therefore, on the one hand, some of them are qualified to search new markets globally; and on the other hand, they feel confident enough to expand abroad as they have successfully kept their foreign rivals at bay in the CCGM.694 Thirdly, in the context of China’s accession into the WTO and foreign giants’ aggressive incursion, some Chinese companies are advocating that wolves are coming. However, some other Chinese companies are appealing that they should become the wolf first through obtaining access to advanced technologies and management skills on the world stage.

Meanwhile, a foremost element for Chinese companies expanding globally is that China’s

---

central leaders such as President Hu Jintao and Premier Wen Jiabao believe that building China’s emerging MNCs facilitate China to become an economic superpower. Hence, Chinese government has been fully supportive to those qualified companies expansion: *firstly*, many favorable policies advocated by government agencies such as the National Development and Reform Commission (NRDC), the Ministry of Finance, the Ministry of Commerce and the State Administration of Foreign Exchange (SAFE) have been constituted in order to encourage Chinese companies to move abroad over the last five years; *secondly*, financial institutions such as the Bank of China or China Development Bank offer Chinese companies with superior services in terms of foreign exchange, financing and insurance for their expansion; the most impressive type of support is for the selected SOEs and POEs, they can enjoy the access to favorable financing in the form of credit lines and low-interest loans.695

These emerging Chinese MNCs have some characteristics in common: 1) they have been occupying stably leading positions in domestic Chinese market; 2) they have some unique products which distinct or better than their foreign counterparts; 696 3) they are concentrating on developing powerful and highly recognizable brands, operating beyond local and regional boundaries and achieving significant market share in their respective product areas; 697 4) most of them are operating actively in global market through exporting branded products, establishing overseas R&D and representative offices, acquiring overseas subsidiaries, or even opening overseas manufacturing facilities; 698 5) they raise and sustain financial resources by operating not only in local capital market but in international capital markets, although this is generally difficult for emerging contenders; 699 and 6) they pay special attention to technology innovations and professional management as essential measures for their development and prosperity. 700

---

695 Beebe, A. et al. (2006), pp. 5-6
697 Steinfeld, E. S. (2002), p. 36
698 Ibid., p. 37
699 Grosse, R. (2003), p. 4
700 Jaffe, E. D. et al. (2005), p. 191
According to a recent report by the Boston Consulting Group, among the top 100 emerging global companies in rapidly developing economies, 44 are Chinese companies.\(^{701}\) Besides above-mentioned two representative cases: Haier in home appliances and Lenovo in PCs which are actively participating in globalization, there are many other cases representing China’s emerging global players. For instance, China’s BYD company is the world’s largest manufacturer of nickel-cadmium batteries and has a 23 percent market share for mobile-hand-set batteries; Hisense is the No. 1 seller of flat panel TVs in France,\(^ {702}\) Guangdong Galanz is producing one out of every three microwave ovens in the world,\(^ {703}\) just to name a few.

Liu Yi, the CEO of Xinjiang Chalkis Corporation, said that his firm used to be merely a marginal player in the tomato ketchup category, primarily doing OEM for established European brands. By acquisition of a manufacturing facility in France, building of a R&D center in Turkey and purchase of Italian distributors, Xinjiang Chalkis successfully “plugged-in” to the local knowledge, brands, and channels in the mainstream markets in Europe. As the second largest ketchup producer in the world, Xinjiang Chalkis Corporation holds a 40% market share in the EU and 20% of the global market. Liu Yi always believes that in today’s business world, Chinese companies really need to have a global perspective to survive and thrive.\(^ {704}\)

According to MoC, there were 7,470 Chinese foreign affiliates spread across 168 economies by the end of 2003. Apart from Hongkong where about 2,336 companies were located, there are about 786, 865, 857, 769, 432, and 384 foreign affiliates were located in the United States, the Central and Eastern Europe, ASEAN, the Middle East and Africa, the European Union, and Latin America, respectively.\(^ {705}\) Some exemplary names of Chinese emerging MNCs are listed in table 4-2 below:

\(^{701}\) Li, C. (2007), p. 8
\(^{702}\) Aguiar, M. et al. (2006), p. 5
\(^{703}\) Zeng, M. and Williamson, P. J. (2003), pp. 92-93
\(^{704}\) Case comes from Luo, A. (2006), pp. 1-2
\(^{705}\) Wu, F. (2005), p. 8
Table 4-2: Examples of Emerging Chinese MNCs

<table>
<thead>
<tr>
<th>Bird-Telecom Hardware</th>
<th>Huawei-Telecom</th>
<th>ZTE-Telecom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brilliance-Automobile</td>
<td>Lenovo-PCs</td>
<td>Nanjing-Auto Parts</td>
</tr>
<tr>
<td>CBMI Contraction-Cement</td>
<td>Lifan-Motorcycles</td>
<td>SAIC-Automobile</td>
</tr>
<tr>
<td>Chery-Automobile</td>
<td>Midea-White Goods</td>
<td>Shenyang Machine Tool-Machine tools</td>
</tr>
<tr>
<td>Galanz-White Goods</td>
<td>Ningbo Bird-Mobile phones</td>
<td>Wanxiang-Auto parts</td>
</tr>
<tr>
<td>Geely-Automobile</td>
<td>Shinco-DVD</td>
<td>TCL-PCs</td>
</tr>
<tr>
<td>Great Wall Motor-Automobile</td>
<td>Skyworth-Consumer Electronics</td>
<td>Hisense-Consumer Electronics</td>
</tr>
<tr>
<td>Haier-White Goods</td>
<td>Changhong</td>
<td>etc.</td>
</tr>
</tbody>
</table>


On the contrary, there are also some unsuccessful examples, such as Chunlan⁷⁰⁶. Chunlan Corporation was a leading manufacturer of air-conditioner in China with abundant capability of financing and technology, and its sales revenue reached 5 billion Yuan in 1995. At that time, Chunlan was armed by competitive advantages in brand and fund, by which it should expand market share constantly while occupying domestic market stably. Then, Chunlan should expand overseas further by transferring those advantages beyond domestic market. However, Chunlan made the opposite decision to adopt unrelated diversification strategy, extending their products to motorcycle and refrigerator. Eventually, due to a serious diversification of competitive resources and energy, Chunlan not only lost its advantages in air-conditioner manufacturing, but also confronted many domestic and foreign competitors in the new industries. This is a similar situation as Lenovo faced in a certain time period. However, the difference is that after experienced unsuccessful diversification, Lenovo rapidly returned to its core business, thereby becoming a today’s emerging contender on the global basis.

Generally, Chinese emerging MNCs employ different globalization strategies, which include differentiation strategy, business model strategy, and market entry strategy.⁷⁰⁷ Meanwhile, these Chinese companies generally avoid head-on competition with foreign giants in the foreign markets.

Additionally, there are at least three ways available for Chinese companies to expand

---

⁷⁰⁶ Case comes from Li, Y. X. (2000), pp. 19-23
⁷⁰⁷ Beebe, A. et al. (2005), pp. 8-11
globally, and they are organic growth, strategic alliance, and merger and acquisition. Organic growth refers to a company depends on itself to build overseas production or sales bases one by one, Huawei Technologies, ZTE and Haier employed this method. The way of forming strategic alliance will be examined in the following section. Among them, outbound M&As are popularly applied method for Chinese companies expanding globally. Chinese companies have increasingly realized that they could not compete merely on low cost, and therefore have targeted overseas acquisitions as a way to build up their R&D and brand value. An impressive reality is that some Chinese companies’ have acquired the world-renowned companies to become the global leader of the industry, such as TCL and Alcatel, TCL and Thomson Electronics, and Lenovo and IBM PC business.

It is perhaps too early to assess the performance of these emerging Chinese MNCs, as most of them are still in the early stages of globalization. We are sure that the road for Chinese companies competing in a global level will be not flat, even very brutal. We hope that within the next few decades these new giants will become real global MNCs.

Naturally, not every Chinese company can realize such successful leap, as globalization pressures in many industries continue to be weak and company’s own assets cannot be transferred abroad. Most Chinese companies will remain focused on their local markets by strengthening their homegrown competitive advantages; whereas others will defend their home markets while keeping an eye on oversea markets.

4.3.5 Strategic Alliances with Foreign MNCs

On the basis of Dawar and Frost, those four survival strategies can be achieved by LCs either independently or interdependently. This interdependent relationship refers to alliances. The forms of cooperative relationships of LCs with foreign entrants involve forming strategic alliances, acting as a sub-contractor for foreign MNCs in the domestic market, or merging with foreign MNCs. Among these options, strategic alliance reveals

---

708 Yeung, A. (2005), pp. 19-20
709 Ibid., p. 19
710 Ibid., p. 8
711 Jaffe, E. D. et al. (1005), p. 187
a “win-win” strategy and members of an alliance are comparatively independent and equal. 712 In reality, strategic alliance, as another form of competition or a competitive response in a sense, has been playing a considerably important role in resistance strategies of Chinese companies against foreign MNCs in the CCGM.

Since 1990s forming strategic alliances with foreign MNCs have been widely applied in Chinese companies as an effective corporate growth strategy. And the number of strategic alliances has increased in the past few years and is expected to increase even more in the future. In principle, strategic alliances in China is still in its initial stage, reflected by the consciousness of strategic alliance of Chinese companies is weak and positioning of Chinese companies in a strategic alliance is always confused, and so on. However, it is through these strategic alliances with foreign MNCs many Chinese companies’ have improved their competitiveness, realized long-term survival or rapid growth, and connected their domestic market with international market successfully in the face of a turbulent, uncertain environment and increasing competitive pressure at home.

Chinese companies employing any of those four survival strategies: defender, dodger, extender, or contender to counter the entry of foreign MNCs into their markets can benefit from forming alliances. 713 Generally speaking, these strategic alliances between Chinese companies and foreign MNCs have something in common in alliance macroenvironment, motivations, and preferences. Firstly, the background for Chinese companies pursuing a strategic alliance involves increasing environmental complexity and uncertainty as well as increasing competition pressures. Meanwhile, adaptation to a changing business environment is something Chinese firms need to learn quickly if they are able to compete against the foreign counterparts. 714 Secondly, to survive and prosper in such circumstances, Chinese companies expect to enhance their own capabilities in R&D, reduce financial risks, and participate in global competition in a short time. Thirdly, Chinese companies lack qualified domestic partners and have to rely on foreign partnership, especially with foreign MNCs. Because these Western giants can provide Chinese companies with the resources and access to advanced technologies, abundant capital, management skill, and rich

714 Wilson, J. and Brennan, R. (2006), p. 4
experience in competition that Chinese companies need very urgently but domestic and regional partners lack seriously. *Fourthly*, Chinese companies enter into a number of horizontal alliances with foreign rivals in the same industry or complementary industries. On the basis of the aforementioned cases, all of case companies have experienced at least one form of cooperative relationships with foreign MNCs in their growing stages, that is, forming JVs with foreign MNCs, or becoming a sub-contractor of foreign MNCs, or being sold out to them, either in a temporary or permanent way. In short, regardless of their current status as defender, dodger, extender, or contender, through strategic alliances Chinese companies’ final objective is to better compete against or even outperform their foreign counterparts in both domestic and global markets.

In addition to the above-mentioned nature in common, there are some differentiations in strategic alliances of defender, dodger, extender, and contender in terms of their nature, objectives, and the attitude of Chinese companies.715

For Chinese **defender** companies, strategic alliance enhances their competitive positions by complementing their missing competences. For instance, Chinese companies in beverage industry have benefited greatly from their foreign partners in terms of modern production line, abundant capital resources, advanced management skill, and so forth.

For Chinese **dodger** companies, strategic alliances may appear to be the only way --- short of selling the company outright --- to survive.716 Under the circumstances, alliances seem like more “subservient” to or “dependent” on their foreign counterparts. A representative example is Chinese cosmetic companies. Alternatively, strategic alliances fill gaps in their capabilities quickly as they move to a different part of the value chain and redefine themselves.

For Chinese **extender** and **contender** companies which have strong market positions and transferable assets, strategic alliances are crucial and essential vehicle for their international expansion and further competition on a global basis. Galanz, Midea and Changhong are several exemplary Chinese companies. Through strategic alliances, they can leverage the resources and strengths of their strategic partners; meanwhile, they can

---

715 These differences come from Dawar, N. and Frost, T. (1999), p. 127
716 Adarkar, A. et al. (1997), p. 120
control risk effectively. In addition, they can access to the established distribution networks in foreign markets.

Strategic alliance, as a form of enterprise’ growth strategies, ever undertakes many Chinese dreams. On the one hand, an incontestable reality is that alliances have made a great contribution to China’s economic development during these 20 years; at the same time, a group of prominent domestic Chinese companies are emerging with increased competitiveness and unique competitive advantages by strategic alliances with foreign counterparts. However, on the other hand, reality also exhibits that many alliances with foreign counterparts have resulted in unsatisfactory performance and serious management problems. Many Chinese companies, even some leading companies in their industry, have suffered seriously from their alliances with foreign MNCs, such as Huoli 28, Zhonghua Toothpaste, Fangchao, Panda, Rongshida, Meiling, Shengzhou, and so on.

In a word, strategic alliance is a complex enterprise behavior, bearing both advantages and disadvantages. Therefore, Chinese companies, regardless of defender, dodger, extender, and contender, should be more careful when forming strategic alliance with foreign MNCs. They should choose a right alliance partner, an optimal alliance form, and an appropriate alliance strategy according to their actual business context concerning objective and motivation of alliances as well as concerned partners’ competences and conditions, etc. In this regard, Chinese government is expected to play an indispensable role, that is, constituting reasonable policies, creating a sound social environment, coordinating policies and regulations of different functional sections, solving problems generated from alliance, and guiding and servicing alliance companies. Although some foreign MNCs started to set up wholly foreign-owned enterprises in China as more and more operation restriction have been released, strategic alliance between local Chinese companies and foreign MNCs should be regarded as a basic and effective growth strategy for Chinese companies in the post-WTO context. In addition, Chinese companies should also pay attention to strategic alliance with one another. Only through cooperating while competing and competing while cooperating, can Chinese companies enhance their competitive strengths and achieve a long-term prosperity.
5 Strategic Implications, Conclusions, Limitations and Suggestions for Future Research

This chapter aims to present strategic implications for Chinese consumer goods companies. Later, it is followed by a conclusion which draws together the study thoroughly. Finally, limitations of the research and suggestions for future research are summarized in brief.

5.1 Strategic Implications for Chinese Consumer Goods Companies

In China, both state-owned and private consumer goods companies have been struggling against a series of strategic challenges from rapidly changing environment and intensifying competition caused by foreign incursion and expansion into the CCGM. In this instance, some strategic implications for CCGCs can be drawn based on the previous research, which are considerably vital for Chinese companies to improve competitive positions and realize a promising future. These strategic implications will be treated in subsequent sections.

5.1.1 Go beyond Low-Cost Approach

So far, the low-cost access to key resources, as one major competitive advantage, has played a critical role in emerging market companies. In brief, these low-cost approaches involve low-cost labor, low-cost property and equipment, low-cost raw materials, and low-cost capital.\textsuperscript{717}

The low-cost approach has made great contributions to China’s economic development and emergence as an export powerhouse. China has accordingly gained the sobriquet “workshop of the world”. Over a long time, many local Chinese companies have employed this approach to survive and develop in the context of cutthroat competition not only with each other but also with foreign MNCs. This phenomenon is intensively reflected by

\textsuperscript{717} Aguiar, M. et al. (2006), pp. 20-21
large-scale price wars in many product areas, like television, refrigerator and air-conditioner. Regardless of the concerned product areas, China’s business environment is characterized by “a proliferation of relatively small-scale firms producing standardized products and competing on the basis of price” in relatively low-value manufacturing activities.\textsuperscript{718}

Is low cost a sustainable and long-term approach for Chinese companies to compete against foreign MNCs? The answer will be NO.

\textit{Firstly}, low-cost approach results in thin margins, as a result of which Chinese companies won’t have sufficient funds for R&D. In turn, low-value manufacturing activities make Chinese companies no choice but to compete on price war. In this case, Chinese companies stuck in a vicious circle, and this would further limit their abilities to move up the value-added and technology ladder.

\textit{Secondly}, the costs of labor and raw materials are getting higher. Even though a company may get cheaper land or underemployed labor, it will still face high pressure for survival due to tiny margins, even not to mention a long-term development.

\textit{Thirdly}, some foreign companies are adapting themselves to Chinese ways.\textsuperscript{719} In other words, they are applying the same low-cost manufacturing techniques or outsourcing their manufacturing to other companies, especially electronics and consumer goods mainly based in Taiwan or Hong Kong.\textsuperscript{720} In such a way, it is difficult for Chinese companies to compete on price against foreign competitors.

Although low-cost approach will continue to work for Chinese companies in the coming years, Chinese companies should employ new and different strategies to obtain sustainable competitive advantages, instead of addicting themselves to the low-cost approach.

Moreover, Chinese companies are not expected to be profiled as suppliers of cheap and low-quality products forever. Hence, they are launching cost innovation, whereby they offer customers high tech products at low cost, present customers with an unmatched

\textsuperscript{718} Steinfeld, E., S. (2002), p. 3
\textsuperscript{719} Tse, E. (2007), p. 3
\textsuperscript{720} Ibid.
choice of products that used to be considered standardized, mass-market segments, offer specialty products at dramatically lower prices, and turn them into volume businesses.\footnote{Zeng, M. and Williamson, P. J. (2003), p. 24}

To sum up, it is significantly vital for local Chinese companies to climb up the value chain from OEM (Original Equipment Manufacturing) to ODM (Original Design Manufacturing) and OBM (Own Brand Manufacturing). And a strategic shift from “world factory” to “world enterprises” is more promising and prosperous for Chinese companies.

\subsection*{5.1.2 Merger and Acquisition Control}

Merger and acquisition (M&A) involves two major facets in China: one is acquisitions of Chinese companies by foreign competitors, and the other is outbound acquisitions by Chinese players, which will be examined in subsequent sections, respectively.

\subsubsection*{5.1.2.1 Acquisitions of Chinese Companies by Foreign competitors}

M&A activity has increased dramatically in China over the past few years and is expected to increase further in the future. It is one of the best ways to destroy rivals and also a usual method for MNCs to occupy markets. Facing some strong domestic brands, foreign MNCs don’t want to spend too much time competing with them, rather than to buy them out through M&A approach. In doing so, foreign MNCs not only can accelerate their localization process with the help of advantages of Chinese local brands, but also eliminate their strong counterparts and penetrate markets more effectively. Further, foreign acquirers can rapidly gain access to established distribution systems and customer networks in China. Another point to be noted is, the proprietors of Chinese state-owned enterprises are facing tremendous loss pressure stemming from overcapacity and market fragmentation.\footnote{Shmith, J. et al. (2006), p. 10} Based on the new state regulation, any state-owned enterprise not in the top three in the industry sector in terms of size, profitability and innovation by October 2007 will be broken up and sold, and this brings them no chance but either to grow fast or to be sold.\footnote{Ibid.}
So far, the reasons for some Chinese companies being acquired are diverse, whereas, the results are quite similar. The previous reality showed that many national brands were left unused and died out after being acquired. For instance, Dada chewing gum almost died out of market after its acquisition by Wrigley. The similar situation happened with Zhonghua toothpaste's acquisition by British Unilever, Mini Nurse’s acquisition by France L’Oreal, and so on. They only left mournful memories in Chinese minds. Under the circumstances, M&As of Chinese companies by foreign MNCs have raised the patriotism recently. There are many arguments against foreign M&As in China, especially in China’s cosmetics industry. The essence of acquisitions of Chinese companies by foreign giants is that Chinese companies obtain fund and advanced technologies from foreign MNCs in return for market access. However, the reality is Chinese companies didn’t get anticipated advanced technologies, and meanwhile, they lost their national brands and market share. In the face of fierce foreign competition, selling of national brands to foreign giants in a sense equals to put sheep into tiger’s mouth. Therefore, there comes a tendency that some Chinese companies buy back their national brands and plan to reconstruct these declining brands.

Actually, foreign M&A is an inevitable tendency in the wave of globalization; however, many foreign countries are very cautious of M&A. Therefore, Chinese companies should be more careful and take a long-term and serious consideration in front of foreign acquisition.

5.1.2.2 Outbound Acquisitions by Chinese Players

In addition to Chinese acquisitions by foreign MNCs, much more attention has been paid to Chinese outbound M&As.

As China’s overseas FDI keeps booming, Chinese companies with global aspirations start to tap global markets by M&A. And the wave of Chinese outbound M&A is expected to intensify in years to come. Generally, Chinese companies prefer to pursue M&A strategies focusing on Europe and the U.S. markets. In such a way, Chinese companies undoubtedly
shorten the time for their global expansions through direct access to well-known brands, management talent, R&D capabilities, distribution and sales channels that are time and cost-consuming for Chinese companies to develop organically.

However, on the one hand, the failure rates of M&A are “historically high”\(^{724}\) as Chinese companies still “lack the internal managerial capabilities to integrate foreign acquisitions”\(^{725}\). The obstacles confronting them involve cultural barriers, lack of understanding of global markets and the complicated local laws and regulations, high labor cost, and strict labor regulations.\(^{726}\) A representative case is that TCL acquired German Schneider Company, but failed due to insufficient assessment of local production cost. On the other hand, in many acquisitions Chinese companies did not acquire useful technologies, as these foreign companies being acquired were running a loss for a long term. For example, Lenovo once bought an obsolete IBM line of business, Baosteel bought up iron ore suppliers in Brazil, Shanghai Motors bought the technologically laggard Rover of the UK, Haier bought Thomson TV, and so on.\(^{727}\)

Certainly, it is just a beginning for Chinese companies to acquire foreign companies. To enhance internal managerial capabilities in executing large-scale and cross-border M&As, Chinese companies still have a long way to go.

### 5.1.3 Branding

For a long time, it is difficult for Chinese companies to build a strong brand effectively and successfully. The reasons behind can be divided into external and internal aspects. From an external perspective, fragmentation of sales and distribution has made it extremely difficult to build a brand in China. Additionally, local governments always have partial protection on their homegrown companies. From an internal perspective, Chinese companies lack the consciousnesses of building brands, the sustainable innovation on these brands and relevant brand protection measures. Further in the global arena, Chinese brands are always

---

\(^{724}\) Beebe, A. et al. (2006), p. 9


\(^{726}\) Jun, C. (2005)

Strategic Implications, Conclusions, Limitations and Suggestions for Future Research

connected with cheap price and inferior quality, compared with Western MNCs’. As a result, foreign MNCs with their famous brands and superior product quality have gained market share in China rapidly and easily since their entrance.

When entering into Chinese markets, foreign MNCs usually employ three steps: first exporting products, then exporting capital, finally exporting brands.\(^{728}\) The last step is the most influential and crucial. Therefore, in order to resist foreign brands’ incursion and develop national industries, Chinese companies should adopt the same countermeasure by building up Chinese own strong recognized brands both at home and abroad. Some major methods are listed as follows:\(^{729}\)

*Firstly*, entrepreneurs should be armed with intense aspiration for developing Chinese national industries and indigenous brands. Whether a company can offer sound brand products depends on not only the capabilities of the whole team, but also entrepreneurs’ awareness of new brand. The success of some well-known Chinese brands are closely associated with enterprises’ rising patriotism, for instance, Changhong’s business slogan is to build up national industry; Kelong’s objective is to produce world standard products, just to name a few. These enterprises exhibit a common character that can be concluded as contributions for developing national industry and establishing global brands.

*Secondly*, national brands should be established and stabilized by means of constant technology innovation and improvement of product quality.

*Thirdly*, in view of the declining returns of advertising, Chinese companies should improve their marketing effectiveness.\(^{730}\) Advertisement, as one of effective marketing strategies, is often used by foreign MNCs to build up well-recognized brands. Similarly, intensive advertisement promotion also facilitates Chinese companies to enhance recognition and credibility of domestic brands in consumers’ minds.

*Fourthly*, government and society should provide Chinese brands with active support.

\(^{728}\) Ma, C. G. (2000), p. 14
\(^{729}\) Ibid.
\(^{730}\) Schlevog, K. A. (2000), p. 57
Government should constitute relevant law and regulation to protect Chinese brands. The whole society should give sufficient trust and confidence to these domestic brands and avoid blind trust in foreign brands.

*Lastly,* Chinese companies should pay sufficient attention to the value of logos.

In a word, branding is essential for Chinese companies to compete against foreign competitors at home and abroad. Strong brand is one of the most effective weapons Chinese companies can apply to survive and prosper. Only through the aforementioned methods along with strong branding consciousness, can Chinese companies create famous national brands or even well-known world brands. Of course, it will take some time before a large number of indigenous Chinese brands become nationally and even globally.731

### 5.1.4 Learn to Live with Foreign Giants

Learn to live with foreign giants includes two aspects: one is how Chinese companies should view Western MNCs as competitors or partners;732 the other is how Chinese companies should learn from foreign MNCs.

As to the first issue, now some critics advocate that foreign MNCs are entering the Chinese markets with a clear intention to annihilate China’s leading companies. In other words, these foreign invaders are trying to lower competition from China’s homegrown brands or establish monopolies in some key industries in Chinese markets, through buying out Chinese companies or freezing well-known national brands after strategic alliance with Chinese companies.733 Besides, in the context of the increasing patriotic sentiment, national pride and a resurgence of protecting national industries and brands, more and more people are considering whether Chinese companies are giving in too easily and too quickly. Accordingly, the aggressive and negative nature of foreign MNCs’ activities in China has been magnified in such a way.

However, this cognition is unfair or incomplete to foreign MNCs. On the one hand, the

---

732 Tse, E. (2007), pp. 6-7
733 Wang, Z. L. (2007), pp. 86-87
The influx of FDI into China has been playing a crucial role in Chinese economic prosperity. More importantly, the incursion and expansion of foreign MNCs throughout China did increase competitive consciousness of Chinese companies. In other words, after foreign MNCs’ entry into Chinese markets, all Chinese companies started to know what “strong and large” meant and what the real world-class competition was. In the face of increasing competitive pressure from foreign giants, Chinese companies have more incentives to develop their firm-specific advantages in order to survive in the local market. Foreign MNCs have dramatically taught Chinese companies about the complexities of a market economy and the importance of integrating into global markets through bringing a really intensive and high-class competition into Chinese companies’ home turf. On the other hand, many Chinese companies have enhanced their competitive positions in a short term through forming JVs with foreign competitors. Although some alliances ended up with failures, cooperative relationships to a great extent help Chinese companies get through their hardest time or accelerate their presence on a global basis.

In short, foreign MNCs can not be simply viewed as competitors or partners. Chinese companies should compete with them in cooperation. For Chinese companies, competition against foreign players is to realize an equal and win-win cooperation, whereas cooperating with them is in turn to create an efficient and healthy competitive environment.

With an objective cognition about foreign MNCs operating in China, Chinese companies should further consider how to learn from well-heeled giants. There comes another key issue.

Confucius once said that individuals gained wisdom in three ways: “first, by reflection, which is noblest; second, by imitation, which is easiest; and third by experience, which is the bitterest.” The fundamental of this sentence is also valuable for Chinese companies.

Firstly, for Chinese companies, the efficient ways to learn from foreign MNCs include adapting Western theories to China’s realistic situation, combining foreign MNCs’ operation in China with Chinese companies’ experience, and constantly reconstructing

---

736 Wharton School of the University of Pennsylvania (2006)
adaptive strategic thoughts. However, this requires relevant organization, qualified leaders and competent team. In this regard, some emerging Chinese MNCs such as Haier, TCL, Lenovo, and Huawei are always regarded as very successful cases.

Secondly, imitating foreign MNCs mainly involves copying IPR or Western advanced strategic thoughts. To gain competitive advantage through copying IPR of foreign MNCs might work temporarily, especially in this instance that the absence of technologies seriously blocks a company’s development, as a prominent Chinese business leader once said, “Imitation is an appropriate form of innovation”.737 However, it will be difficult to sustain this option in a long run. Because the imitation of foreign MNCs’ technological know-how results in either lack of incentives to make investments in product innovation or not be able to participate in global competition just providing low-cost products.738 Further, Chinese companies should be more careful to learn by imitating management skill, as the successful strategic options and experience for foreign MNCs might not be suitable for specific Chinese companies in the Chinese unique business environment.

Learning by experiencing has been so far the greatest but the bitterest for Chinese companies.739 There are many Chinese companies with abundant experience of both successes and failures in competing against foreign competition. Although bitter, it is a crucial learning source for Chinese companies if they can make objective conclusion and appropriate reflection.

In conclusion, Chinese companies regardless of defender, dodger, extender, or contender should learn actively from foreign counterparts at present, while making tremendous efforts to improve their own capabilities of R&D, production, marketing, and management.740

737 Tse, E. (2007), p. 4
738 Wharton School of the University of Pennsylvania (2006)
739 Ibid.
5.1.5 Innovation

Although science, technology, and innovation have greatly developed since China’s opening-up, the ratio of investment contributed on R&D to GDP is still far behind that of developed countries. In contemporary China, thus, enhancing innovation capability has become an important task of 11th Five-Year Plan (2006 – 2010), in which the central government indicated the promotion of technological innovation as a priority.

Meanwhile, innovation capabilities in many Chinese companies are far behind foreign counterparts. In 2005, the total value of China’s exports of electronics and IT goods reached $268bn, 29 percent higher than that of 2004; and of these exports, foreign-owned and foreign-invested companies contributed 87 percent and the proportion supplied by domestic companies actually declined.\textsuperscript{741} This situation resulted from a severe and long-standing lack of independent and autonomous innovation in China. From a traditional perspective, Chinese companies’ resources of innovation stemmed from importing from Western companies directly, copying while learning, receiving government’s support and protection, or innovating through copying Western business models.\textsuperscript{742} Besides, IPR protection is still very weak in China, and capital markets are not ready for supporting those high-tech companies.\textsuperscript{743} However, today these Chinese companies are confronting the strongest pressure to upgrade their capabilities of R&D. In the context of ferocious competition, two efficient methods: low cost and imitation of foreign technological know-how that Chinese companies used cannot sustain a long term success. Chinese companies seem to have no choice but to become innovative and move up in the value chain.

Surely, there are a number of Chinese companies doing well in this regard, for instance, Huawei, ZTE, Haier etc. Noteworthily, Huawei has grown to one of the world’s leading telecommunication equipment manufacturers, with almost half its staff engaged in R&D,\textsuperscript{744} and having its own R&D centers in India, Sweden, the United States and Russia.\textsuperscript{745} However, successful examples are too few in this regard.

\textsuperscript{742} von Zedtwitz, M. (2006)
\textsuperscript{743} Dickie, M. (2006), p. 1
\textsuperscript{744} Shmith, J., Li, P. and Royle, T. (2006), p. 2
According to an international convention, the third-class country works for others by producing products, the second-class country exports production lines, and the first-class country establishes standards. At present, most Chinese companies still belong to the third-class producing for others.

Therefore, strategic implications for Chinese companies’ innovation include the following aspects. Firstly, a favourable legal, institutional and policy environment is crucial and necessary to the protection of IPR, fair competition, tax policy, credit policy, government stock, investment policy and so on. Secondly, innovation needs strong national confidence. That is, Chinese should have the courage to liberate their thoughts, to be factualistic, break down blind adoration of foreign technologies, and increase national confidence. Thirdly, core technology is the soul of innovation, and it cannot be acquired directly. A company holding core technology can obtain high return. Consequently, innovating core technology is very significant for Chinese companies to compete on a global basis. Lastly, independent and autonomous R&D and introduction of foreign technology should be employed simultaneously.

In a word, in the context of great changes in science and innovation worldwide, only through sustainable, independent, autonomous innovation and R&D can China and Chinese companies realize a long-term development.

### 5.1.6 Qualified Human Resources

The qualified human resource is one of indispensable elements to address aforementioned issues. Precisely, qualified human resources involve two aspects: one is the key leader or manager in an enterprise and the other is its personnel and technologists.

In contemporary China, a new generation of modern entrepreneurs has emerged in both SOEs and POEs, they are characterized as young, well-educated, and very knowledgeable of Chinese markets and managerial experience compared with the previous generation. Representative leaders include Edward Tian of China Netcom, Liu, Chuanzhi of Lenovo, Zhang, Ruimin of Haier, Zong, Qinghou of Hangzhou Wahaha, Ni, Runfeng of Changhong, He, Xiangjian of Midea, Hou, Weigui of ZTE, Liang, Qingde of Galanz, etc. This group of leaders already understand how to lead their companies towards success through constant
reflection. However, they have a lot more to learn about global markets and competition.  

To some extent, there exists serious individual heroism. In short, “the need is great both for people who can develop global business strategies at the corporate level and for those who can operate effectively on the ground in the target markets.”

In addition, more and more undergraduates become employees or technical experts of Chinese companies. As China’s education system keeps developing, the number of graduate students is increasingly fast. In 2010 China is expected to have 800,000 graduated engineers, mathematicians, technicians, and scientists.

In this regard, local Chinese companies and foreign MNCs will keep competing in alluring, encouraging, and maintaining the talent at present and in the future. Chinese companies should fully capitalize on their knowledge of understanding China’s education system and internal motivation in order to absorb better employees than foreign counterparts. Equally important, Chinese companies should concentrate more on employees training, try to cultivate senior talent inside company, set up reasonable encouragement and punishment system, and offer employees more opportunities to practice management and coordination skills.

To sum up, Chinese companies should actively work to overcome their traditional weaknesses, understand the industry they are located, foreign competitors and themselves, design and implement one or more resistance strategies, and equally important, keep flexible in a rapidly changing environment.

5.2 Conclusions

The primary purpose of this dissertation is, by using case studies, to examine options for resistance strategies of local Chinese companies against foreign competition in the CCGM at the corporate strategy level. Generally speaking, there are four strategic options available for Chinese companies, and they are defender, dodger, extender, and contender strategies. Specially speaking, these four resistance strategies can be conducted independently or cooperatively, accordingly generating eight strategic options. There are

746 Wharton School of the University of Pennsylvania (2006)
748 Ibid., p. 22
two criteria for choosing these options: one is the strength of globalization pressures in an industry and the other is the company’s transferable assets. Furthermore, a company may employ one or a combination of those eight options in its different growth stages.

The analysis of five case studies has yielded important insights into the broader trend of local Chinese companies that are competing actively against foreign MNCs in the CCGM. Based on the foregoing theoretical and empirical analysis, the following three major conclusions can be drawn in terms of the competitive context, strategic thinking, and prospects of local Chinese companies.

Firstly, the current competitive context can be described as Chinese dragons are playing with Western wolves at home. As a result, some domestic companies have disappeared; some are struggling with foreign players as government’s protection cannot work as efficiently as before; some gave up struggle and turned to cooperate with foreign giants; and some not only compete against foreign MNCs but also try to grasp market share from foreign MNCs by expanding to Western markets and competing actively there.

In the face of China’s accession into the WTO, some Chinese enterprise analysts shouted “wolves come!” Today, these western wolves are characterized by speaking fluent English while using chopsticks instead of knives and folks. In other words, after implementing a series of localization strategies, these foreign MNCs have expertly mastered the rules of Chinese market economy and even some latent rules that are vital for their successful operation in China.

In order to prevent Chinese markets from becoming a mere gameland for foreign MNCs and to develop Chinese national industry, Chinese companies have no option but to compete against Western giants for the limited domestic markets, although they are small by both global and Asian standards. Actually, globalization has encountered least resistance in China than any other places, such as India and Latin America, just by considering the scale of losing domestic brands and market share.749

Secondly, globalization has yielded not only competitive pressures and threats but also numerous opportunities for the established local Chinese companies. Thus, they should seize these opportunities through strategic thinking.

749 Anonymous (2005h)
In the face of aggressive incursion and expansion of foreign MNCs, strategically reactive models of Chinese companies can be mainly divided into the following three groups:

- **Acting as the sheep (i.e. Dodger)!**

  Compared with foreign well-heeled MNCs, most Chinese companies are far lagging behind in many aspects. Thus, they can only act as sheep in front of the coming wolves. In view of the asymmetric competitive advantages, the essence of acting as sheep is to dodge attacks of wolves. They have to find a way, whereby not to be eaten by wolves. They may move to other living spaces or cooperate with wolves. Of course, in this case, cooperating with wolves may bring sheep temporary living space, but it is a very dangerous approach. Moreover, it is worthy to note that when Chinese companies compare foreign MNCs to the wolf, they have already put themselves in a disadvantageous position as the sheep. Actually, local Chinese companies should view themselves as the immature wolf instead of the sheep.

- **Acting as the deer (i.e. Defender)!**

  Wolves eat meat, which is a core competence that deer don’t possess; whereas deer eat grass, which is also a core competence that wolves don’t possess. In other words, deer and wolves have different surviving conditions and spaces within a territory. Therefore, deer can survive by exploiting their own habitat and living conditions rather than disrupting wolves’ living space or fighting against them in a brutal way. Moreover, deer may have set foot in certain territory stealthily when wolves still focus on fighting against sheep. For deer, the cooperation with wolves is also risky and should be very careful. If deer are fearful of being eaten by wolves and try to become a member of them, they may face the fate that they will be eaten eventually when wolves feel hungry. Therefore, the key issue for Chinese companies is not cooperation, rather realizing their own development by virtue of cooperation. When Chinese companies become stronger, they can act as the wolf themselves.

- **Acting as the wolf (i.e. Extender and Contender)!**
By positioning itself as the wolf, Chinese companies can dance actively with foreign MNCs both at home and abroad. On the one hand, by acting as the wolf, Chinese companies at least will not be eaten by foreign wolves shortly. On the other hand, when local Chinese companies are strong enough, foreign MNCs consider more cooperation rather than defeat, as foreign MNCs also need partnerships at their initial stage of entering a new territory. Under the circumstances, the result of cooperation may be that both sides will develop by adopting the win-win strategy and nobody can depart from or defeat each other. This is an optimal status, which enables Chinese companies to directly confront real contest and dance with foreign MNCs at the same stage. Of course, acting as the wolf accordingly requires that Chinese companies have sufficient core competences and firm-specific advantages.

Many smart Chinese companies know that what they win today may not guarantee their survival in tomorrow. Accordingly, they have to keep flexible in response to ever-changing environment.

*Finally,* survival issue is still a big concern for most Chinese domestic companies today. Some frustration and failure of Chinese companies experienced seem normal because of being at the initial stage competing against foreign MNCs. However, after competing with foreign rivals over the past several decades, lack of experience can not be an excuse for local Chinese companies any more. Chinese companies should grasp the most opportune time to revitalize their competitive advantages, reconstruct their organizations, make appropriate strategic decisions, and re-launch themselves in both domestic and global arenas aggressively. Only by doing so, can they shorten their process of transiting from manufacturing low-cost products to provide innovative products and value-added services, from offering China-made products to China-branded products.\(^{750}\)

This research clearly indicates that local Chinese companies possessing specific advantages have been able to compete effectively against foreign MNCs in certain areas on their home turf. They are anxious to participate in the wave of globalization and are prepared to open a new chapter in the companies’ history. Undoubtedly, on the basis of

\(^{750}\) Chan, J. (2007), pp. 35-36
Chinese diligence and brightness, the rising of local Chinese companies in the domestic market and their further emergence on a global basis are inevitable trends. This is just a time issue.

5.3 Limitations and Suggestions for Future Research

This study has focused on examining an extensive and complex phenomenon: applied options for resistance strategies for local Chinese companies threatened by foreign MNCs incursion and expansion in their home market. This study conducts five in-depth case studies to confirm the proposed theoretical framework of defender, dodger, extender, and contender.

Generally speaking, the approach adopted and the way conducted by this study might include some limitations, which are shortly discussed below in order to provide potential starting points for future research. Specially speaking, the first main limitation arises from the disadvantages of applying case study methodology.

- Case studies are often criticized as lacking of methodological rigor. This methodology seems always a description of simplistic picture of reality and is thus disadvantageous in establishing causality.

- Case studies provide very little basis for scientific generalization. In this research, options for resistance strategies of Chinese companies against foreign rivals at home are examined by analyzing a quite small number of Chinese companies in limited consumer goods sub-industries for a short period of time only. As investigated previously, strategic options of local Chinese companies will be greatly diverse according to their located industries regarding globalization pressures and other elements. Moreover, even in the same industries, the strategic options and competitive responses of local Chinese companies against foreign competition will be also distinguishing according to their own competences and transferable assets. Consequently, in this research, the analysis of strategic options of local Chinese companies are characterized by case-specific and the

751 The following limitations mainly come from Davies, M. (2005), p. 9
generalizability of the results to other companies in other consumer goods industries such as mobile phone or automobile industries is still questionable.

- Case studies contain a subjective bias. Excessive dependence on a mass of secondary data and retrospective information has their own biases.

Another limitation results from the disadvantage of applying descriptive case studies. As discussed previously, descriptive methodology requires that the investigator must begin with a descriptive theory; if this fails there is the possibility that the description lacks rigor and that problems may occur during the project.\textsuperscript{752} Furthermore, descriptive case study is primarily disadvantageous in identifying a causal relationship between different variables.

The last limitation comes from the source of case study evidence: documentation. Documentation is disadvantageous in containing bias of authors, or biased selectivity when collecting incomplete documents, and so forth.\textsuperscript{753}

Therefore, given the complex and dynamic nature of conducting case study approach, further research may extend the case study approach to other strategies of doing social science research. A predominant direction could be to analyze options for resistance strategies of local Chinese companies by using questionnaire surveys with related quantitative analysis which is also an essential type of research for the development of social science.\textsuperscript{754} Conducting survey methodology is to find out how many percentages of each strategy typologies adopted by local Chinese companies and how many local Chinese companies are adopting one or a combination of resistance strategies. Of course, survey strategy is, to some extent, an unpractical method here in face of tremendous size of China, Chinese market and local Chinese companies. However, if possible it would be useful to undertake these analyses within a research program and achieve larger sample sizes.

Meanwhile, given the limitations of applying descriptive case studies, another predominant direction for future research is to analyze options for resistance strategies of local Chinese companies through the explanatory case study, as this approach focuses on studying causal

\textsuperscript{752} Zainal, Z. (2007), p. 3
\textsuperscript{753} Anonymous (2006j), p. 33
\textsuperscript{754} Flyvbjerg, B. (2004), p. 432
relationship between surface phenomena and in-depth reason. In other words, the attention in further research could be put mainly on testing the theoretical framework by exploiting deeper causal relationship between applied options for resistance strategies that local Chinese companies adopted and the reasons why they chose those options in the context of an uncertain, complex environment and increasing foreign incursion and expansion in their home turf.

Finally, a potential direction for further research can be the use of mixed methods research. “Mixed methods research is characterized as research that contains elements of both qualitative and quantitative approaches”.\footnote{Rocco, T. S. et al. (2003), p. 19} Although mixed methods research can be presented by various terms such as multiple methods, mixed methods, multi-method research and methodological mix, the core concept of these various terms is concerned with the term “triangulation”, referring to “the use of multiple methods in the study of the same object”.\footnote{Marschan-Piekkari, R. and Welch, C. (Editors-2004), p. 164} The aims of conducting triangulation are to validate the research results, to complement each other, to inspire the research process and/or to facilitate interpretation of the results.\footnote{Ibid., p. 167} Concretely, this research subject of the dissertation can be studied by using the following diverse alternatives:\footnote{These following options come from Marschan-Piekkari, R. and Welch, C. (Editors-2004), pp. 167-175} 1) from a quantitative pilot study to in-depth cases, that is, a quantitative pilot study, which offer a broad overview and create a pre-understanding of the subject, mix with a qualitative case study based on several in-depth cases; 2) from a survey-tested hypothesis to in-depth cases, that is, a combination of a quantitative phase by virtues of mail survey or telephone interviews etc. and a qualitative case study of several Chinese companies; 3) a qualitative multiple-case study and a quantitative survey intertwined; and 4) from case-based hypotheses to testing by survey, that is, several diverse methods are used sequentially: first the qualitative pilot study and the in-depth case studies and then the quantitative survey. In a word, the key decisions on the use of mixed methods depend on the order, role and purpose.


Anonymous (2005a), “Risks and rewards of geographic expansion”, DOW CORNING Corporation, Form No. 01-3111-01,
http://www.dowcorning.com/content/publishedlit/solarticles/Geo_expansion.pdf, pp. 1-5.


Anonymous (2005f), “China’s Consumer Revolution-Fresh Perspectives”, Cheskin,


Anonymous (2005h), “Globalization in China and strategy a corporation should take to enter China market”, Boxun News,

Anonymous (2006a), “Vertical Integration”, QuickMBA.com,


Interbrand, Business Week,
References

1-22.


References


Byars, L.L. (1984), “Strategic Management: Planning and Implementation –Concepts and
References

Cases”, Harper & Row, New York, NY.


Ernst & Young (2005), “The Path to Success for Retailers and Consumer Brands in China”, Global Retail and Consumer products & Ernst & Young China, Ernst &Young, EYGM Limited, EYG No. CP0004, June, pp. 1-8.


Gupta, P. and Mundhra, S. (2005), “Restructuring of India Firms for Catering to Emerging Markets”, Faculty of Management Studies, University of Delhi.
Haier Official Website (2007),
http://www.haier.com
Paul, MN: West.


http://www.handels.gu.se/epc/archive/00001788/01/Holst%5F1999%5F13.PDF, pp. 1-164.


Hong Kong Trade Development Council (2007), “Credit Suisse: Chinese consumer goods markets to rank second behind U.S. by 2015”, Xinhua Online,  


Humad, A. (2005), “Wahaha Corporation”, MarketBuster,  


Hunt, L. (2005), “Haier Group Company”, MarketBuster,  


Companies in Developing Countries”, Harvard Business Review, October, pp. 60-69.
Li & Fung Research Centre (2005), “The Booming Cosmetics Market in China”, Industry


Lin, J. Y. F. (2004), “Lessons of China’s Transition from a Planned Economy to a Market Economy”, Peking University and Hong Kong University of Science and Technology, prepared for the Distinguished WSPIZ and TIGER Lecture at Kozminski School of Management, Warsaw, Poland, pp. 1-38.


People’s Daily Online (2004), “China’s Cosmetic Industry Embarks on Reshuffle”, Xinhua,


References


Management Process Theory --- based Textbooks”, Faculty Business Administration, Memorial University, pp. 1-21.
(a) http://www.gov.cn/jrzg/206-03/18/content_230443.htm
(b) http://english.gov.cn/2005-08/30/content_27397.htm


for the Study of Globalization (GWCSG), Occasional Paper Series,
CSGOP-04-29, April, pp.1-13.
Conference presentation,
enterprises in employment Generation in China”, EGDI and UNU-WIDER
Conference, Parallel Session 3.1,
Wang, X. Z. (2005), “State-owned Enterprise Reform and Corporate Governance of
China”, School of Management, Fudan University,
Enterprises in the Process of Globalization”, International Food and Agribusiness
http://english.cri.cn/974/2006/03/19/271@63860.htm, 12-08-2007.
Management-Grundlagen-Prozess-Implementierung”, 3. Auflage, GABLER.
Wharton School of the University of Pennsylvania (2006), “A Crucible of Competition’:
The Emerging Chinese Company”, Knowledge@Wharton,
comparative Analysis of the ‘Interaction and Networks’ and ‘Chinese
1-21.


