Evolution of International Business

Session 8 MNCs in China and local firms' survival strategies

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Part1 Foreign Direct Investment in China

- General situation of FDI in China
- Impacts of Foreign Invested Enterprises on Chinese Economy
- Why is China so attractive to MNCs?
  - Opportunities
  - Challenges

The basic means of China's absorption of foreign investments

Direct investment

- **Sino-foreign joint ventures**
- **Exclusively foreign-owned enterprises**
- **Cooperative businesses**
- Joint exploitation (*maritime and overland oil joint exploitation*)
- Companies Limited by Shares with Foreign Investment (*the shares purchased and held by foreign investors account for more than 25% of the total registered capital of the company*)

Other means of investment

- Compensation trade
- Processing and assembling
- International leasing
- Issuing stocks overseas

The means of absorbing foreign investment in China during 1979-1998(1)

Year	No. of FIEs	Equity Joint Venture	Cooperative Joint Venture	Wholly foreign-owned	Others*
1979-1983	2452	190	1123	48	1091
1984	2166	741	1089	26	310
1985	3073	1412	1611	46	4
1986	1498	892	582	18	6
1987	2233	1395	789	46	3
1988	5945	3909	1621	410	5
1989	5779	3659	1179	930	10

* "Others" includes cooperative exploitation and compensation trade during 1979-84, only cooperative exploitation during 1985-96, Companies Limited by Shares with Foreign Investment and cooperative exploitation during 1997-1998.

The means of absorbing foreign investment in China during 1979-1998(2)

Year	No. of FIEs	Equity Joint Venture	Cooperative Joint Venture	Wholly foreign-owned	Others *
1990	7273	4091	1317	1860	5
1991	12978	8395	1778	2795	10
1992	48764	34354	5711	8692	7
1993	83437	54003	10445	18975	14
1994	47549	27890	6634	13007	18

* "Others" includes cooperative exploitation and compensation trade during 1979-84, only cooperative exploitation during 1985-96, Companies Limited by Shares with Foreign Investment and cooperative exploitation during 1997-1998.

The means of absorbing foreign investment in China during 1979-1998(3)

Year	No. of FIEs	Equity Joint Venture	Cooperative Joint Venture	Wholly foreign-owned	Others *
1995	37011	20455	4787	11761	8
1996	**24556**	12628	2849	9062	17
1997	**21046**	9046	2371	9604	25
1998	**19846**	8146	2010	9674	16

* "others" includes cooperative exploitation and compensation trade during 1979-84, only cooperative exploitation during 1985-96 and foreign-funded share-holding and cooperative exploitation during 1997-1998.

Source: 《对外经济贸易年鉴》

Foreign Investment in China (1984-1997)

	Number of Foreign Projects	**Foreign Capital by Contract (Unit: 0.1 billion US $)**	**Practical Foreign Capital Utilized (Unit: 0.1 billion US $)**
1984	2166	28.75	14.19
1985	3073	63.33	19.56
1986	1498	33.3	22.44
1987	2233	37.09	23.14
1988	5945	52.97	31.94
1989	5779	56	33.93
1990	7273	65.96	34.87
1991	12978	119.77	43.66
1992	48764	581.24	110.08
1993	83437	1114.36	275.15
1994	47549	826.8	337.67
1995	37011	912.82	375.21
1996	24556	732.76	417.26
1997	21001	510.03	452.57

IJV vs. WOS: FDI in China 1999-2006

Year	No. of Equity Joint Ventures	No. of Wholly foreign-owned Subsidiaries
1999	7066	8370
2000	8560	12199
2001	8893	15643
2002	10380	22173
2003	12521	26943
2004	11570	30708
2005	10480	32308
2006	10223	30164
2013	4476	18125

Source: 《中国统计年鉴》，中国商务部网站

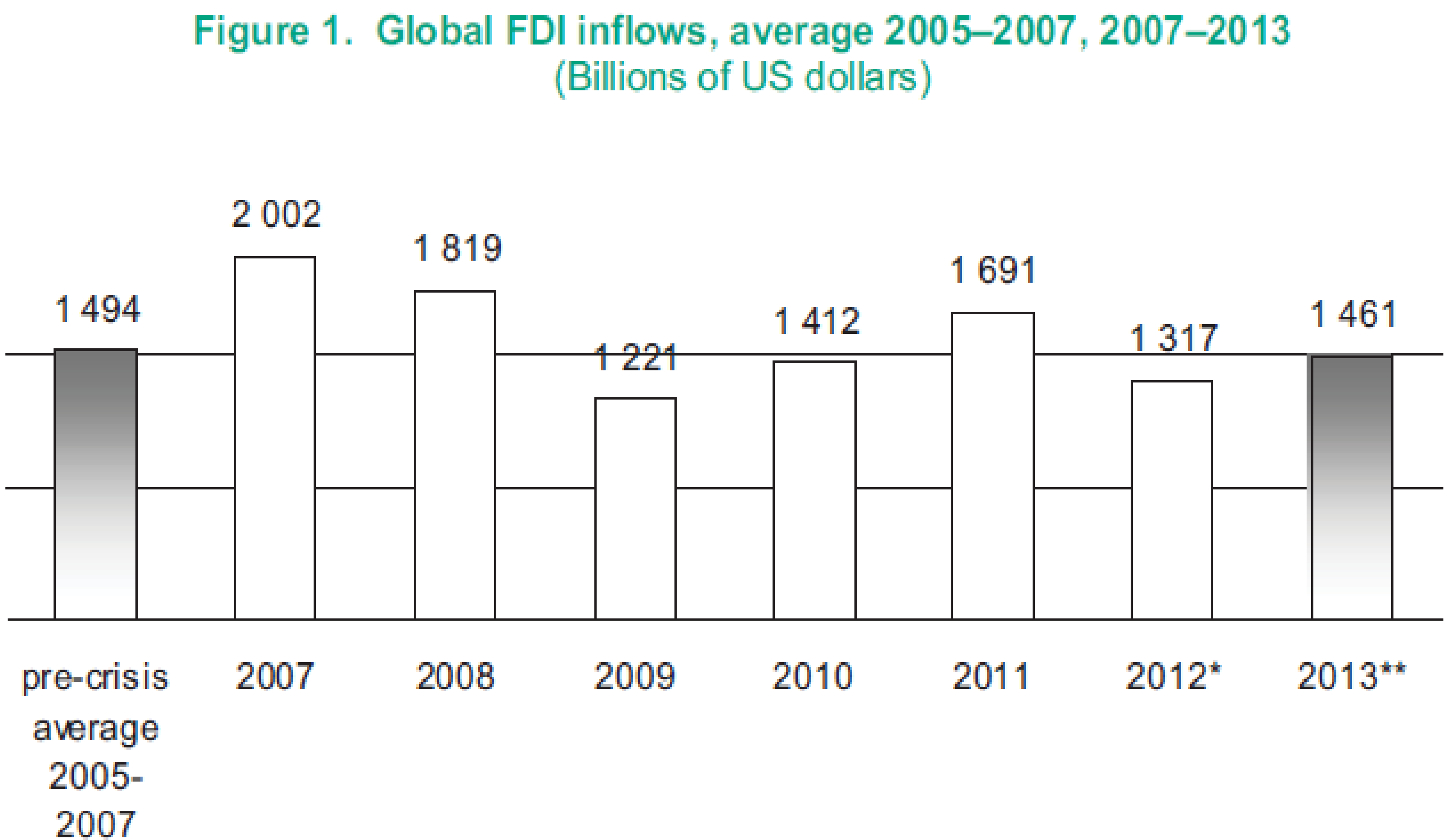
Latest development of FDI in China

Year	Number of New MNEs	Practical Foreign Capital Utilized (billion US dollars)
2003	41081	53.505
2004	43664	60.63
2005	44019	72.406
2006	41485	69.468
2007	37888	82.658
2008	27514	92.395
2009	23435	90.033
2010	27406	105.735
2011	27712	116.011
2012	24925	111.716
2013	22773	117.586
2014	23778	119.56

Top 10 home areas (including those coming through Tax Heavens) **with the most FDI in Mainland China in 2014** (in terms of practical capital utilized)

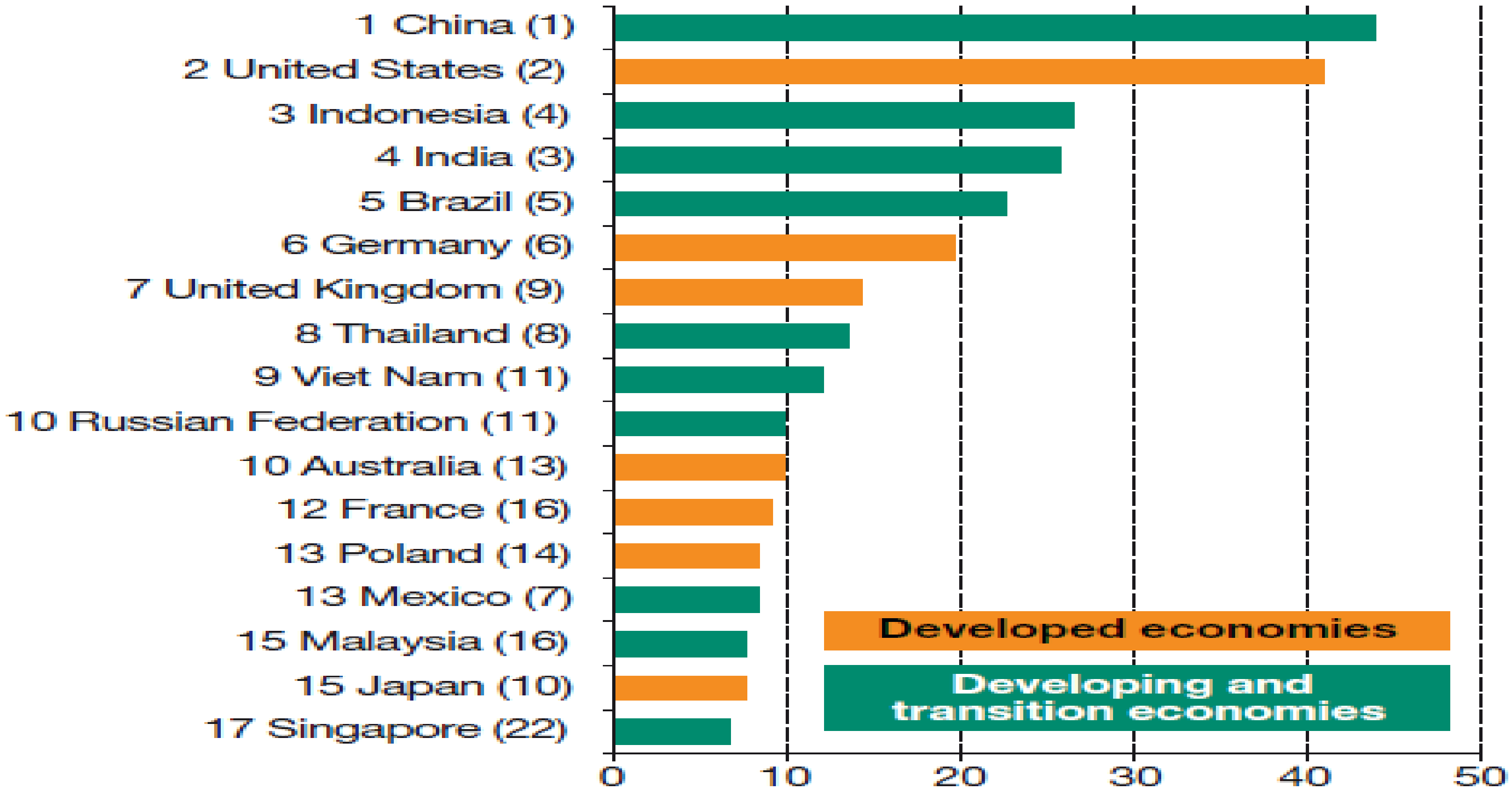
Hong Kong	85.74 billion U.S. $	(2013 78.302)
Singapore	5.93	(7.327)
Taiwan	5.18	(5.246)
Japan	4.33	(7.064)
South Korea	3.97	(3.059)
USA	2.67	(3.353)
Germany	2.07	(2.095)
UK	1.35	(1.039)
France	0.71	(0.762)
Netherlands	0.64	(1.281)

The top 10 accounted for 94.2% of all practically utilized foreign capital in 2014 (93.15% in 2013).



Source: UNCTAD.
* Revised
** Preliminary estimates.

Figure I.28. TNCs' top prospective host economies for 2014–2016
(Percentage of respondents selecting economy as a top destination, (x)=2013 ranking)



Source: UNCTAD survey.
Note: Based on responses from 164 companies.

Impacts of Foreign Invested Enterprises on Chinese Economy

- 1980s

Providing capital and foreign exchange; creating employment; bringing technology and management; increasing exporting

- 1990s

Facilitating industrial upgrading by creating new industries and transforming old ones; breaking the monopoly by SOEs ; Fostering competition and the market economy

- Early 21st century

Full access from and to the worldwide market; World factory;

Further developing the market economy

Why is China so attractive to MNCs?

- ***China*** is big & has been able to sustain rapid growth over the last few years.

- ***China*** is now profoundly affecting the competitive capabilities of all ***multinational corporations***. Companies throughout the world are affected by the impact of low-cost Chinese manufacturing on worldwide pricing, for instance, whether or not they have operations there or engage in direct trade.

Two major business opportunities that ***China*** presents to MNCs:

- ***Multinationals*** can actually go after the Chinese domestic market--and it's worth going after.
- Improvements in ***China's*** infrastructure, human capital, and regulatory environment are making it possible for companies to lower their costs and reap new ***regional and global competitive advantage.***

Example:

- Alcatel and Lucent merged in 2006
- It will have a stronger presence in China
- Besides trying to capture more market share in China, it also tries to contain the overseas expansion of Chinese competitors (e.g. Huawei) by reducing the profit of the competitors at their home.

-----global competitive strategy, rather than just strategy for the Chinese market

Challenge to CEOs of MNCs

- The challenge is not only to compete successfully in ***China's*** growing domestic market but also to use the country's resources to compete ***in the region and around the world***.

- Companies like Wal-Mart are already effectively leveraging their ***China*** operations both for sales in the country and for sourcing for the Western market.

- Every CEO must consider what competitors will do with access to the resources, the increased sales volume, and the reduced unit costs that the ***China*** market will offer. For at least the next decade, understanding how to do well in ***China*** and with ***Chinese resources*** will become a critical component in a global competitive strategy.

Best Buy Shuts China Stores to Focus on More Profitable Brand (***Bloomberg News*** - **Feb 22, 2011** **3:59 PM GMT+0800**)

Entry year:

2006

Part 2 Evolution of MNCs in China

- Stages of MNCs' operations in China
- Some latest strategic moves by MNCs in China
- How MNCs evolve in China?

Three phases of MNCs' operations in China

- Entry
- Country development
- Global integration

- Key goals ?
- Role of the China office ?
- Ideal China manager profile ?

Phase 1: Entry

- **Key goals:**

➢ Determine the right business model:

- **Use *China* as a manufacturing base?**
  - **Sell into *China*?**

➢ Establish a presence:

- **Choose locality**
  - **Select partner (or establish wholly foreign-owned enterprise)**
  - **Learn domestic operating environment**

Phase 1: Entry

- **Role of the China office:**
  - Establish the corporate brand with local and national government
  - Provide services to business units as they enter the China market

Phase 1: Entry

- **Ideal China manager profile:**

- Entrepreneurial manager who is creative and flexible
- Experienced starting operations in developing countries

Case: Epta, Oracle

Phase 2: Country development

- **Key goals:**

  - Expanding operation to several initiatives and several localities
  - Coordinate lobbying and negotiation with Chinese government across business units; articulate “one face to China”
  - Seek positive P&L results

Phase 2: Country development

- **Role of the China office:**

- Build brand awareness with customers
- Manage coordination between business units and local governments
- Lead “one face to China” strategy with Chinese government
- Manage awareness of China operation at corporate headquarters

Phase 2: Country development

- **Ideal China manager profile:**

  - Senior manager with strong ties to leadership at corporate headquarters

  - Experienced in communicating across complex corporate matrix

Case: Dover, Oracle, Epta

Phase 3: Global integration

- **Key goals:**

 Establish full integration of China operations into regional and global efforts

- **Role of China office:**

 Further integrate China operations into regional and global strategy

Phase 3: Global integration

- **Ideal China manager profile:**

  - Senior manager able to work with several business divisions

Case: Unilever

Some latest strategic moves by MNCs in China

----Shanghai as the example

- Setting up regional headquarters

- Setting up R&D centers

MNCs' RHQs in Shanghai

- With most companies basing their Asia-Pacific operations in either Singapore or Hong Kong at the time, some people thought we were a bit crazy (establishing our regional headquarters in Shanghai). But we did it anyway because that's where we saw our future.

  ---- *Ron Spithill, former President of Alcatel's Asia-Pacific operation*

(Alcatel moved its Asia Pacific headquarter from Australia to Shanghai in January, 2000)

- There were 154 RHQs of MNEs in Shanghai at the end of 2006. And the number reached 174 six months later, among which 56 MNEs are Fortune 500 firms.

- The number of RHQs in Shanghai (only those with certificates from the Shanghai government) had been 260 by the end of 2009, and 305 by the end of 2010,347 by the end of 2011 ,445 by the end of 2013 and 490 by the end of 2014(highest among mainland Chinese cities).

Motivations and Incentives of MNCs' RHQs in Shanghai

- Due to its huge market size and growth potential, China has become strategically important.
- Improving the country units or subsidiary's management.
- Facilitating business integration and resources sharing across different units within the region, with other RHQs and global HQ.
- Getting closer to main customers and markets.
- Exercising more control over regional operation.
- Relationship with government.
- Shanghai municipal and district government's incentive policies towards RHQs of foreign MNEs.
- Shanghai as the business center in China.

Foreign R&D centers in Shanghai

- By March 2004, 111 foreign R&D centers had been established in Shanghai.
- By the end of 2006, the number of foreign-invested R&D centers in Shanghai had been 196. By the end of 2010, the number had been 319. The number reached 332 at the end of 2011 , 366 at the end of 2013 and 381 at the end of 2014.
- Example 1: Autodesk, around 6000 R&D people globally, among them, 1300 in Shanghai
- Example 2: CIBA Special Chemical

Around 90 people work in CIBA Special Chemical's R&D center in China. 60% of the people have university degrees; 40% have advanced degrees, including masters and PhDs.

Three parts: RC (research center); AC (Application center); RTC (Regional technical center)

How MNCs evolve in China

e.g. GE

Globalization	Localization	Local Innovation	Reverse Innovation
▪ Standard **products and services** ▪ Innovation **happens centrally in** developed markets ▪ Lack competitive offering **for emerging markets**	▪ **Some** adjustments to meet local needs ▪ De-feature products **to meet customer budget**	▪ **Develops products/services** "in-country, for country" ▪ "Market-back" **perspective** ▪ **Leverage** global resource base in R&D	▪ Innovation **in country,** for the world ▪ Bring successful local products/services worldwide

Part 3 Local firms' survival strategies

- MNCs vs. Indigenous firm in China
- Survival strategies for firms in emerging markets
- Case examples

MNCs versus indigenous firms

- **For the next ten years, and probably considerably longer, *multinationals* should be the biggest winners, as *China's* economy becomes increasingly open.**
- **During this period, few indigenous manufacturing and service-sector firms will be able to compete successfully outside the country on any basis other than cheap labor.**

  (By "indigenous," we mean Chinese firms that have not attracted investments from any foreign companies and are not producing anything under foreign license.)

SMALL Vs. BIG ?

Competing with GIANTS:
Survival Strategies for Local Firms in Emerging Markets

Two key questions to answer :

- How strong are the **pressures** to globalize in your industry?
- How internationally **transferable** are your company's competitive assets?

Position for emerging-markets companies

Pressures to Globa[illegible] in the industry

	Customized to home market	Transferable abroad
high	**Dodger** (focused on locally oriented link in the value chain, enters a JV or sells out to a multinational	**Contender** (focuses on upgrading capabilities and resources to match multinationals globally, often by keeping to niche markets)
low	**Defender** (focused on leveraging local assets in market segments where multinational are weak)	**Extender** (focuses on expanding into markets similar to those of the home base using competencies developed at home)

Transferability of Competitive Assets

Defender:
Defending with the home field advantage

- Pay close attention to changing demands and utilize its own advantages.
- Focus on consumers who appreciate the local touch and ignore those who favor global brands.
- Protect the established brand and make reasonable prices.
- Build an extensive distribution network and control it.

Example： Shanghai Jahwa （defender）

- **Focuses on local consumers who are fond of traditional products.**
- **Ignoring fashion-conscious consumers who favor global brands, such as Unilever, P&G …**
- **Developed low-cost, mass-market brands that are not profitable for multinationals.**

Extender:
Extending local advantages abroad

- Defend the domestic market

- Leverage the assets more effectively by seeking analogous market
  - ✓ Culture
  - ✓ Language
  - ✓ Consumer preference
  - ✓ Geographic proximity
  - ✓ Distribution channels
  - ✓ Government Regulation

Example : Jollibee Foods Corporation (<u>Extender</u>)

- Jollibee Foods is a family-owned fast-food company in Philippines.
- The company first overcame the competition from McDonald’s in its home market
- Jollibee had the confidence to go elsewhere.
- The company now established dozens of restaurants near large expatriate population in Hong Kong , the middle east and California.
- Extenders can use their assets most effectively by seeking analogous markets

Dodger:
Dodging the onslaught

- Sell out to MNCs
- Enter a Joint Venture with MNCs
- Focus on links in the value chain where its assets provide competitive advantages
- Reach deep into the interior of the country
- Supply products that either complement MNCs' offerings or adapt them to local tastes
- Become local component supplier to the newly built factories of MNCs

Example 1: Luckyfilm (<u>dodger</u>)

乐凯 ⟵ Vs. ⟶ Kodak

- Pressure to globalize is strong;
- Local assets are not transferable;
- Joint-venture with Kodak finally (Kodak owns 20% of Luckyfilm).

Luckyfilm moves to links in the value chain where its local assets still work well (traditional film manufacturing).

Example 2:
Tianfu Cola (天府可乐） and Pepsi Cola

- Tianfu Cola ---Coca Cola (insisting on Coke brand only)
- Taifu Cola ---Pepsi Cola (agreeing on producing Tianfu brand products and later on some Pepsi brands upon approval from the govt. institution)
- IJV, with 18 million US$ total investment, 60%(Pepsi)-40%, was established in 1994
- Pepsi Cola was allowed to produce in 1995; but "the sales of Taifu Cola should not be less than 50%";
- Due to many years of loss (30 million loss borne by the Chinese partner), Chinese partner's share was sold out to Pepsi at 130 million RMB;
- The sales of Taifu Cola only accounted for 0.5% of the company in 2007

Mr. Li Peiquan, the founder of Taifu Cola wants to get the local brand back by filing a series of suits(China Business News, Oct. 10, 2008).

In Dec. 2010, the court asked Chongqing Pepsi-Taifu Co. to return the recipe to Tianfu Cola Group and stop using relevant ingredients and production know-how. Taifu said there were still a lot of know-how used by Pepsi, so there would be further suits (China Business News).

Contender:
Contending on the global level

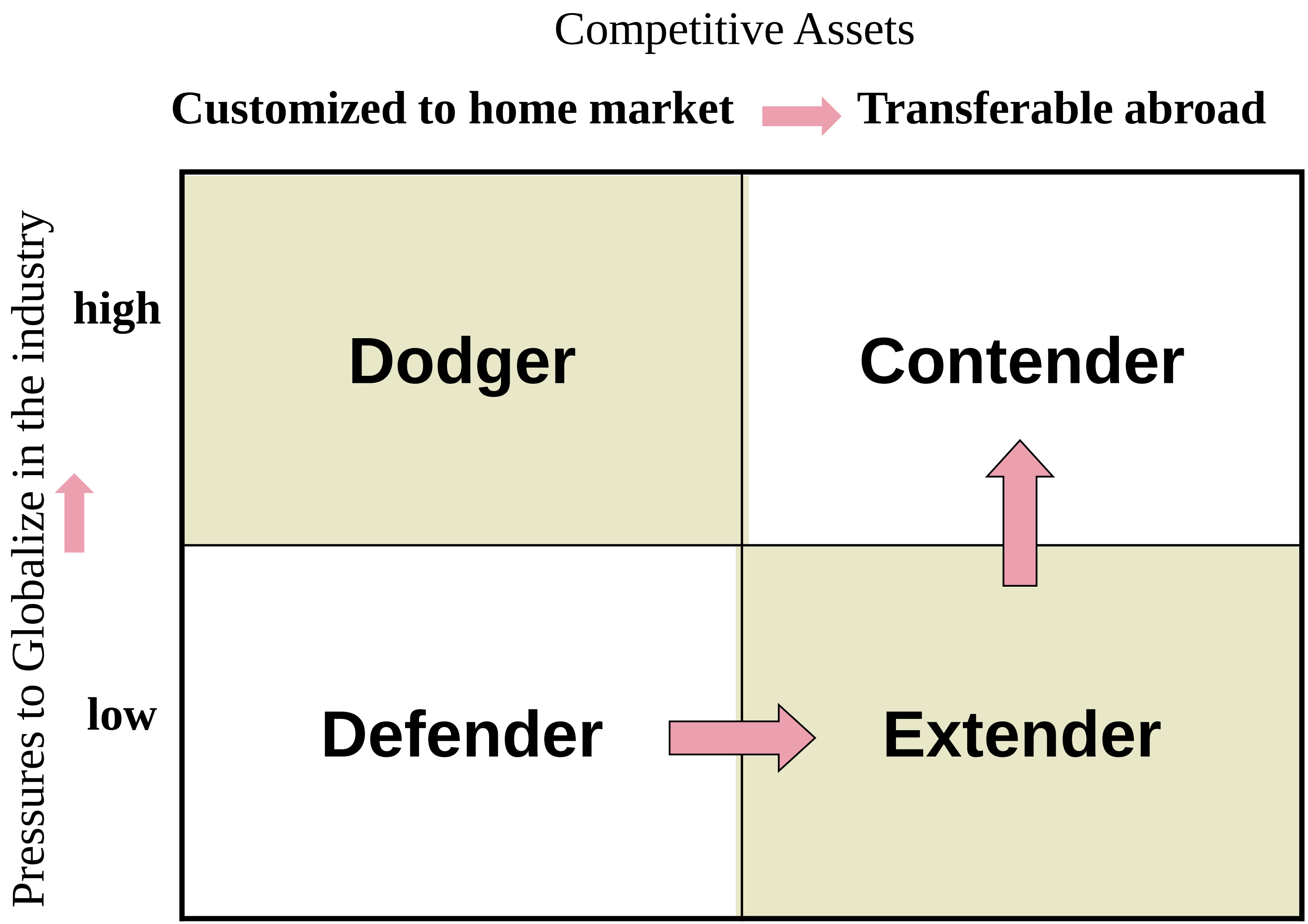
- May become full-fledged MNCs, eg. Samsung, Acer
- Find a distinct and defensible market niche if lacking access to key resources
- Join a production consortium, in which a lead company manages a regional or global web of component developers and suppliers
- Access resources in developed countries
- Pay attention to your weaknesses
- Keep learning and build expertise

Example : Samsung (<u>contender</u>)

- It moved to the frontier of memory chip technology by establishing a major R&D center in Silicon Valley

- It transferred the know-how gained there to HQ at Seoul

Position for emerging-markets companies



A reminder

- Since the environment keeps changing, as a future manager , you'd better not only focus on present situation but also pay attention to the dynamics to modify the strategy when necessary.

Next Session on April 23

- Case study: Shanghai Jahwa: The MAXAM brand
- Outward FDI from China and Chinese firms’ internationalization