



CLOSING CASE

Subsidiary initiative at Schenck Shanghai Machinery

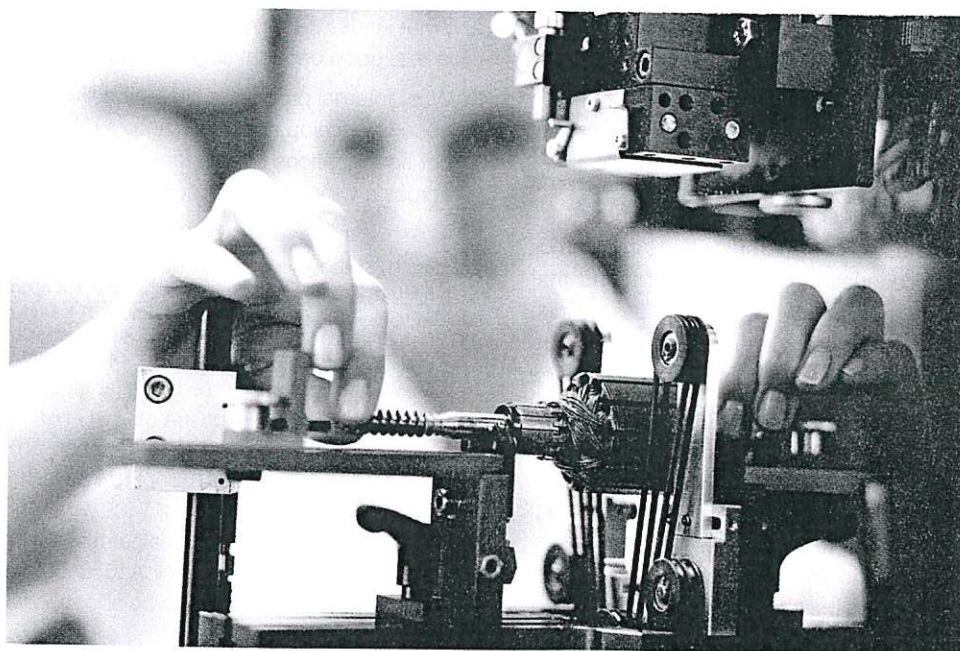
German machine tool maker *Dürr* has been operating sales and manufacturing subsidiaries in China since the mid-1990s, providing state-of-the-art machines for the fast-growing car industry in particular. Its flagship division built and installed paint shops, the technologically most complex part of a car assembly line. Initially, its main customers were foreign-Chinese joint ventures, such as *Shanghai Volkswagen*, but local businesses were also increasingly demanding cutting-edge machines like those offered by *Dürr*. In the quest to improve their products, Chinese producers sought machines from a global leader.

However, not all German-engineered machines sold well in China. *Schenck*, a division of *Dürr*, produced in Germany one of the best balancing machines for armatures (small engines), achieving world-leading performance in accuracy and speed by balancing an armature in less than five seconds. Customers in high-cost countries appreciated the highly automated machine that helped to eliminate manual labour. Yet for several years, its Chinese subsidiary, *Schenck Shanghai Machinery (SSM)*, could not sell a single one

of these machines in China. China-based manufacturers considered the machine 'over-engineered', and at a unit price of around €500 000 much too expensive. What to do?

The main purchasing criteria of customers for machines in the lower price segment were brand name, price, quality, after-sales service and delivery period. *Schenck* had a very good brand name and it sold expensive high-quality machines in other segments in China. However, the delivery period for *Schenck* was longer than its competitors, as its machines were tailor-made and had to go through rigorous testing before being delivered to customers. Two Japanese competitors served the 'good enough' market with machines manufactured in China priced at around €100 000. They dominated the segment that *SSM* found difficult to penetrate as its cost base was too high, even after relocating production to China.

The management of *SSM* believed that there was a market in China for balancing machines for armatures if they could be offered at the right price. Yet serving the 'good enough' segment was not in line with *Dürr's* global strategy, which focused on the premium segment, offering the best of German engineering. The subsidiary leadership faced a difficult choice: should



they give up this market segment or should they take some action? If so, should they take the machine made in Germany and strip it down to the essentials? Or, should they develop a new machine from scratch for the China market?

In 2005, SSM started to develop its own machine 'for China' by forming a development team of five engineers. The team liaised closely with marketing teams familiar with potential local customers, and with sourcing staff who could identify suitable components and suppliers in China. The work of this development team was kept very low profile, without engaging HQ or other units outside China. At the time, the subsidiary leadership believed that it would be difficult to convince HQ and engineers in Germany to develop the machine for China only by developing a machine first, the local leadership team expected to be able to earn the support from German-based engineers.

The new machine was an automatic balancing machine for armatures with grinding and drilling functions. The Shanghai-based development team developed the machine entirely from local components, apart from the measuring unit, which they bought from Germany. Once it was done, they presented a prototype of the new machine to HQ.

The subsidiary leadership was somewhat nervous how HQ would react. The German leadership team did not favour adding lower-quality machines to the product portfolio because of the potential damage to the brand image. The idea of a less sophisticated machine under the *Schenck* name conflicted with the positioning of *Schenck*. How would clients in Europe react if they learned that *Schenck* offered a similar machine in China at a much lower price? Moreover, the *Dürr* leadership in Germany at that time did not have in-depth understanding of the imperatives of the Chinese markets, nor did German-based R&D teams have great trust in their China-based colleagues.

Thus SSM invested considerable efforts in communicating with colleagues in Germany, and found that managing the relationship with HQ was less difficult than anticipated. Key players in Germany quickly realized that it was probably the right approach for the China market. Essentially, the prototype convinced

HQ that their China-based development team was both technically capable and had deep insight into their local market. On this basis, engineers from Germany and from China worked together to finalize the development.

Once the product was ready for market, SSM quickly secured orders. Customers were surprised to see that *Schenck* was able to produce a machine suitable for the China market because, in their minds, *Schenck* had not been in this market for quite a few years. Priced at the same level as the machines by *DSK* and *Kokusai*, the machine quickly attracted customers away from these Japanese competitors.

The new machine benefited not only from the *Schenck* brand name and the reputation of its technology, but from SSM's ability to provide a range of different machines and integrated solutions. Thus by leveraging the *Schenck* name and the combined capabilities of German and Chinese engineers, SSM successfully built a leadership position in the balancing machines for armatures in China in this particular segment, with a market share of 35 to 40%. The machines were also exported, especially to Southeast Asia, where local government encouraged the development of local car manufacturing industries.

CASE DISCUSSION QUESTIONS

- 1 From a resource-based perspective, what resources are needed to develop a machine for a distance market, such as China, and where in the MNE are those to be found?
- 2 What kinds of adaptations are needed to compete in the 'good enough' segment in China?
- 3 What internal processes do MNEs like *Schenck* need to develop and manufacture different product specifications for different market segments across a wide range of countries?

Sources: (1) Klaus Meyer's field research in Shanghai; (2) *Handelsblatt*, 2014, Für Dürr is in China der Lack noch nicht ab, March 24, 2014; (3) K.E. Meyer & J. Zhu, 2014, Dürr AG: A German Premium Manufacturer Goes Mid-Market in China, Shanghai: CEIBS.