

# *Management in China*

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- ▶ **1. Introduction**
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# Introduction



## Map of China



Source: World Bank.

## Basic data (2020)

**Population:** 1.41 billion.

**GDP:** US\$14.7 trillion.

**GDP per capita:** US\$10,434.8.

**GDP growth:** 2.3%.

**Life expectancy:** 77 years

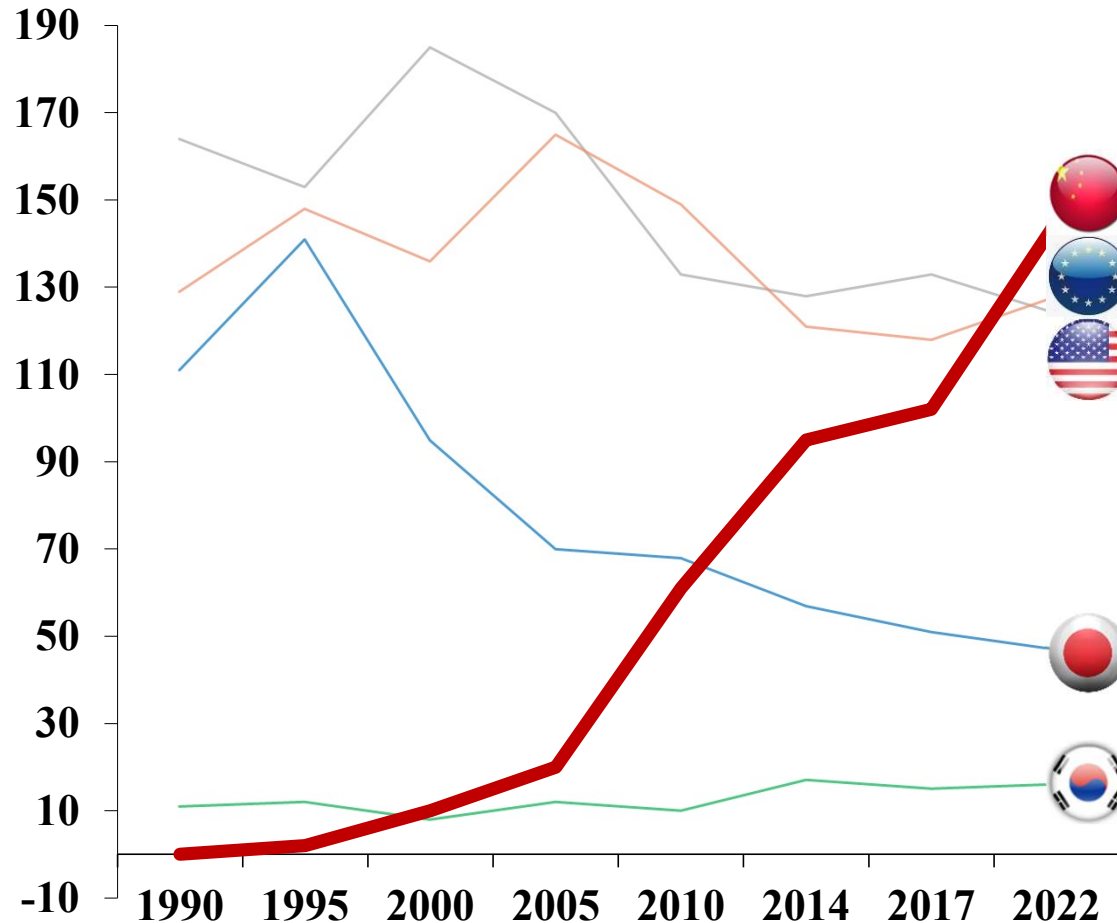
**Unemployment rate:** 4.8%.

**Inflation rate:** 1.0%.

# Introduction



## ■ Global Fortune 500, 1990-2022



Source: Fortune Global 500.

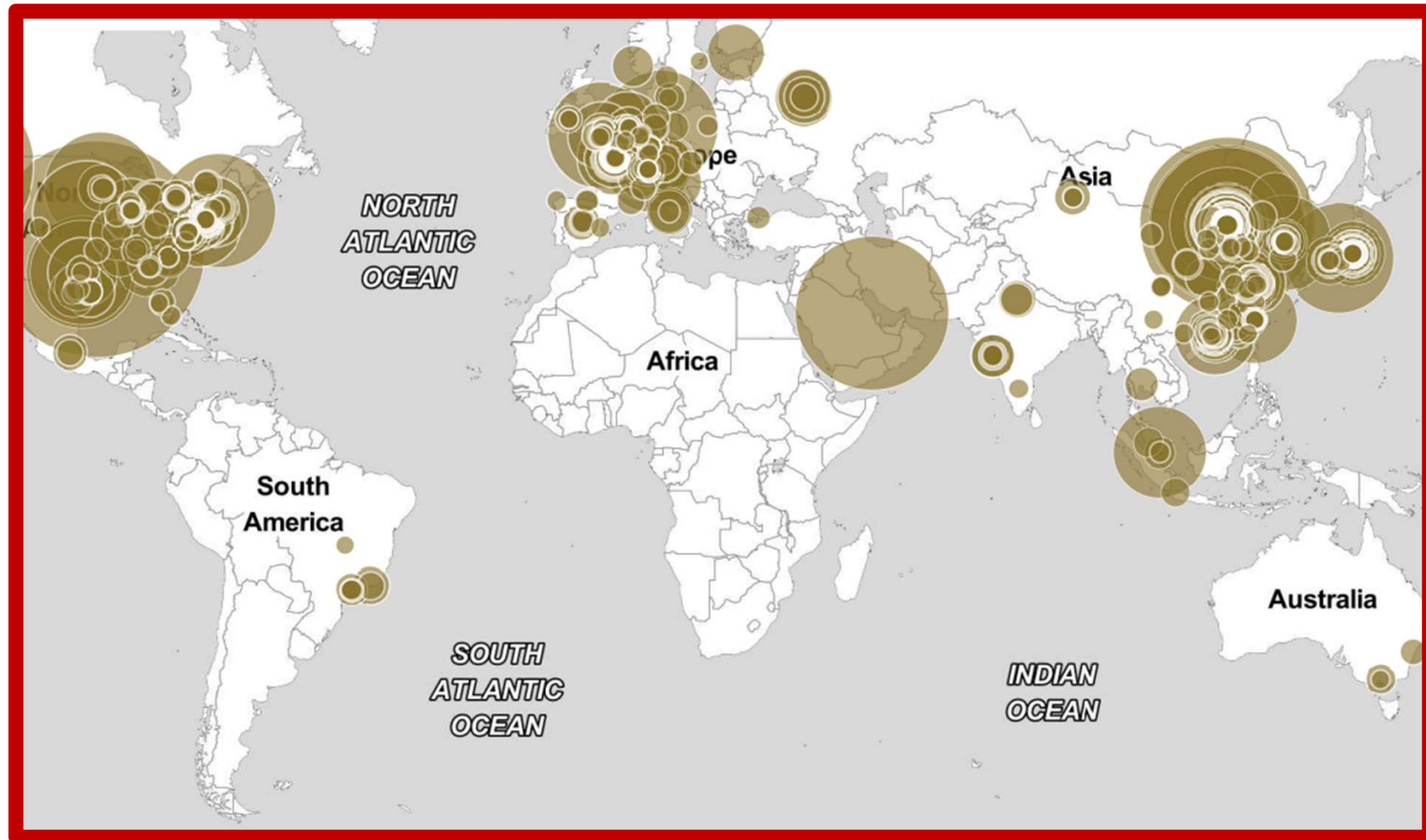
### KEY POINTS

- > MNCs from **Triad countries** account for **60%** of Fortune Global 500.
- > The number of **Japanese MNCs** has declined (**111 in 1990 to 47 in 2022**).
- > **Chinese MNCs** have rapidly grown in significance (**0 in 1990 to 145 in 2022**).
- > **16 Korean MNCs** are ranked in Fortune Global 500 as of **2022**.
- > **Japanese firms** maintain strong competitiveness in **capital goods & intermediate goods**.
- > Korean & Chinese companies still rely heavily on **highly added-value components made by Japanese companies**.

# Introduction



## ■ Global Fortune 500, 1990-2022





## ■ Costs Arising from Rapid Economic Growth



### ❖ Environmental destruction

- > Depletion of resources, such as air & water.
- > Creating illnesses.



### ❖ Social inequality

- > The disposable income of the **richest** 10% of families is **8 times greater** than that of the **poorest** 10%.



### ❖ Rising wage levels

- > **17%** (↑) in the manufacturing in Chinese cities (while China has abundant sources of rural labour & a shortage of skilled management.).



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## ■ The Command Economy: The Soviet Mentor

- > Industries, universities & managerial structures were reorganized on **Soviet lines**.
- > **Central planning & macroeconomic governance**.
- > Many Chinese technologists & engineers were trained in **Russia**.

## ■ Reassertion of China's Managerial Tradition

- > **Mao Zedong's Initiative (1956)**: Obtaining control **from experts** & handing it back **to party committees** in industrial enterprises.
- > **Cultural Revolution**: Preventing the rise of a new technocratic elite.
- > **Wages** were determined by **political activism**.
- > **Low** enterprise efficiency, **low** innovativeness, **inadequate** training.





## ■ Creation of a New Managerial Mindset

- > The 3rd Plenary Session of the 11<sup>th</sup> Central Committee in **1978** → **demand for managerial reform** = Implementation during the 1980s.
- > **Limits to autarchy & need for the generation of capital for growth**
- > **Deng Xiaoping**: Trade & FDI lead to China's sustainable growth.

## ■ Managerial Autonomy of the State Enterprises

- > The 12<sup>th</sup> Congress in 1982
  - (1) Abolition of life tenure for managerial cadres;
  - (2) Attempts to raise their educational levels;
  - (3) Reduce their average age;
  - (4) Commercial accountability; &
  - (5) Entrepreneurship.





## ■ Working Conditions & Labor Mobility

- > **The *danwei* system** (a work unit) in a SOE.
- > Industrial factories, schools, hospitals, & government departments.
- > Workers' allegiance to the *danwei* was social & psychological.
- > Low enterprise efficiency & low labor mobility.
- > Adding **financial burden** on the SOE (= **surplus labor**).

## ■ Property Rights & Corporate Governance

- > **The rise of private & foreign firms**, the reduction of direct family control → the **separation of ownership & management**.
- > State's budgetary allocation towards **bank lending** & through **equity**.
- > **The Company law in 1994** → Firms are **legal entities with their own property rights** & responsibility for their own profit & loss.



## ■ The Business System

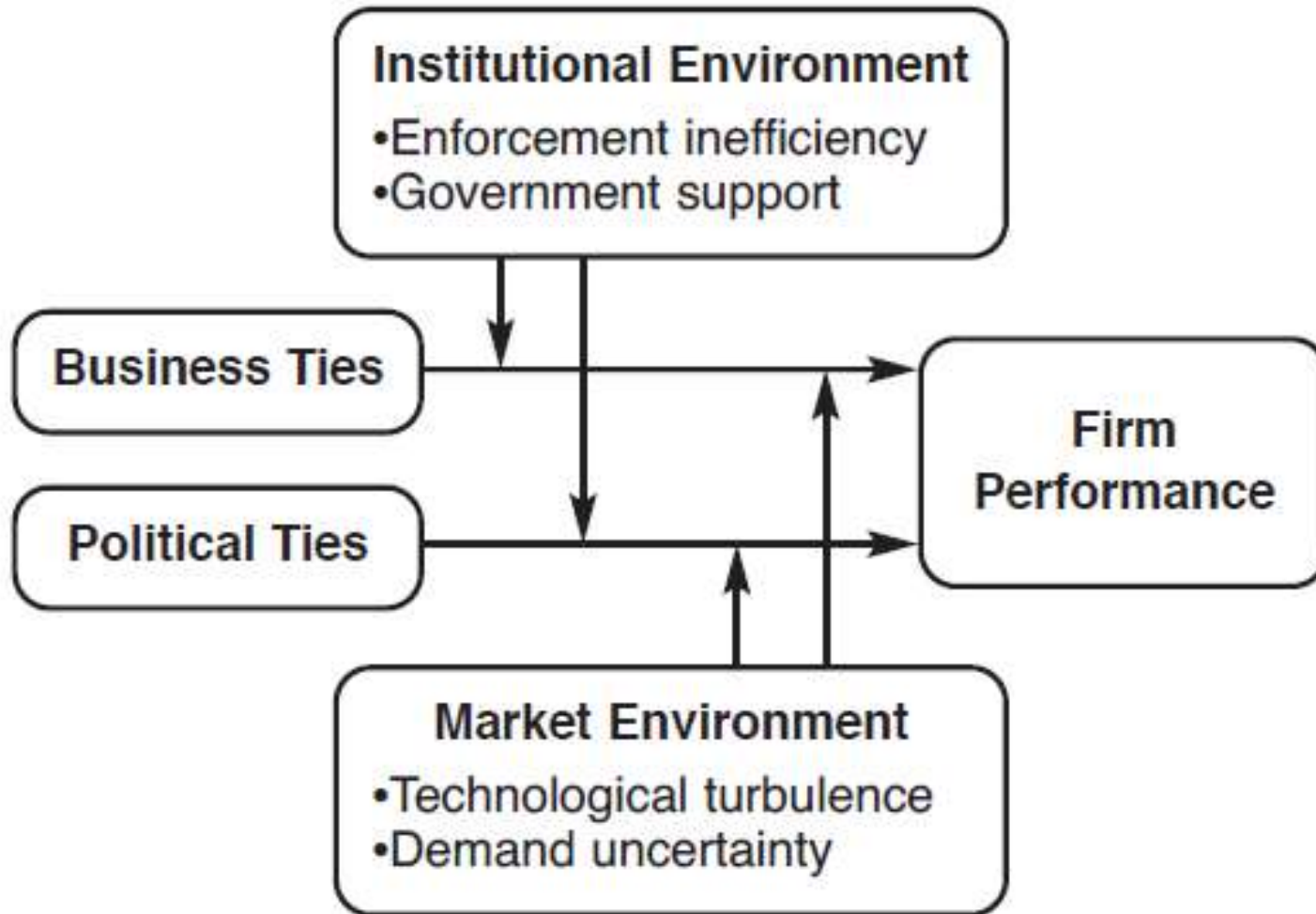
❖ China has **3** business systems inside its complex economy.

- (1) **SOEs:** Legacies from the communist era of **central planning & totalitarian control**. Most of it has been sold off in recent years & its remaining industries are those seen as crucial to the **national interest**. SOEs operate under very close scrutiny & account for about **15% of GDP**.
- (2) **The Local Corporates:** The construction of factories to meet all local needs. As reform took hold in the 1980s & speeded up in the 1990s, to permit the disposal of these assets to **entrepreneurs often in coalition with local administrators**.
- (3) **Private Business:** SMEs under personal control & often connected with a family. Since the 1980s, privately owned companies in China have received increasing legal & political support & legitimacy, & now account for about **65% of the economy**.

# Chinese Business System



## ■ Importance of ‘Guanxi’



Source: Sheng et

# Chinese Business System



## ■ Definition of '2' Types of Social Ties?

### Business Ties

- > Ties with **buyers, suppliers, competitors & other market collaborators.**
- > Offering **'market' resources** (e.g., information on products & partners, changes in the market).
- > **Learning & mutual adjustment.**
- > **Technology** acquisition.
- > **Network legitimacy** as a strategic resource.

### Political Ties

- > Ties with **government officials.**
- > Key **'regulatory' resources** (e.g., access to policy & aggregate industrial information).
- > Access to **'scarce' resources** (e.g., land, bank loans, subsidies, tax breaks etc.).
- > **Political legitimacy** (e.g., exclusive government endorsements & favorable treatment).

Source: Sheng et al. (2011: 2)

# Chinese Business System



## ■ How Business & Political Ties Differ in Their Time

### Business Ties

- > Common interests in **maximizing economic returns**.
- > Partners **work together** to coordinate exchanges over **long-time horizons**.
- > **Relational norms** (*e.g.*, trust, commitment, mutual dependence) constrain any opportunistic behaviour of parties.
- > Encourage **long-term cooperation**.

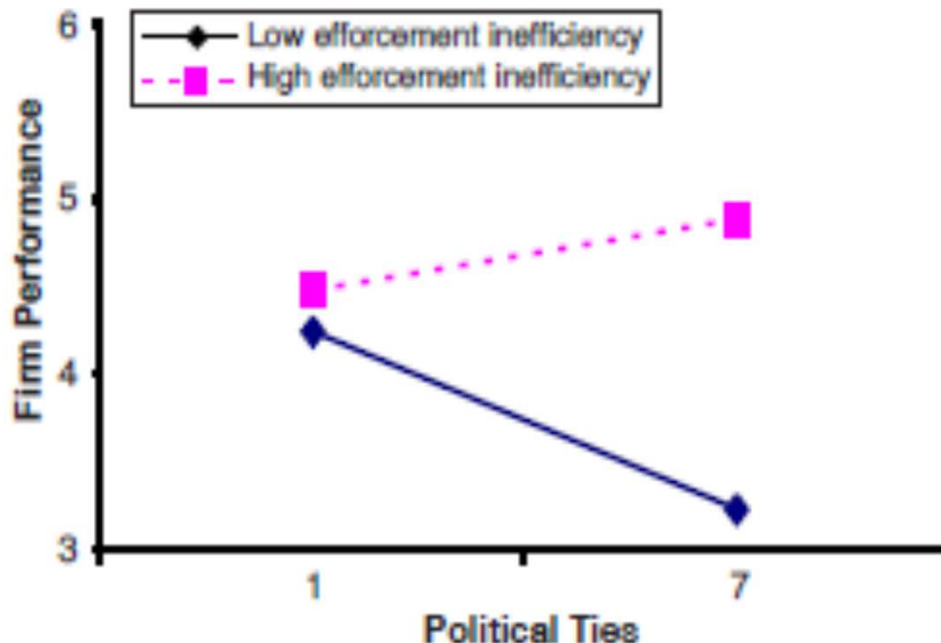
### Political Ties

- > ... **lack an effective mechanism** to ensure long-term cooperation.
- > Government officials' primary interests center on **developing their political careers**.
- > The top priority is to **please superordinate officials**, not to support business organizations.
- > **Goal divergence** causes relationship conflict.
- > **Rotate positions**.

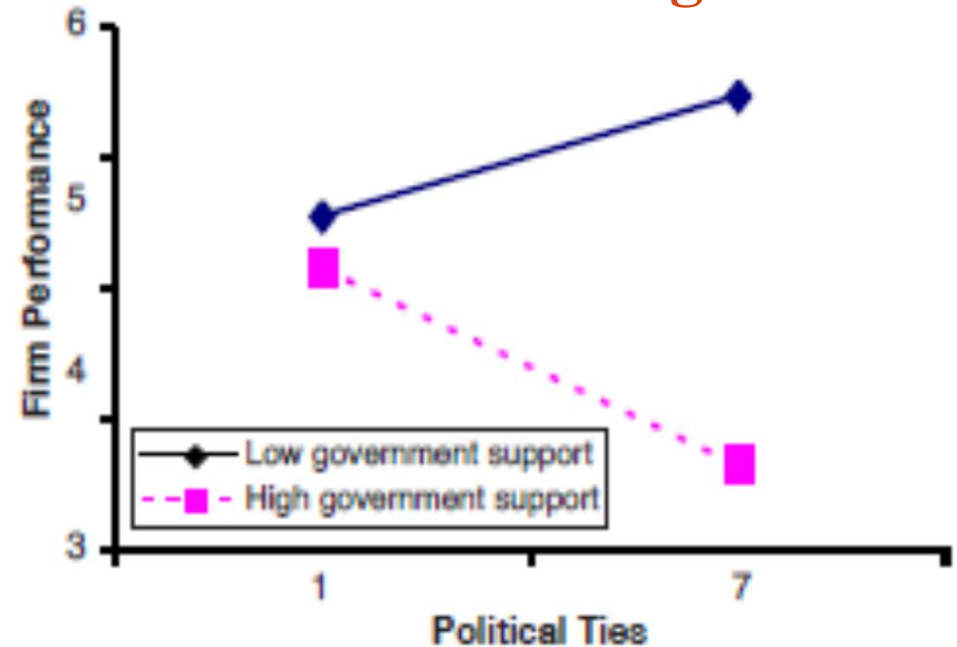
Source: Sheng et al. (2011: 2)



## Contingent Effects of Institutional & Market Settings



- > Government involvement against **unlawful behaviour**.
- > Political intervention in **unfair competition**.
- > Political ties support transactions.
- > Efficient legal enforcement ( $\uparrow$ )  $\rightarrow$  the importance of political legitimacy ( $\downarrow$ )



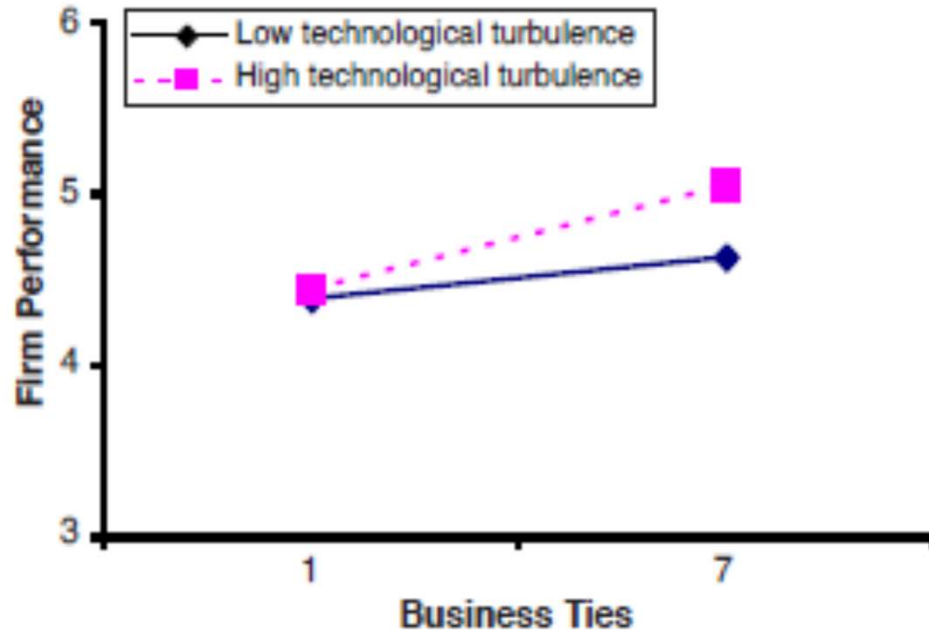
- > A supportive government (a **formal market institution**) provides **valuable policy** to all **firms** through **public channels**.
- > Scarce resources (*e.g.*, **tax breaks & subsidies**).
- > Formal government support reduces the need for relying on informal social ties.

Source: Sheng et al. (2011: 2).

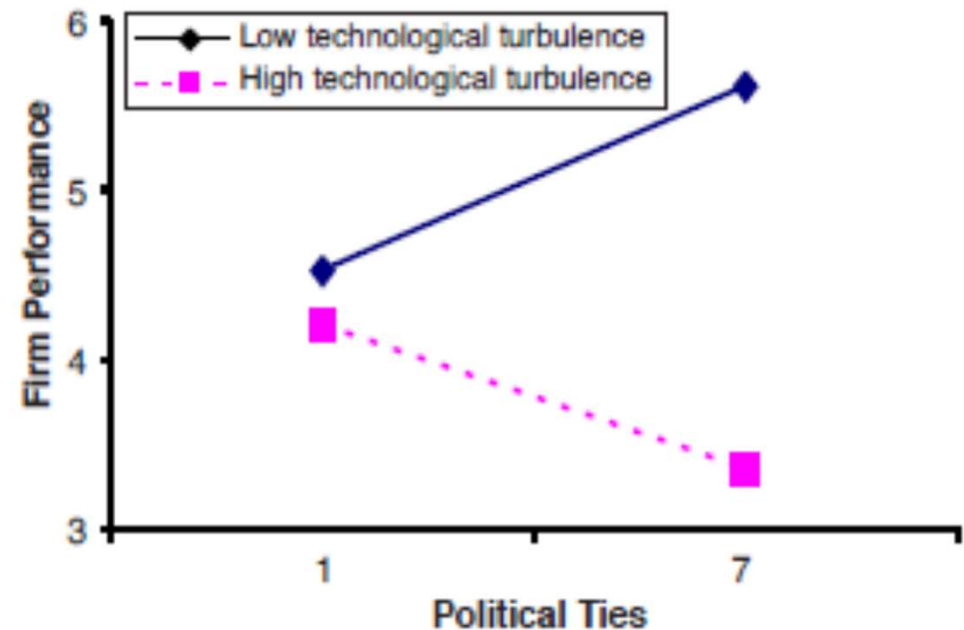




## Contingent Effects of Institutional & Market Settings



- > Latest market information (e.g., changes in technologies & customer demands).
- > New market opportunities.
- > In industries characterized by complex & expanding knowledge, **innovation** emerge from **networks of learning**.



- > **Government-controlled resources** (e.g., land, bank credits or tax subsidies) **do not directly improve technological innovation capability**.
- > Managers in firms with political ties (e.g., **SOEs**) are **less innovative & tolerant of risk**.
- > e.g., **Real estate industry (+++ political ties)**.

Source: Sheng et al. (2011: 2).



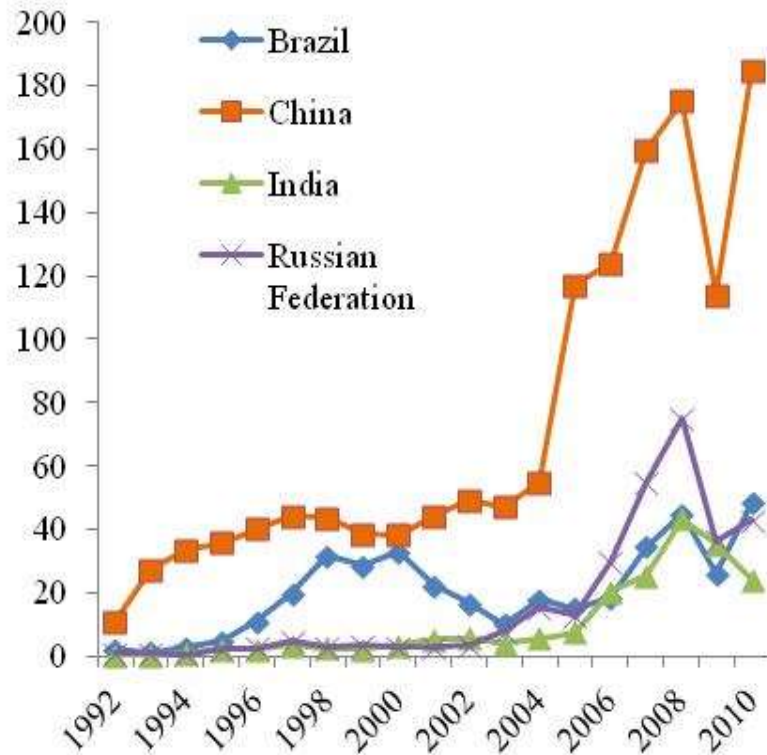


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# Foreign Direct Investment in China



## FDI Net Inflows (US\$ billion)



Source: Own illustration based on World Bank

## □ Determinants of FDI

- > Market Potential
- > Market Performance
- > Infrastructure
- > Resources
- > Strategic Positioning

## □ Benefits of FDI

- > Technology spillovers
- > Employment creation
- > Tax revenue
- > International trade integration
- > Competition
- > Human capital formation

# Foreign Direct Investment in China



## Rise and fall

GDP at purchasing power parity (PPP) rankings

2009 rank		GDP at PPP*	2050 rank		Projected GDP at PPP*
1	US	\$14,256bn	1	China	\$59,475bn
2	China	\$8,888bn	2	India	\$43,180bn
3	Japan	\$4,138bn	3	US	\$37,876bn
4	India	\$3,752bn	4	Brazil	\$9,762bn
5	Germany	\$2,984bn	5	Japan	\$7,664bn
6	Russia	\$2,687bn	6	Russia	\$7,559bn
7	<b>UK</b>	<b>\$2,257bn</b>	7	Mexico	\$6,682bn
8	France	\$2,172bn	8	Indonesia	\$6,205bn
9	Brazil	\$2,020bn	9	Germany	\$5,707bn
10	Italy	\$1,922bn	10	<b>UK</b>	<b>\$5,628bn</b>
11	Mexico	\$1,540bn	11	France	\$5,344 bn
12	Spain	\$1,496bn	12	Turkey	\$5,298bn
13	South Korea	\$1,324bn	13	Nigeria	\$4,530bn
14	Canada	\$1,280bn	14	Vietnam	\$3,939bn
15	Turkey	\$1,040bn	15	Italy	\$3,798bn
16	Indonesia	\$967bn	16	Canada	\$3,322bn
17	Australia	\$858bn	17	South Korea	\$3,258bn
18	Saudi Arabia	\$595bn	18	Spain	\$3,195bn
19	Argentina	\$586bn	19	Saudi Arabia	\$3,039bn
20	South Africa	\$508bn	20	Argentina	\$2,549bn

SOURCE: WORLD BANK ESTIMATES FOR 2009, PWC MODEL ESTIMATES FOR 2050

Constant 2009 US\$

## Economic growth

Projected average annual real growth in GDP, 2009-2050

Vietnam	8.8%
India	8.1%
Nigeria	7.9%
China	5.9%
Indonesia	5.8%
Turkey	5.1%
SouthAfrica	5.0%
SaudiArabia	5.0%
Argentina	4.9%
Mexico	4.7%
Brazil	4.4%
Russia	4.0%
Korea	3.1%
Australia	2.4%
US	2.4%
<b>UK</b>	<b>2.3%</b>
Canada	2.2%
Spain	1.9%
France	1.7%
Italy	1.4%
Germany	1.3%
Japan	1.0%

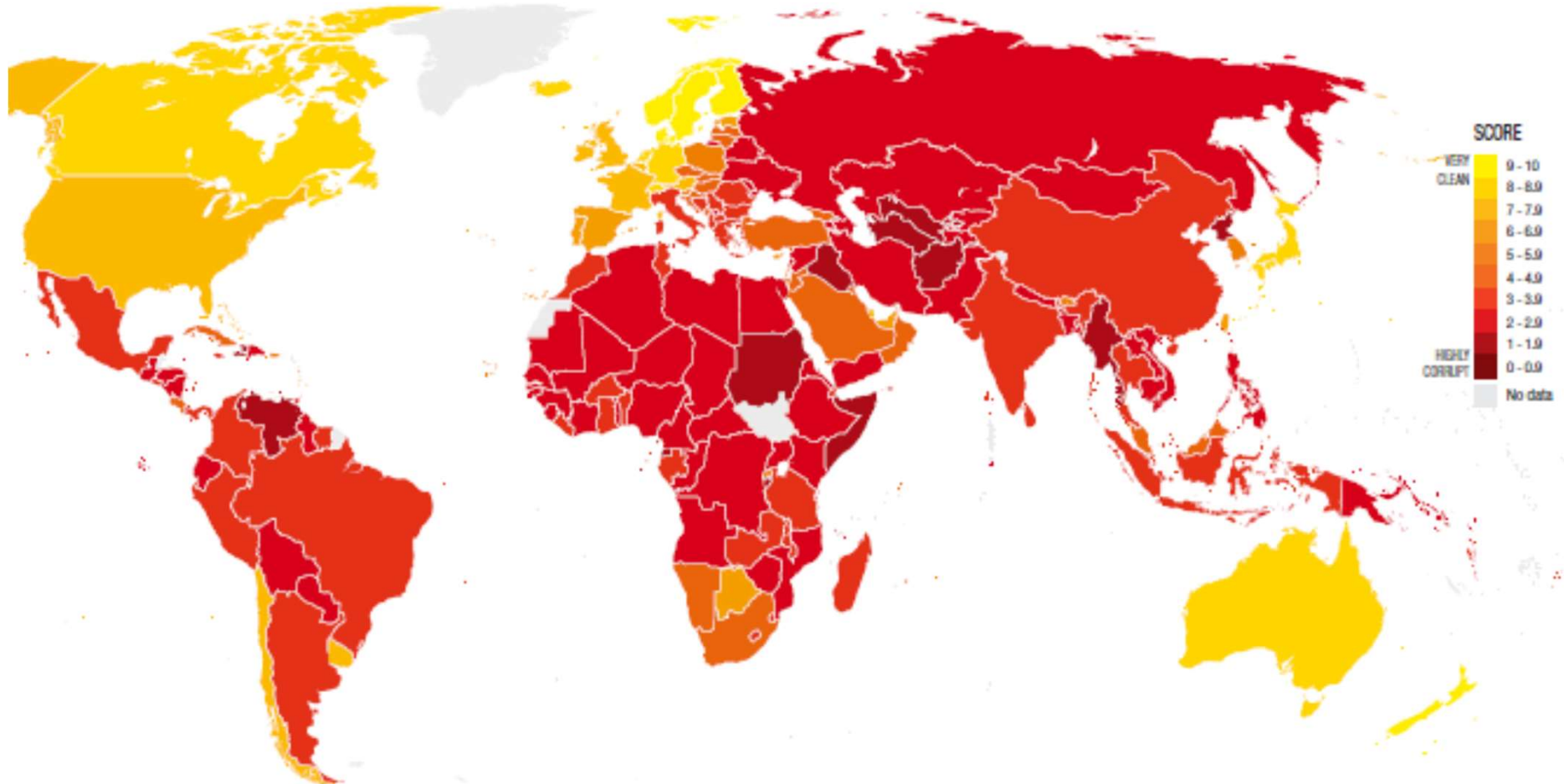
SOURCE: PWC MODEL ESTIMATES

Source: www.gurdian.co.uk based on World Bank for 2009, PwC main scenario model projections for 2010-50.

# Foreign Direct Investment in China



## Corruption Perception Index



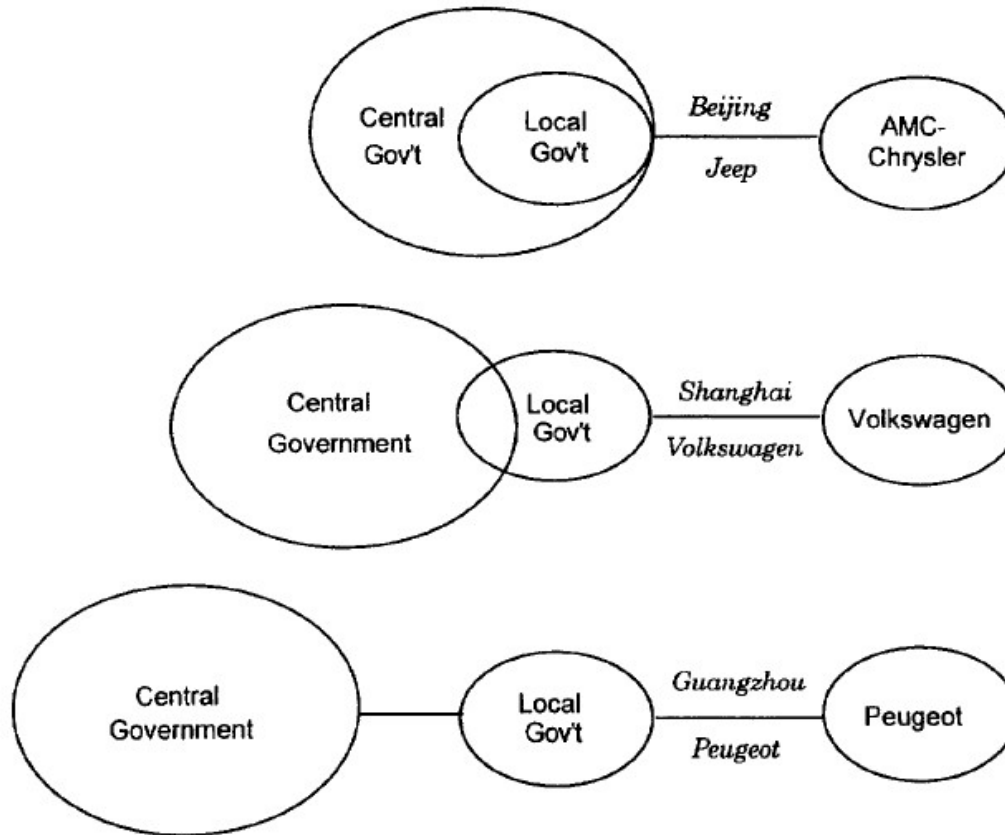
Source: Transparency International.



# Foreign Direct Investment in China



## ■ Different Government-MNE Relationships



Source: Peng (2000: 160).

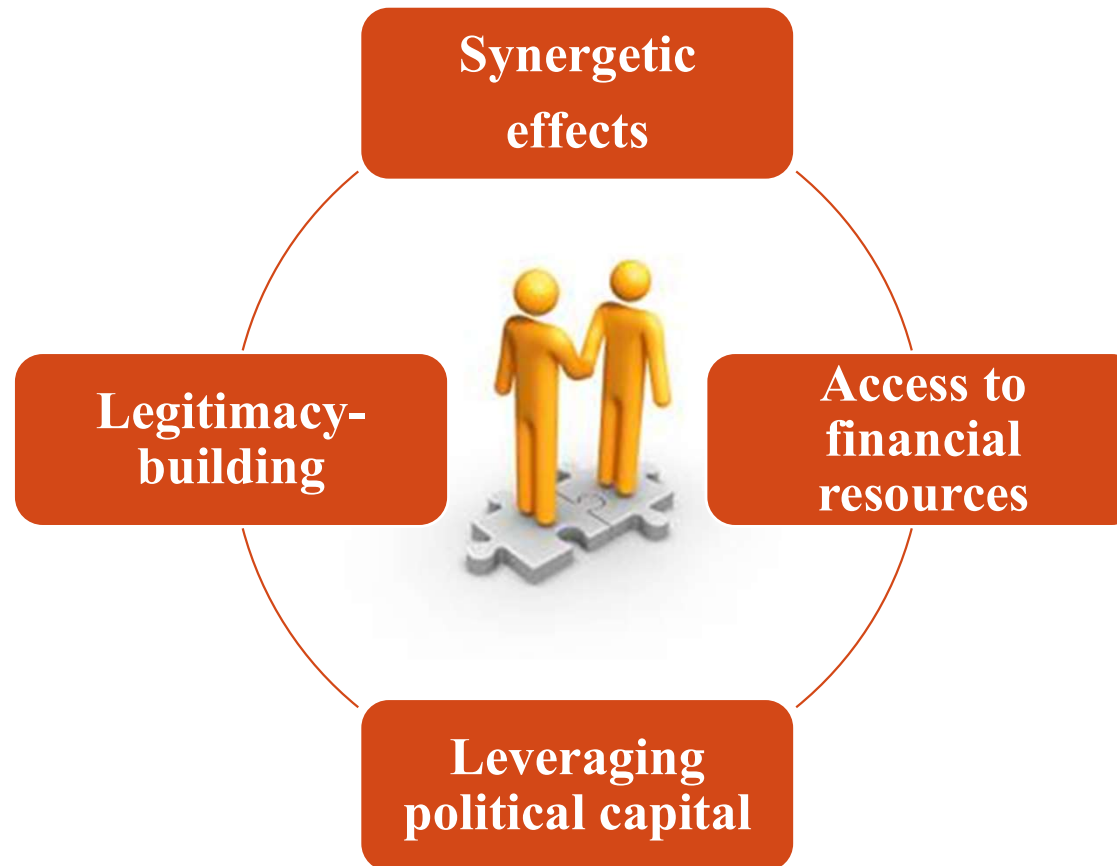
### KEY POINTS

- > AMC's "**BAIT & SWITCH**" strategy versus VW & Peugeot's more **FRANK** approach.
- > In the case of VW & Peugeot, local governments became more **SYMPATHETIC** toward the JVs.
- > During later stages of the JV development, local governments, except in Beijing, tended to actively **LOBBY** for the JVs.
- > Local governments **BARGAINED** hard with the central government.
- > **DIALOGUE**-based solutions of the conflicts between principals & agents

# Foreign Direct Investment in China



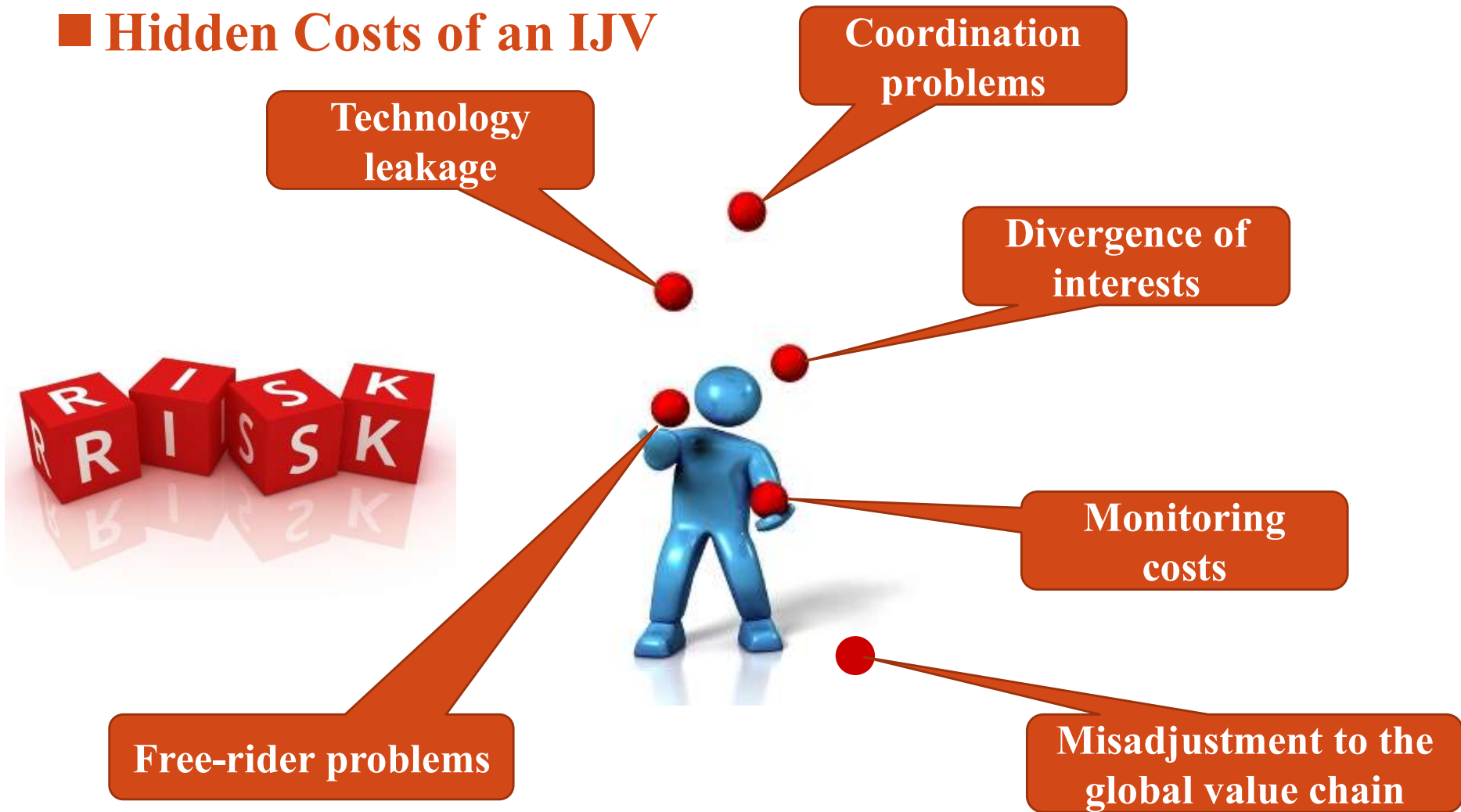
## ■ Benefits of an IJV



# Foreign Direct Investment in China



## ■ Hidden Costs of an IJV





## ■ Effective Ways to Growth through a WOS

### ❖ Agreements with Chinese Agents to Make Liaisons

- *Guanxi*, necessary or unnecessary?
- Local agents to help procure land, materials & services.
- Local agents to identify which connections will help.

### ❖ Integrating Your Company into the Local Community

- Do **NOT** be perceived as a foreign island.
- Localize production, hiring Chinese managers.
- Be active in socially responsible projects (e.g., financing community movie theatres, commitment to public safety, sponsoring events).

### ❖ A WFOE or an EJV? Not Necessarily an Either-or Decision

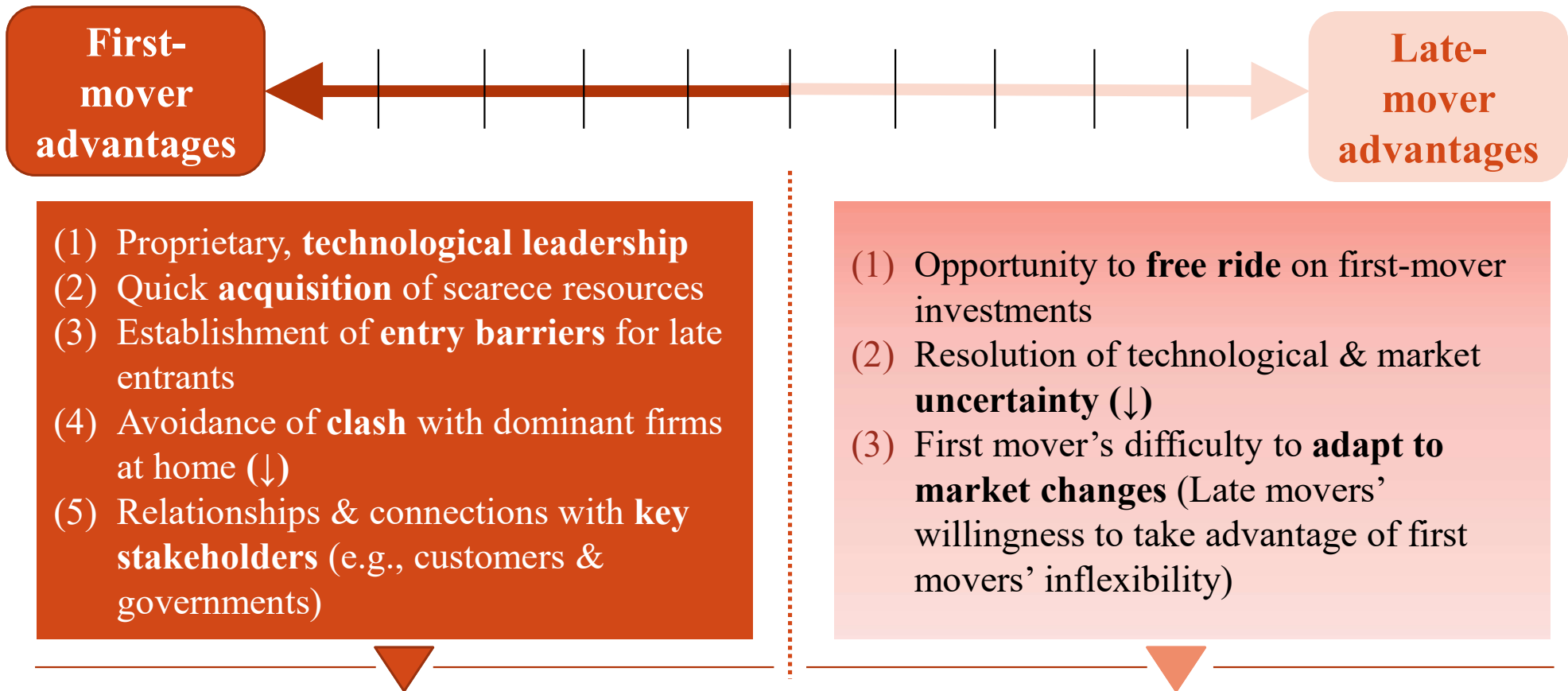
- Combine WOS production operations with JVs that sell & market products (e.g., Motorola in Tianjin).
- Consider a JV & a WOS as a natural sequence.



# Foreign Direct Investment in China



## ■ Tse (2011). Is it Too Late to Enter China?



*“Entry timing per se is not the sole determinant of success & failure of foreign entries. It is through interaction with other strategic factors that **entry timing affect performance**”.*

# Foreign Direct Investment in China



## ■ 3 'C'

- > By 2020 **city dwellers** will account for **60%** of the population.
- > Differentiated & multitiered segments.
- > The creation of **reliable transport & communication infrastructures**.

### Customers

- > A large number of **middle class** (↑)
- > No other country has as many products & brands as China does.  
→ A **lack of brand loyalty** & **quick shift** in market share.

### Context

- > Understand the government's **priority**.
- > **State ownership** of key companies in the communications, energy, finance, & media sectors.
- > **Google** vs Chinese laws (**censoring of search results**)
- > Economic freedom does **NOT** promote political freedom.

### Competitors

- > Growing **global giants** (Lenovo, Haier, Huawei).
- > China's economic reform creates a number of **start-ups**.
- > It results in forging **strategic alliances**.



## ■ ‘5’ Questions for Shaping a China Strategy (1/2)

- (1) ‘**How open**’ is - & will be – our industry in China?
  - Even in completely open industries, the Chinese government will **intervene** whenever it deems it **necessary**.
- (2) What **business models** should we use?
  - ‘2’ models: **Sourcing-centric** (e.g., consumer electronics) & **sales-centric** (e.g., consumer goods & automobile industries) → **Combine them** !
  - Managing **multiple business models** is tough but often necessary to cash in on the opportunities in China.
- (3) Can we live with China’s **uncertainties**?
  - The **pace** of change, **lack** of (reliable?) data, & high executive turnover.
  - Many Chinese CEOs are **fearless experimenters** who are willing to learn, launch, adapt, & improve in quick bursts.



## ■ '5' Questions for Shaping a China Strategy (2/2)

- (4) How can we **integrate** our China operations with our businesses elsewhere in the world?
- Pressure from **rising costs** (e.g., labor & raw materials).
  - In order to keep costs down, companies will have to **integrate** their China operations with their businesses **elsewhere** by developing products in China & manufacturing them in **other Asian countries**.
  - **Coca Cola & Nokia: R&D laboratories** & product development centers.
- (5) Can we move more parts of our **value chain** to China?
- The **relocation** of value-creation activities to China.
  - **4 stages**: (1) Setting up manufacturing facilities → (2) Making China as a sourcing location → (3) Integrating China facilities into global manufacturing networks → (4) Making China as a key part of value chains
  - Moving some operations from **headquarters** to **China**.



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## ■ Questions

**Q1:** What is the **main argument** of this paper?

**Q2:** Why is it important for us to discuss the **competitive dynamics** between local & multinational firms in China?

**Q3:** How did the Chinese market **change** over the last 20 years?

**Q4:** Briefly summarize the nature of the **2-by-2 matrix**.

**Q5:** Explain industry variations in the level of competitive dynamics & **how** MNCs should **design, develop & execute** their strategies in response to **industry heterogeneity**.

**Q6:** What do the authors suggest MNCs to do in order to enhance their **operational efficiency** under conditions of intensified competition?

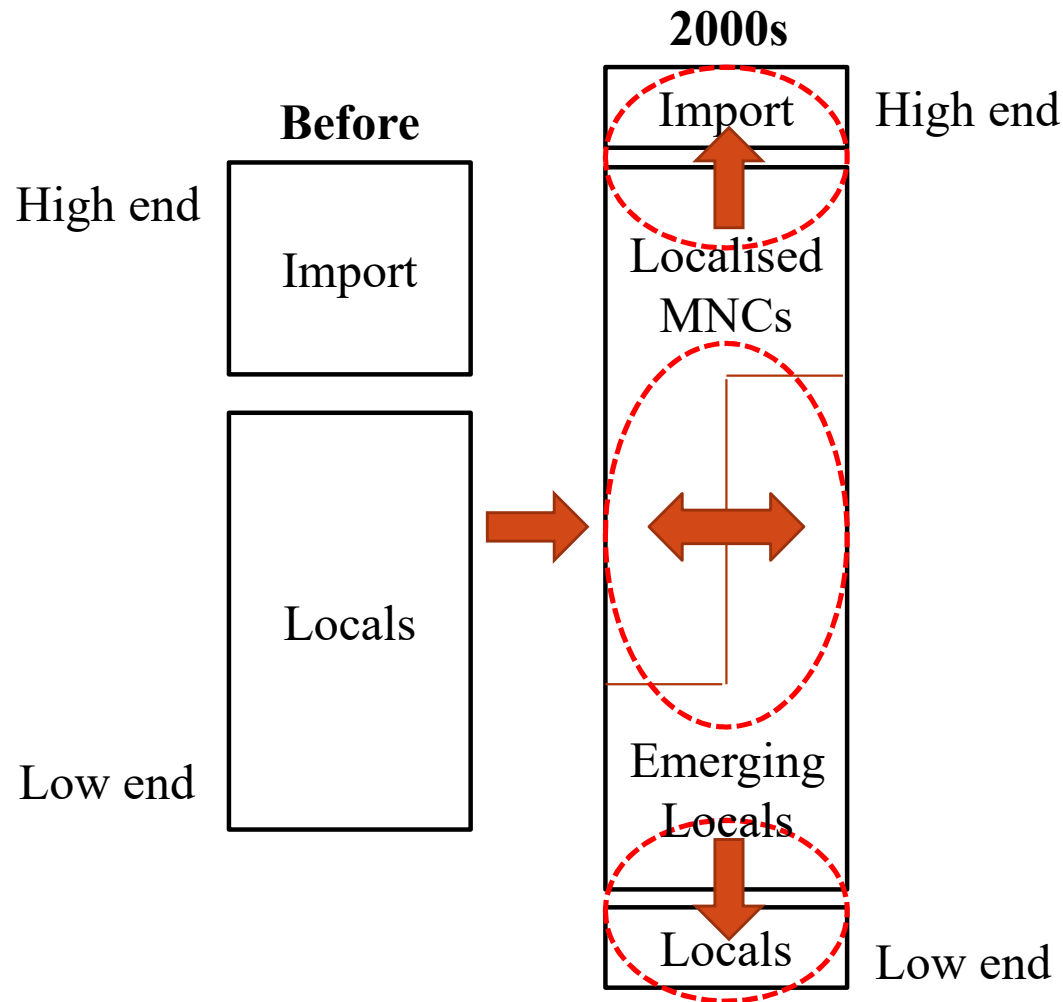


## ■ China's Market Environments

- ❖ Despite the collapse of the US property bubble, Asian economies remained **unaffected** by the crisis (China: > **9%** growth in 2011).
- ❖ **China** has witnessed **noticeable changes** in the competitive environment for MNCs in recent years.
- ❖ MNCs' costly failures & exit
  - **Carlsberg, Bass & Fosters** – unable to maintain their market positions against strong domestic competitors such as **Tsingtao & Yanjing**.
  - **Anheuser-Busch InBev** opted to exit China.
  - Foreign MNCs left China which operated in the **mobile handsets** market.
- ❖ **Why?**
  - Local firms **challenge** MNCs with (1) **low costs**, (2) **managerial flexibility** & (3) **extensive distribution networks**.



## Competitive Dynamics in China



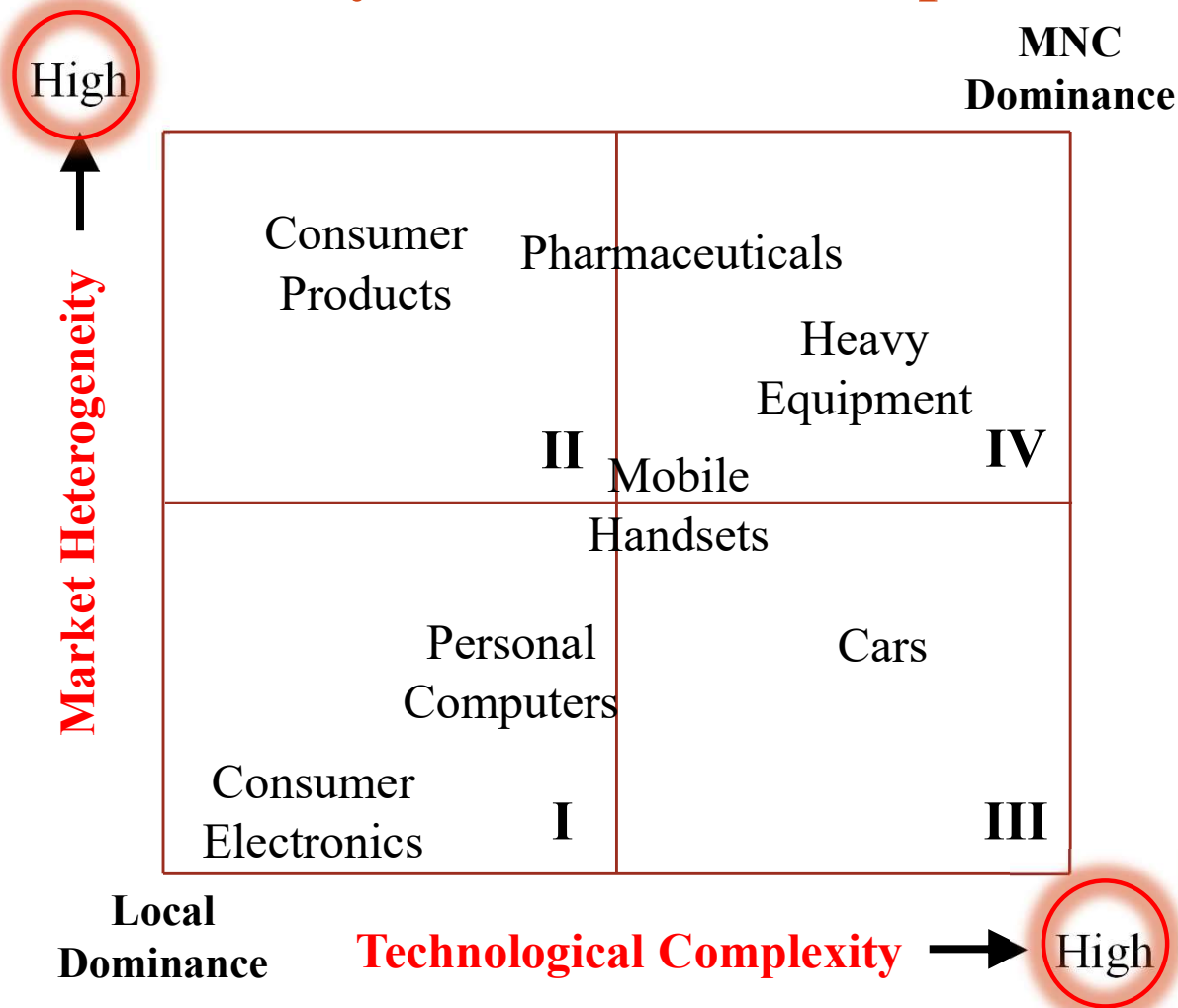
### COMMENTS

- > **Deng Xiaoping.**
- > **Localized MNCs:** The high-end segment by localizing production & sourcing.
- > Massive **changes in retail chains & customer behaviors.**
- > People's perception changes: **Locally-made cars** are of **high quality.**
- > **The middle market => Complexity.**
- > **New local players** in the low-end segment became strong **contenders.**
  - JV (VW-SAIC & GM-SAIC)
  - Private entrepreneurial firms or restructured SOEs (e.g., Hair)
- > Localized **MNCs** - Emerging **local firms.**





## Industry Variation in Competitive Dynamics

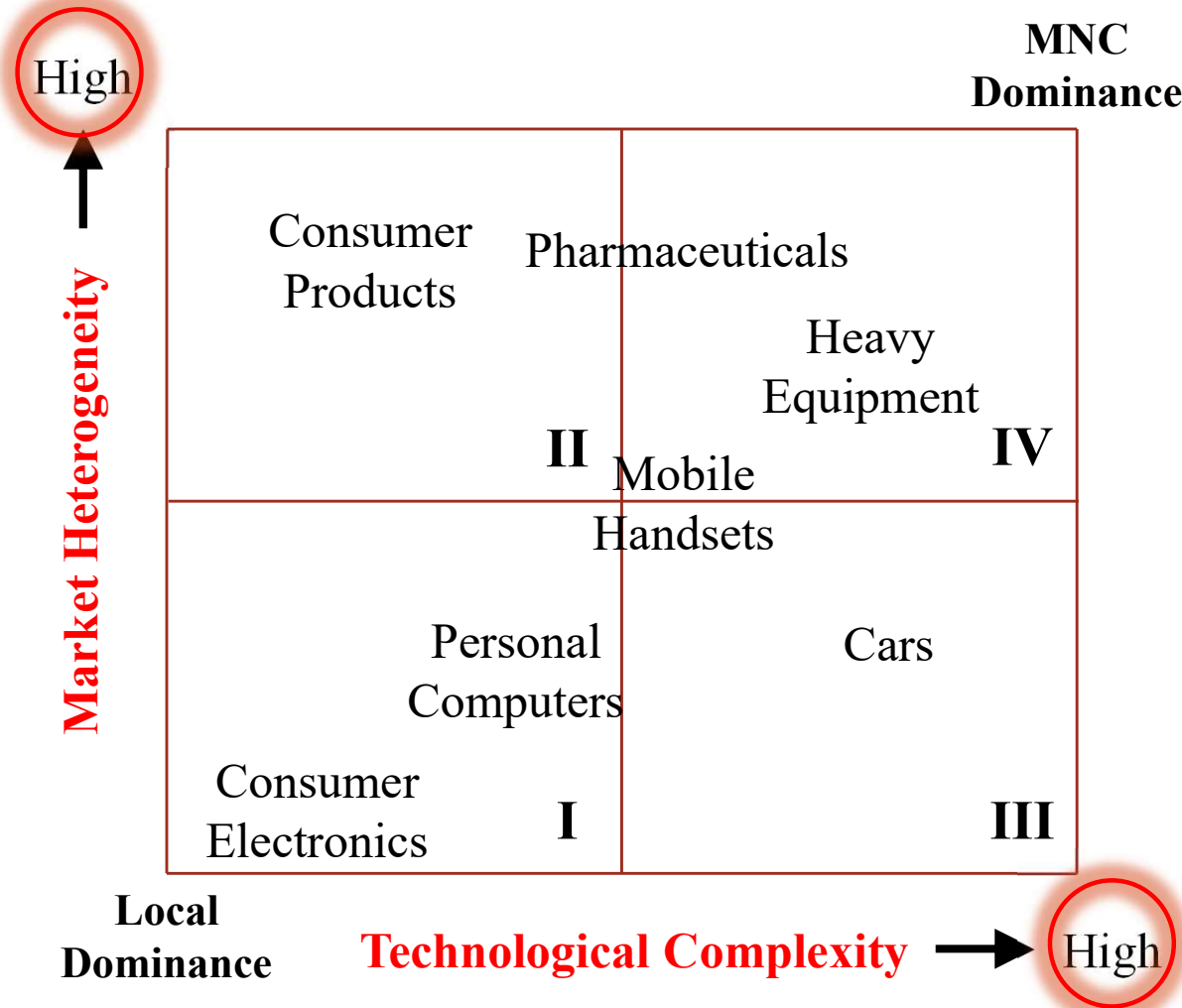


### COMMENTS

- > **Quadrant I: Local firms' challenges** against MNCs are the most severe.
- > **Quadrants II & IV:** Local firms would have **difficulty catching up** with MNCs in industries with high levels of market heterogeneity.
- > **Quadrants III & IV:** When an industry involves complex technologies, it is **not easy for local firms to imitate** or to keep up with MNCs' product advantages.
- > **Quadrant IV:** This is **the most difficult & challenging area** for locals to catch up with foreign competitors.

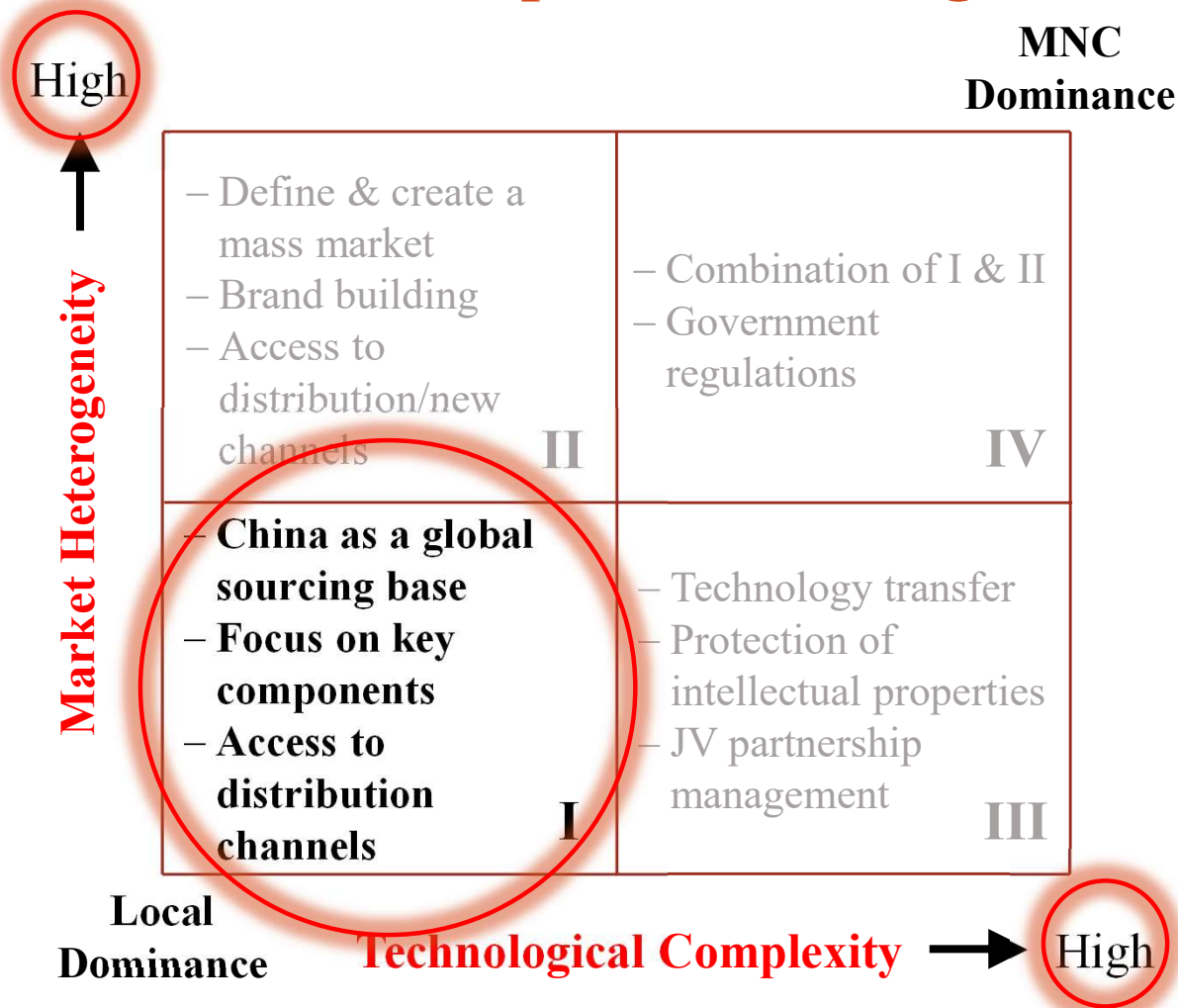


## ■ QUESTION: How to Compete against Emerging Locals?





## ■ Generic Competitive Strategies for MNCs in China

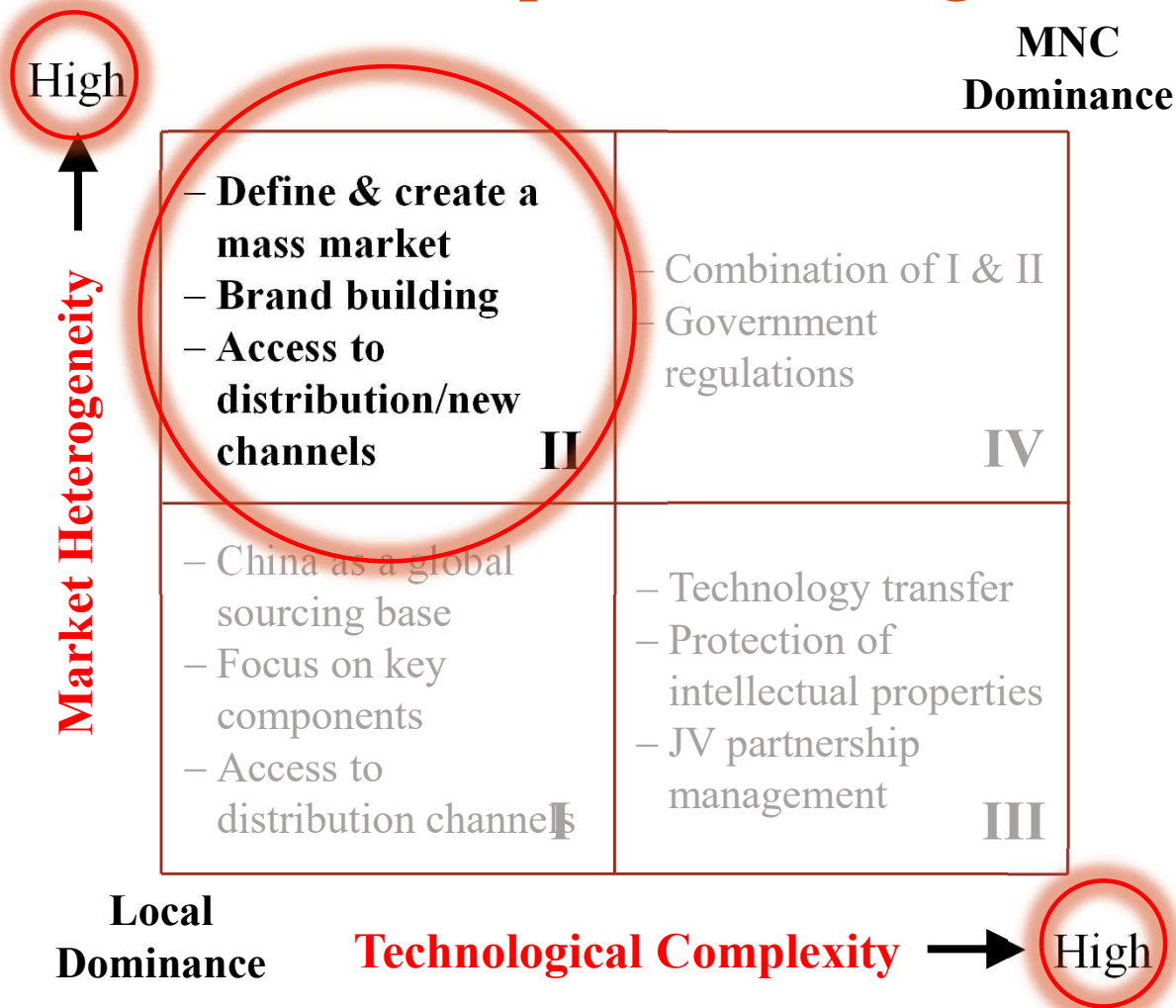


### COMMENTS

- > **Local firms** challenge MNCs based on **cost advantages**.
- > **NOT** pursue a strategy competing with local firms **on price**.
- > **Local sourcing** is a critical starting point to address the cost pressure.
  - **Evaluate sourcing** in the context global strategies.
  - **Source** not only **from China** but **globally for China**.
  - **Sell key components to local producers** rather than to compete solely on finished sets.
  - **Optimize their supply chains & maintain the highest level of efficiency.**



## ■ Generic Competitive Strategies for MNCs in China

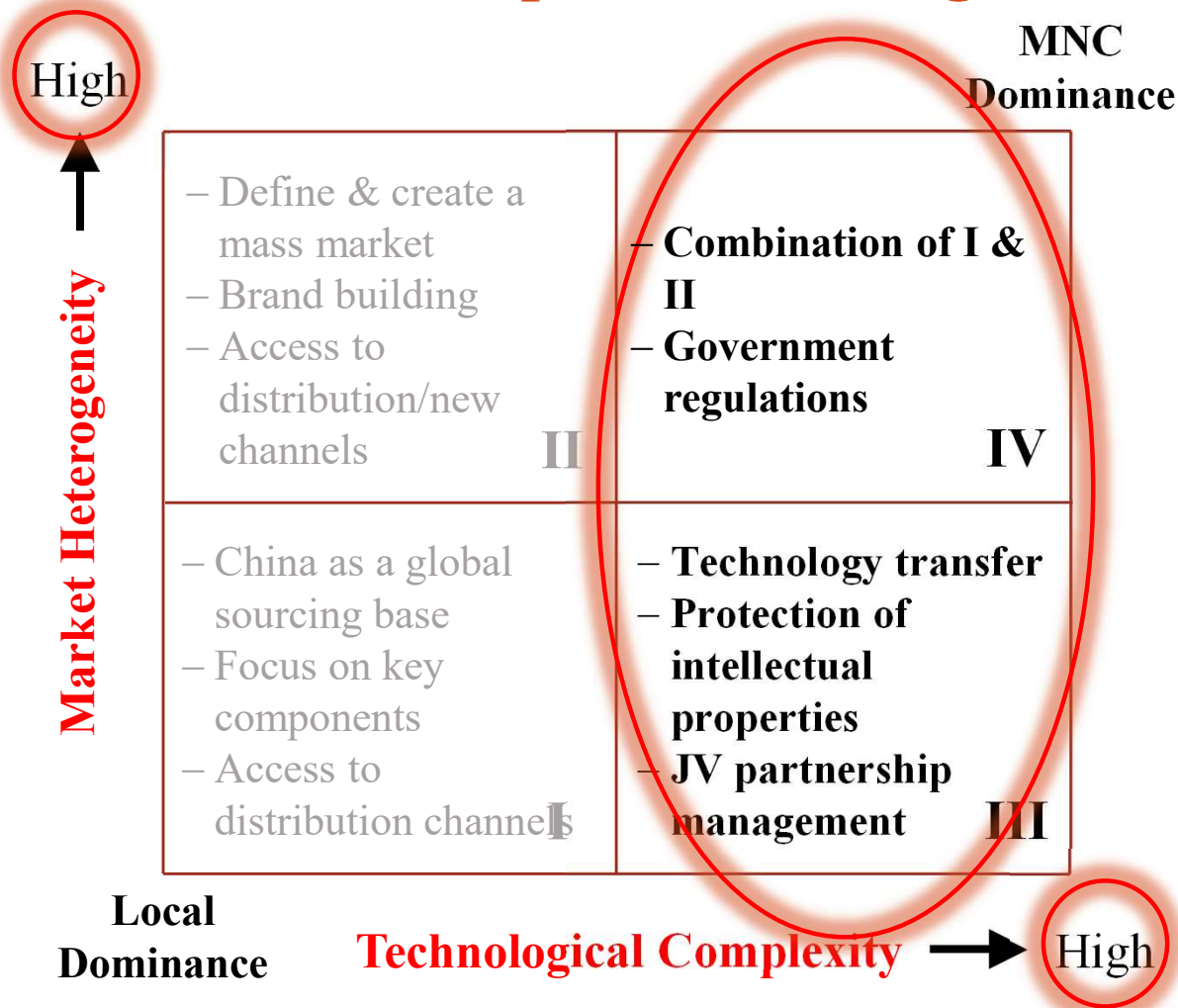


### COMMENTS

- > “We have to de-average any statistics in China. If we try to sell a product to all customers across the country, we are bound to fail”.
- > **Price cutting** is **NOT necessarily** a good strategy in the long run.
- > Take a more elaborate **segmentation** strategy with **multiple brands across different tiers** !
- > Develop low-priced products specifically **tailored** to Chinese customers without sacrificing the original quality & performance !
- > Sustain **large-scale brand-building** efforts !
- > Manage **distribution channels** !



## ■ Generic Competitive Strategies for MNCs in China



### COMMENTS

- > Local firms started **narrowing** the design & technology **gaps**.
- > Bring **the newest products** to win over the intense competition !
  - **Volkswagen** was compelled to **introduce its newest models**, when GM & other foreign car makers entered the local market with their latest models.)
- > How to **guard against technology spillovers** to local & other multinational competitors.
  - **Arrange** joint ventures with its foreign suppliers & certifying parts with acceptable quality !



## ■ How Can MNCs Win the Intense Competition?

### ❖ Flexible execution

- **NOT** get involved in **price wars**.
- Do **lab testing** & **marketing test** at the same time !
- **Decentralization** & **empowerment** of subsidiary employees give a **sense of ownership**.

### ❖ Leading the change

- Being a proactive part of change, **bring the newest**, & drive the change !

### ❖ Being an insider

- MNCs should be **an insider in the government's decision-making process** in order to act quickly !
- **Hyundai**: By sending a pool of talented **expatriate managers** for future operations to study at major **local Universities**, Hyundai built connections with important stakeholders in Chinese society.
- **GM**: “Every business has **a lawyer** & **every function**”.





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## ■ How Can MNCs Win the Intense Competition?

- ❖ China experiences many **social & environmental problems** in exchange for of **rapid economic growth**.
- ❖ China had **a command economy** from 1949 to 1978.
- ❖ The reforms of the 1980s → Create **a new managerial culture** granting **more autonomy** in decision making to SOEs.
- ❖ In the 1990s, the **separation of ownership & management** in SOEs was initiated with private ownership.
- ❖ **Social ties & political ties** are important, but they are contingent upon different settings.
- ❖ **Strategies** should be aligned with **varying external conditions**.



# The End of Today's Lecture



ご清聴有難う御座いました。

**Thank you so much !**

**Vielen Dank für Ihre Aufmerksamkeit !**

**Grazie mille !**

**Merci beaucoup !**

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