

# *Management in China*

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## **1. Introduction**

2. Chinese Business System

3. Foreign Direct Investment in China

4. Chang, S. J. & Park, S. H. (2012)

5. Conclusion

# Introduction



## Map of China



Source: World Bank.

## Basic data (2023)

**Population:** 1.41 billion.

**GDP:** US\$17.79 trillion.

**GDP per capita:** US\$12,614.

**GDP growth:** 5.2%.

**Life expectancy:** 78 years

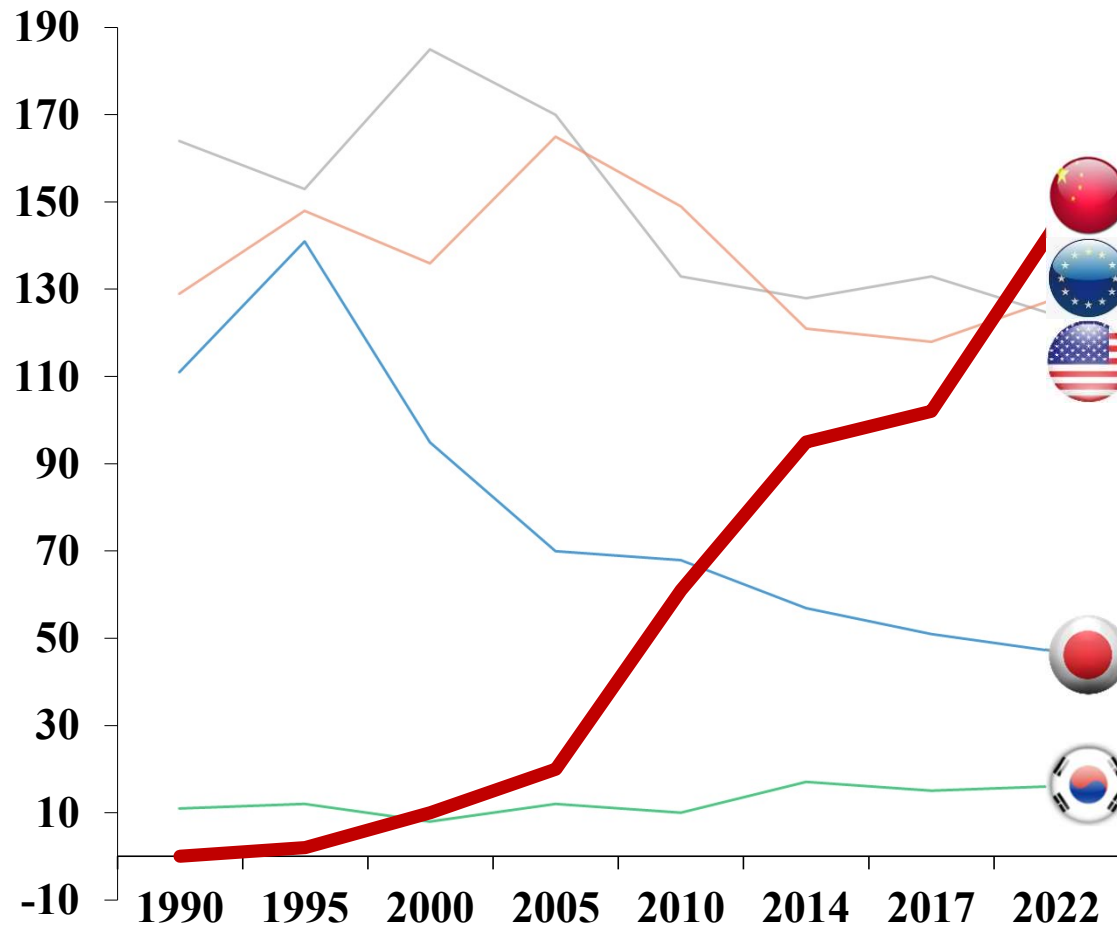
**Unemployment rate:** 4.6%.

**Inflation rate:** 0.2%.

# Introduction



## ■ Global Fortune 500, 1990-2022



Source: Fortune Global 500.

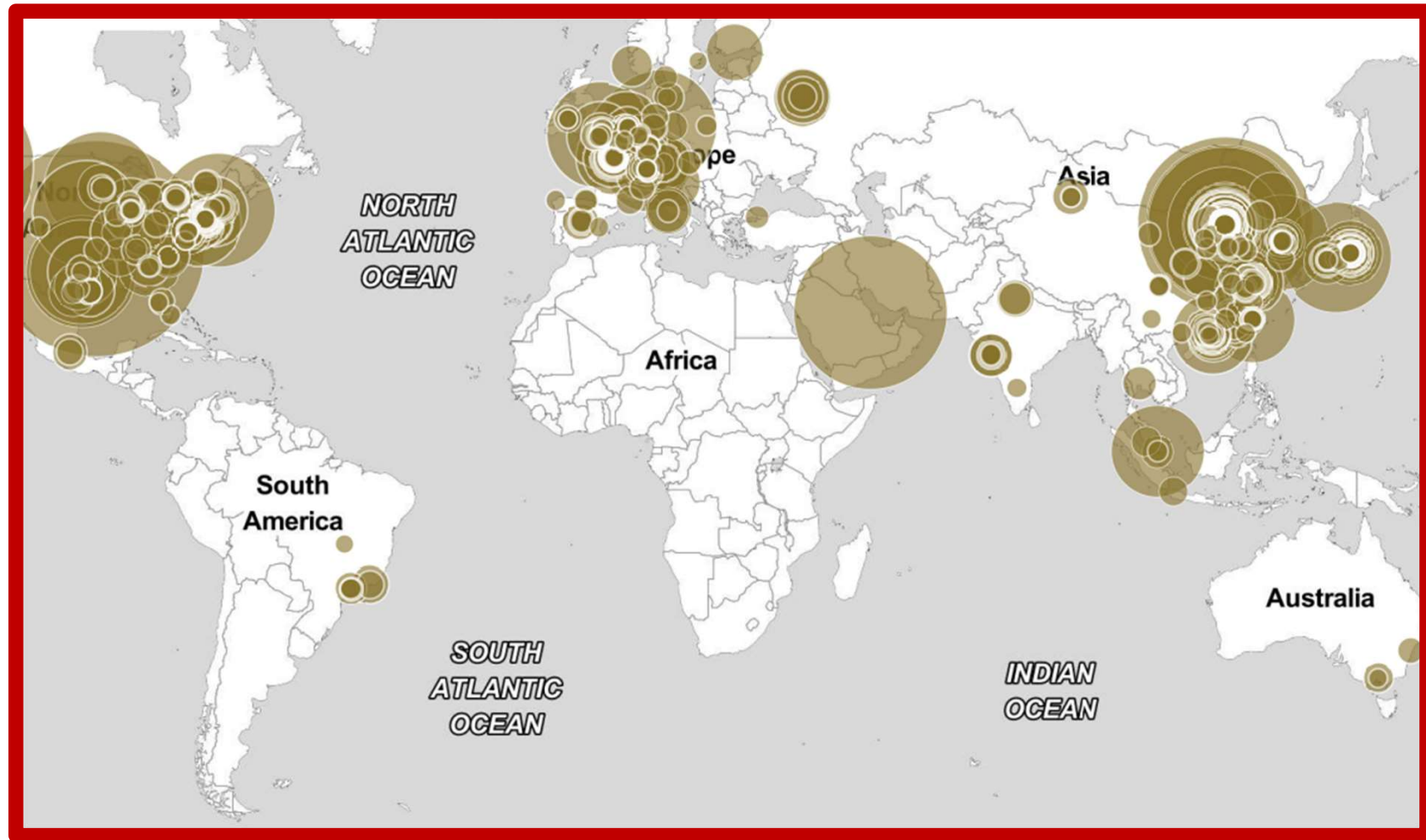
### KEY POINTS

- > 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

- > High levels of air, water & plastic **pollution**.
- > Biodiversity loss.
- > Creating illnesses.



### ❖ Social inequality

- > The disposable income of the **richest** 10% of families is **8 times or 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**.
- > Chinese scientists & engineers were trained in the **Soviet Union**.

## ■ 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.



## ■ Different Cultural Factors within Confucian Asia



### *Guanxi*

- > **Guanxi** occurs between two individuals & the **bond** that is created between the individuals is **one of obligation** to **exchange favours** (rather than a bond based on personal feelings or sentiment).
- > **Guanxi** often **connects people** who have very different ranks.
- > **Guanxi** is helpful for **getting things done**.



### *Wa*

- > **Wa** refers to **mutual cooperation & consensus** to achieve **group goals** & establish **group harmony**.
- > **Wa** is **NOT about the relationship** between individuals, as is the case with *guanxi*, **BUT** rather it is the **link between individuals & groups**.
- > **Wa** demands **strong group cooperation & trust**.



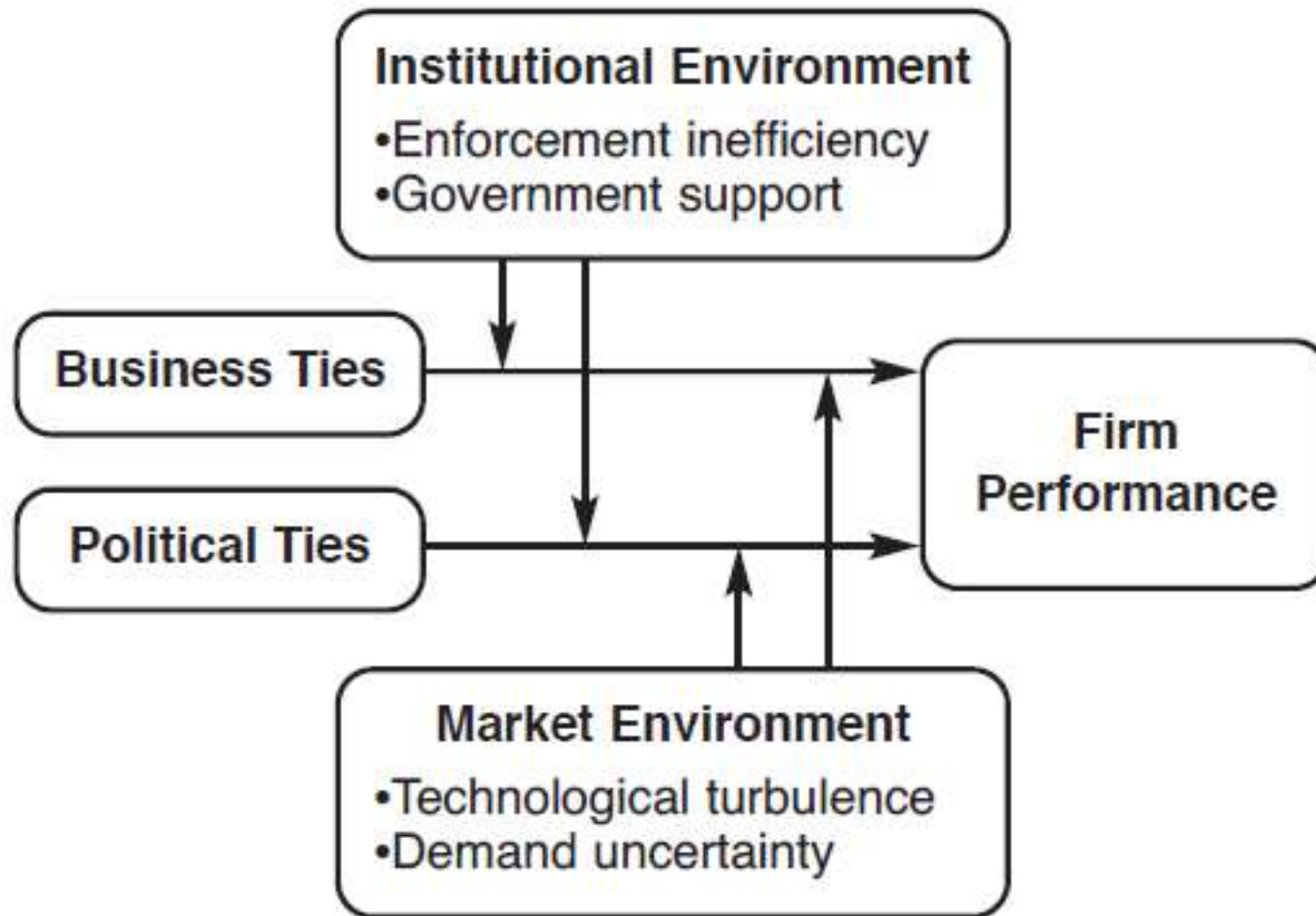
### *Inhwa*

- > **Inhwa** is loosely defined as **harmony** in Korea.
- > Based on the **Confucian principle** of **loyalty to parents & authorities**, **inhwa** focuses on the **subordinate** showing **loyalty to the superior**.
- > In exchange for that, the **superior** shows **protection & concern** for the **subordinate & its family** → **The superior-subordinate relationship**.

# Chinese Business System



## ■ Importance of ‘*Guanxi*’



Source: Sheng et



## ■ 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).



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

### 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**.

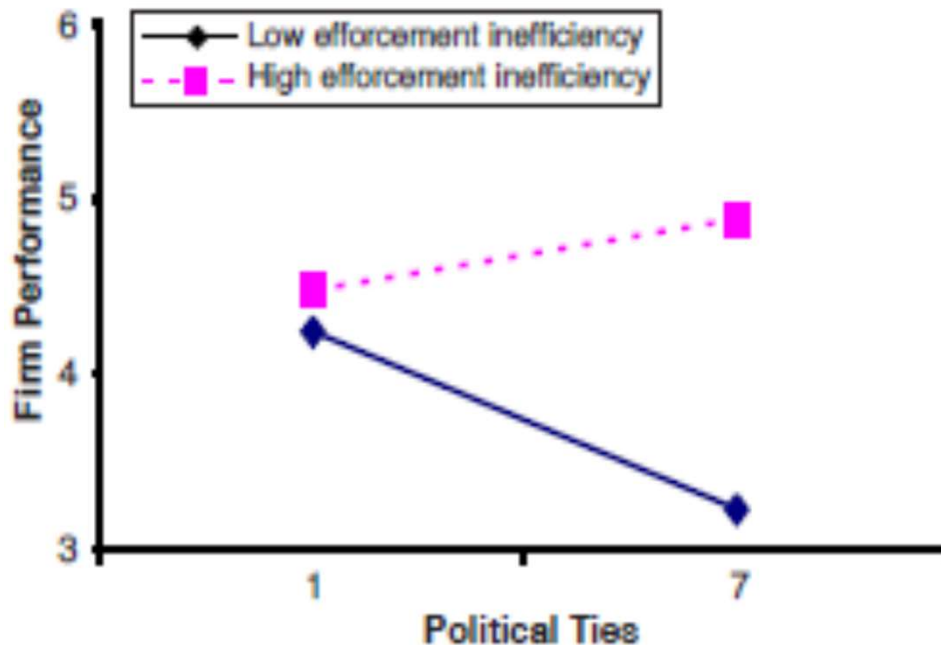
### Political Ties

- > ... **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**.

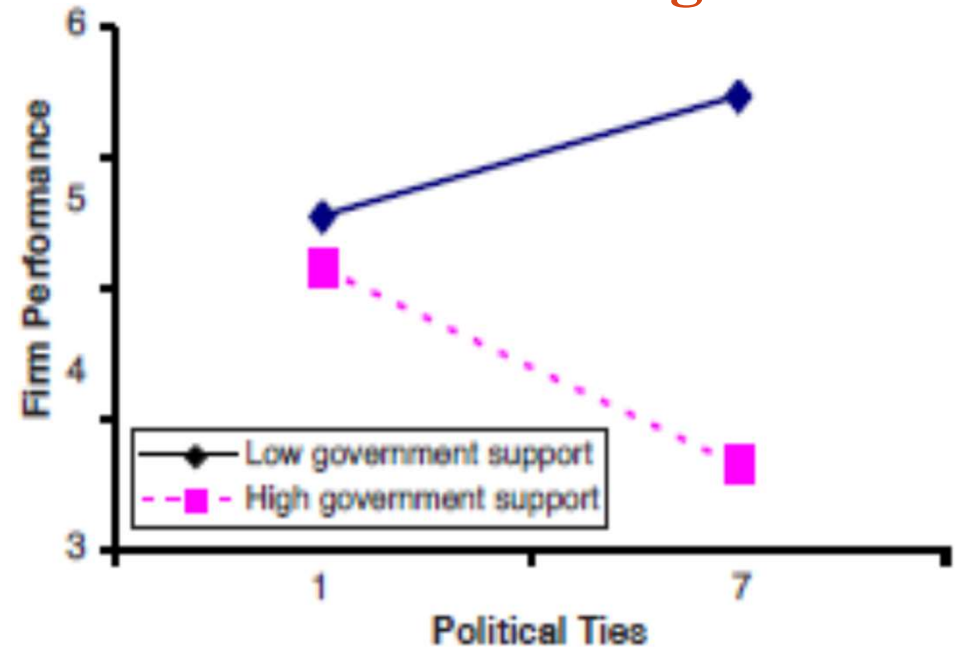
Source: Sheng et al. (2011: 2).



## ■ Contingent Effects of Institutional & Market Settings



- > Government involvement against **unlawful behaviour**.
- > Political intervention in **unfair competition**.
- > Political ties support transactions.
- > Efficient legal enforcement (↑) → the importance of political legitimacy (↓)



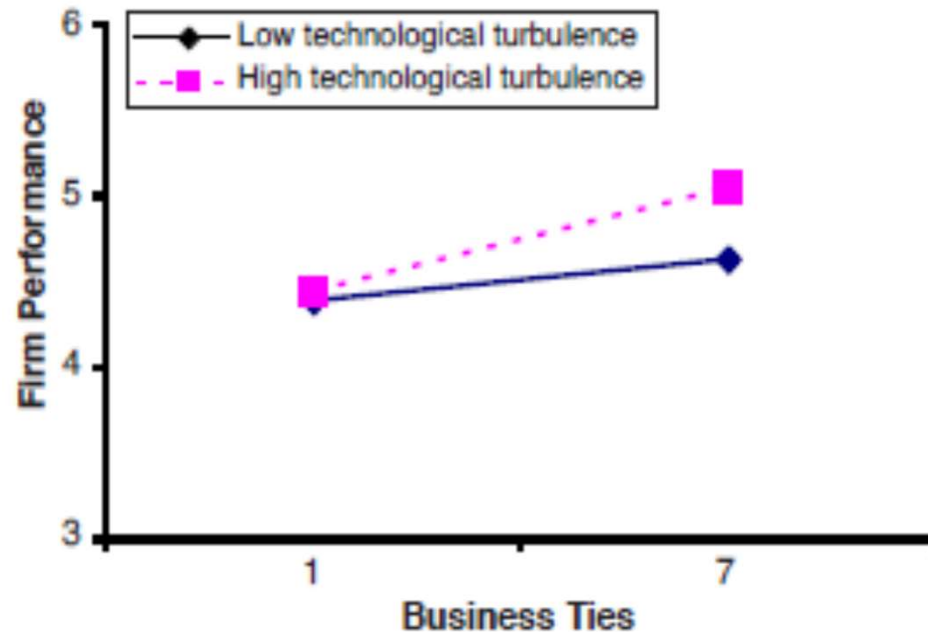
- > A supportive government (a **formal market institution**) provides **valuable policy** to all **firms** though **public channels**.
- > Scarce resources (*e.g.*, **tax breaks & subsidies**).
- > Formal government support reduces the need for relying on informal social ties.

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

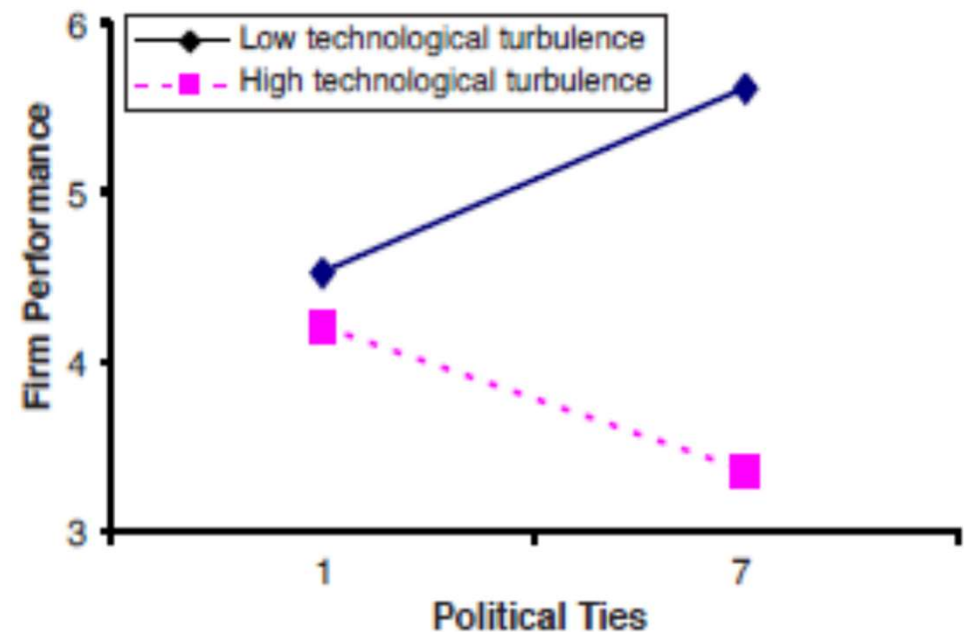




## Contingent Effects of Institutional & Market Settings



- > **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).



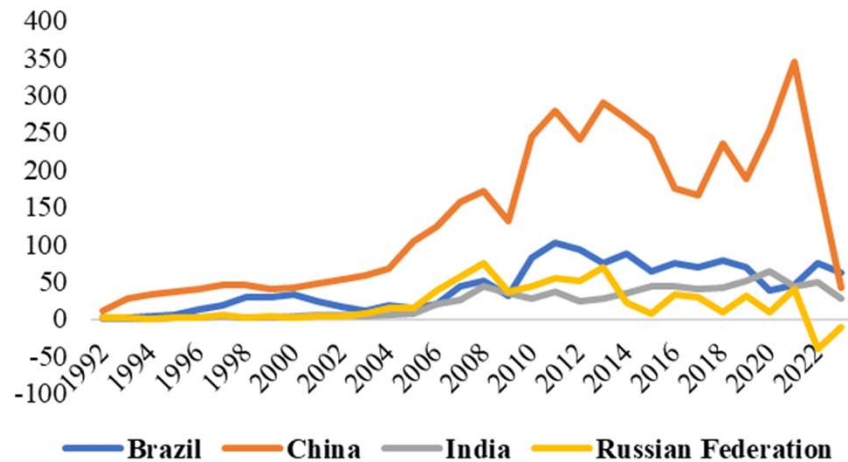


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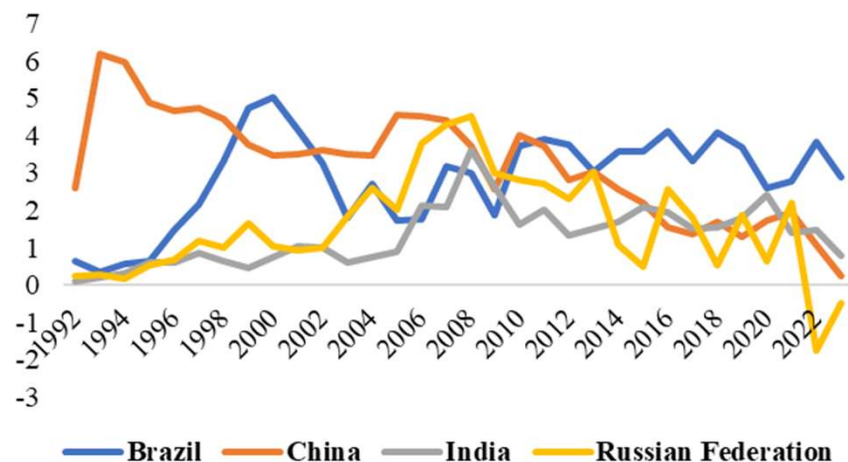
# Foreign Direct Investment in China



FDI Inflows (Billions of US\$)



FDI Inflows (% of GDP)



## □ 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%
South Africa	5.0%
Saudi Arabia	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%

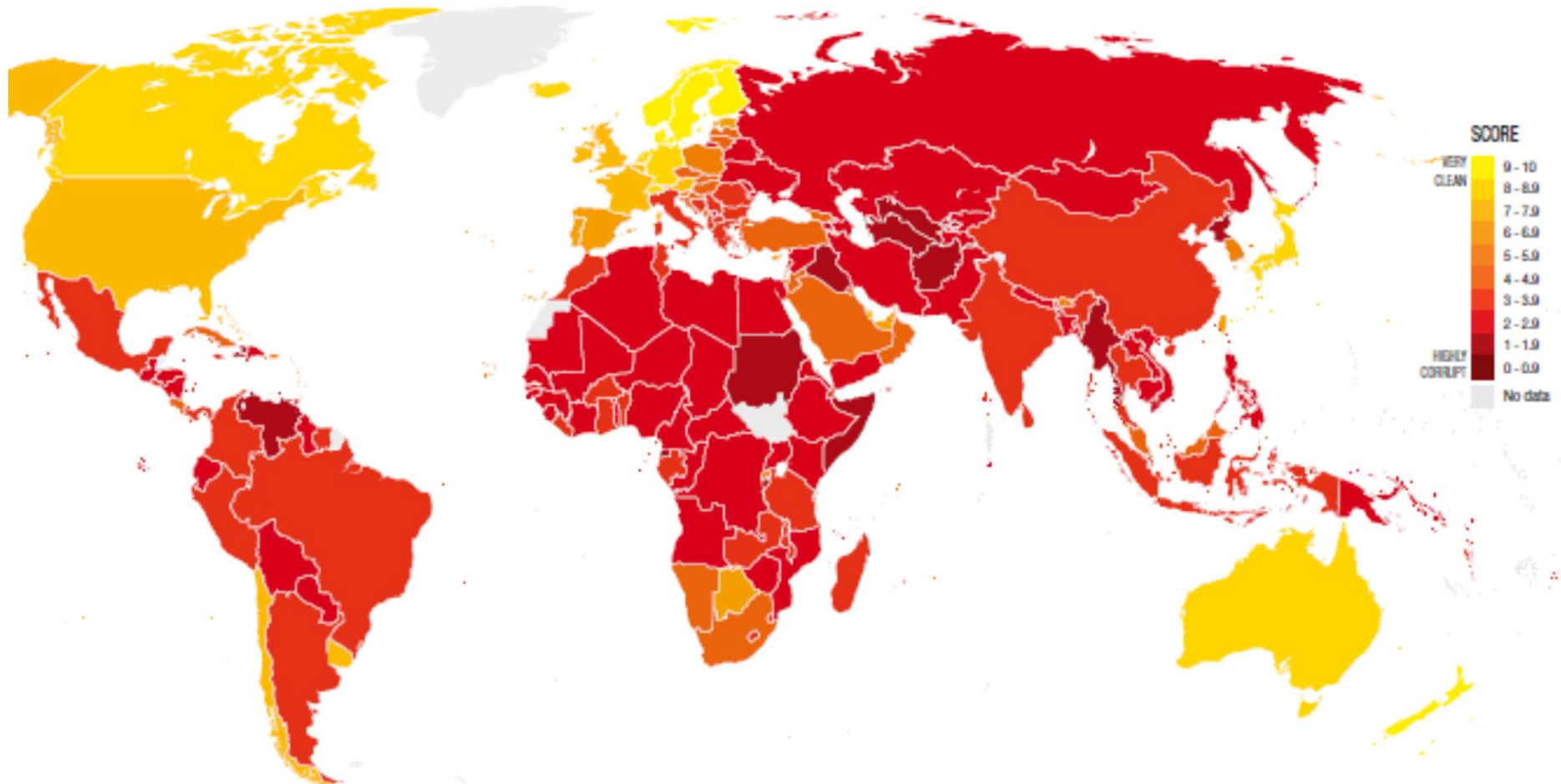
SOURCE: PWC MODEL ESTIMATES

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



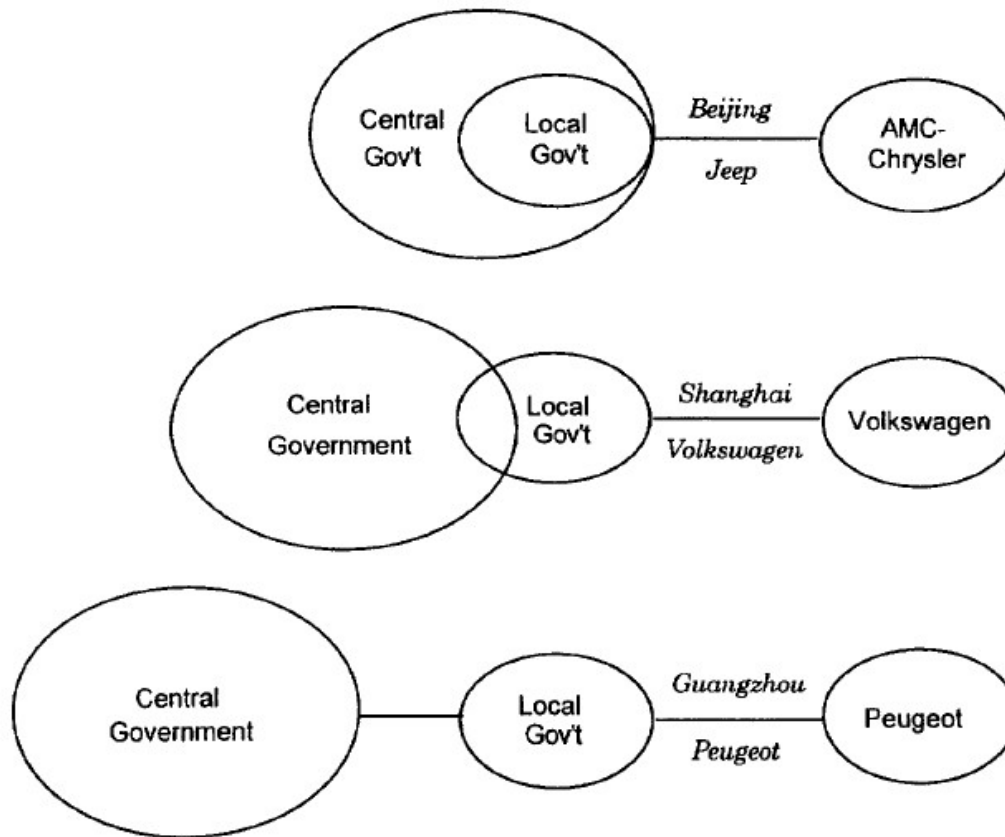
Source: Transparency International.



# Foreign Direct Investment in China



## ■ Different Government-MNE Relationships



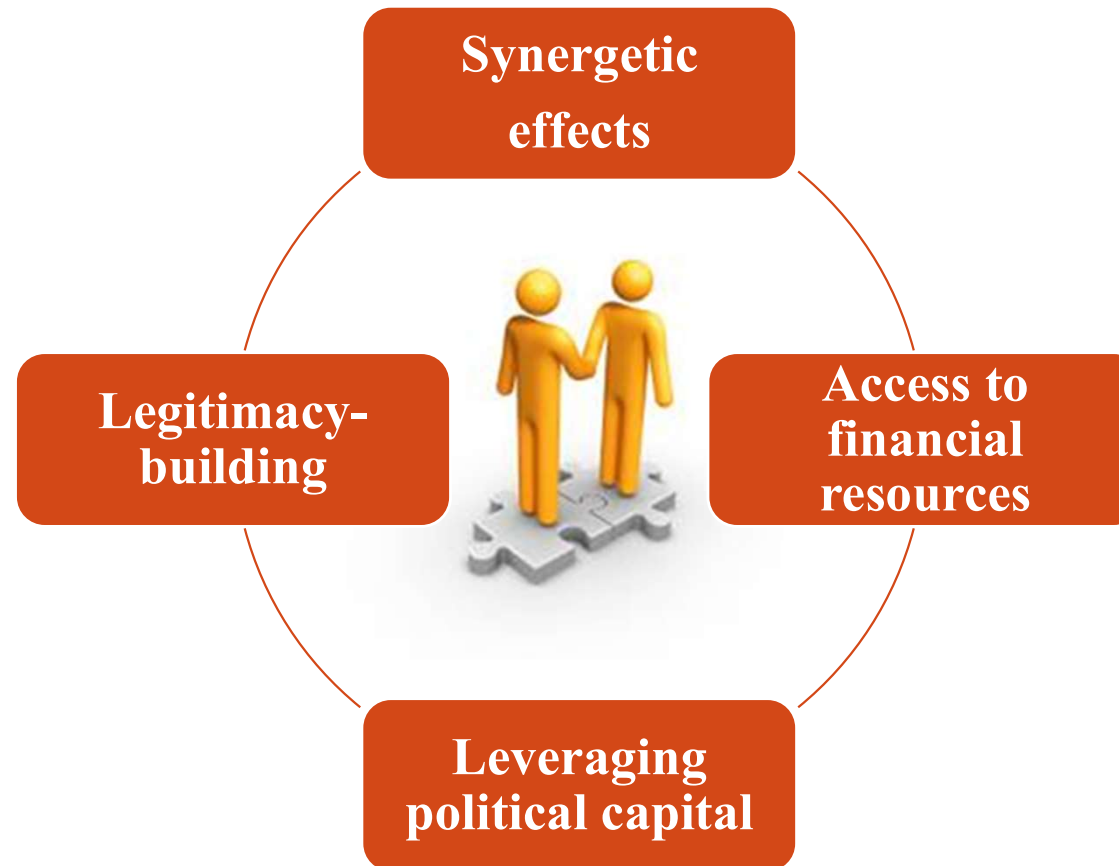
Source: Peng (2000: 160).

### 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



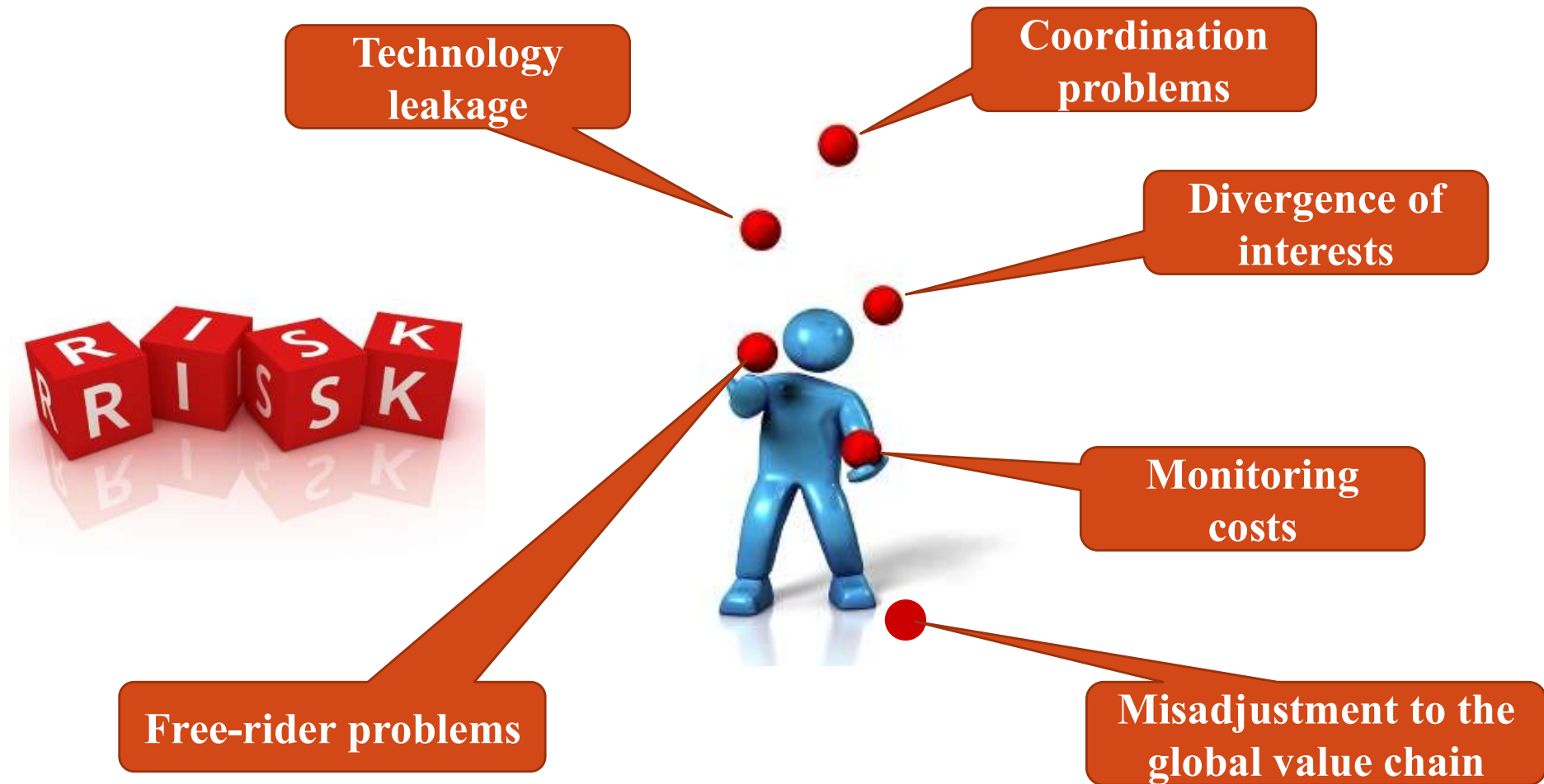
## ■ Benefits of an International Joint Venture (JV)



# Foreign Direct Investment in China



## ■ Hidden Costs of an International Joint Venture (JV)





## ■ 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

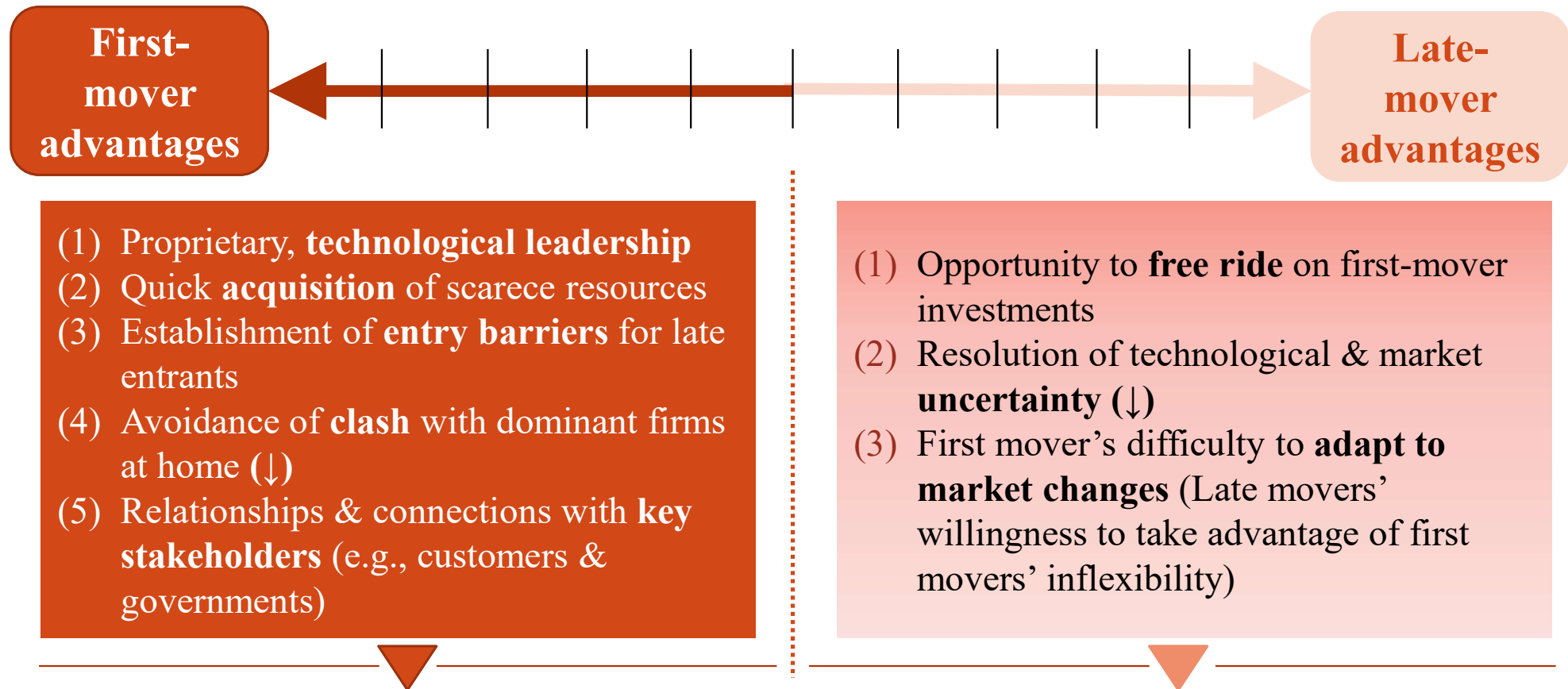
- Combine WOS production operations with JVs that sell & market products (e.g., Motorola in Tianjin).
- Consider a JV & a WOS as a natural sequence.



# 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 2030, **city dwellers** will account for **75%** 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 business 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-creating** (=adding) activities to China.
  - **4 stages**: (1) Setting up **manufacturing facilities**→(2) Making China as a **sourcing location**→(3) Integrating **China facilities into global production networks**→(4) Making **China as a key part of value chains**
  - Moving some crucial 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 burst of the US property bubble, Asian economies remained **unaffected** (**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**.





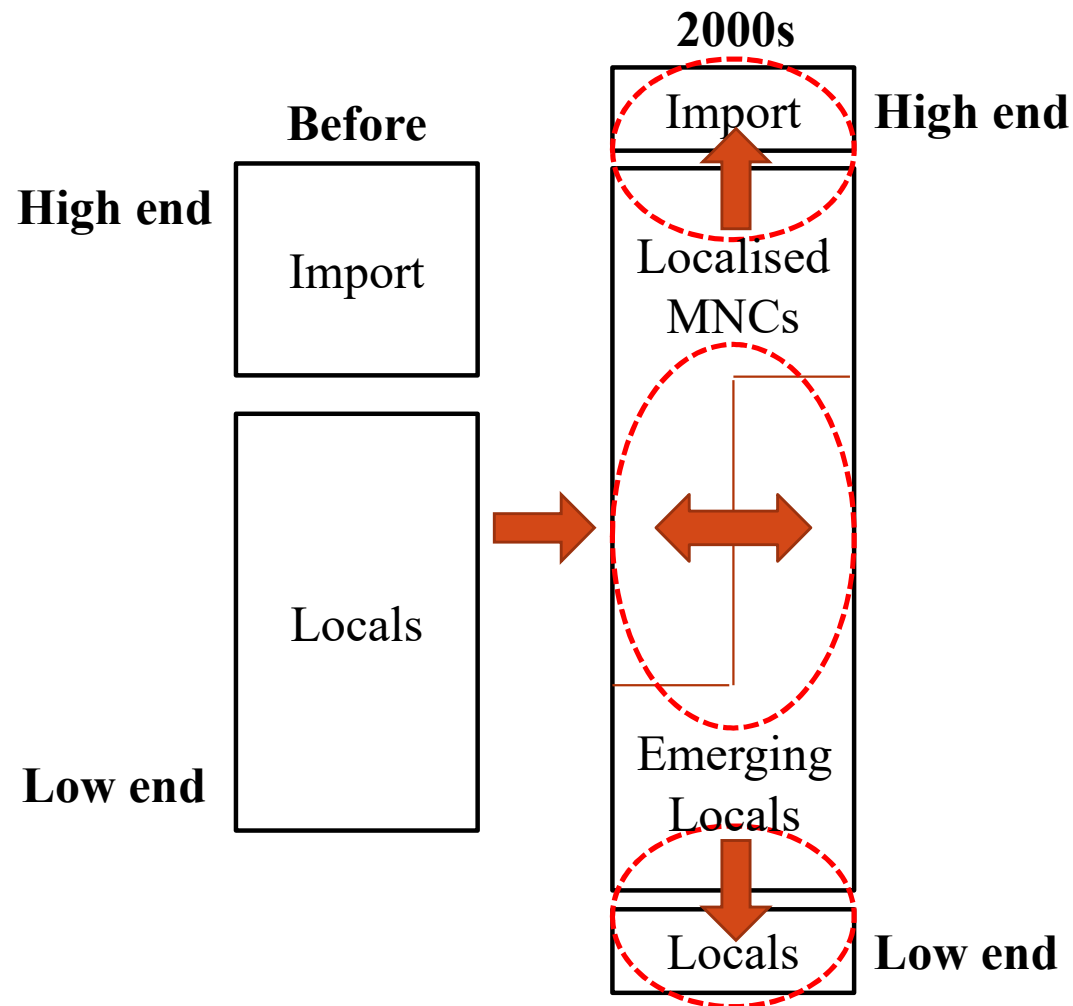
## ■ China's Market Environments

- ❖ Despite the burst of the US property bubble, Asian economies remained **unaffected** (**China**: > 9% growth in 2011).
- ❖ **China** has witnessed **noticeable changes** in the competitive environment.
- ❖ “It is necessary to understand **local firms** that will be potential **competitors in the global marketplace!**”
  - **Lenovo** in personal computers
  - **Hair** in consumer electronics
  - **Geely** in cars (from local players to global players)
- 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

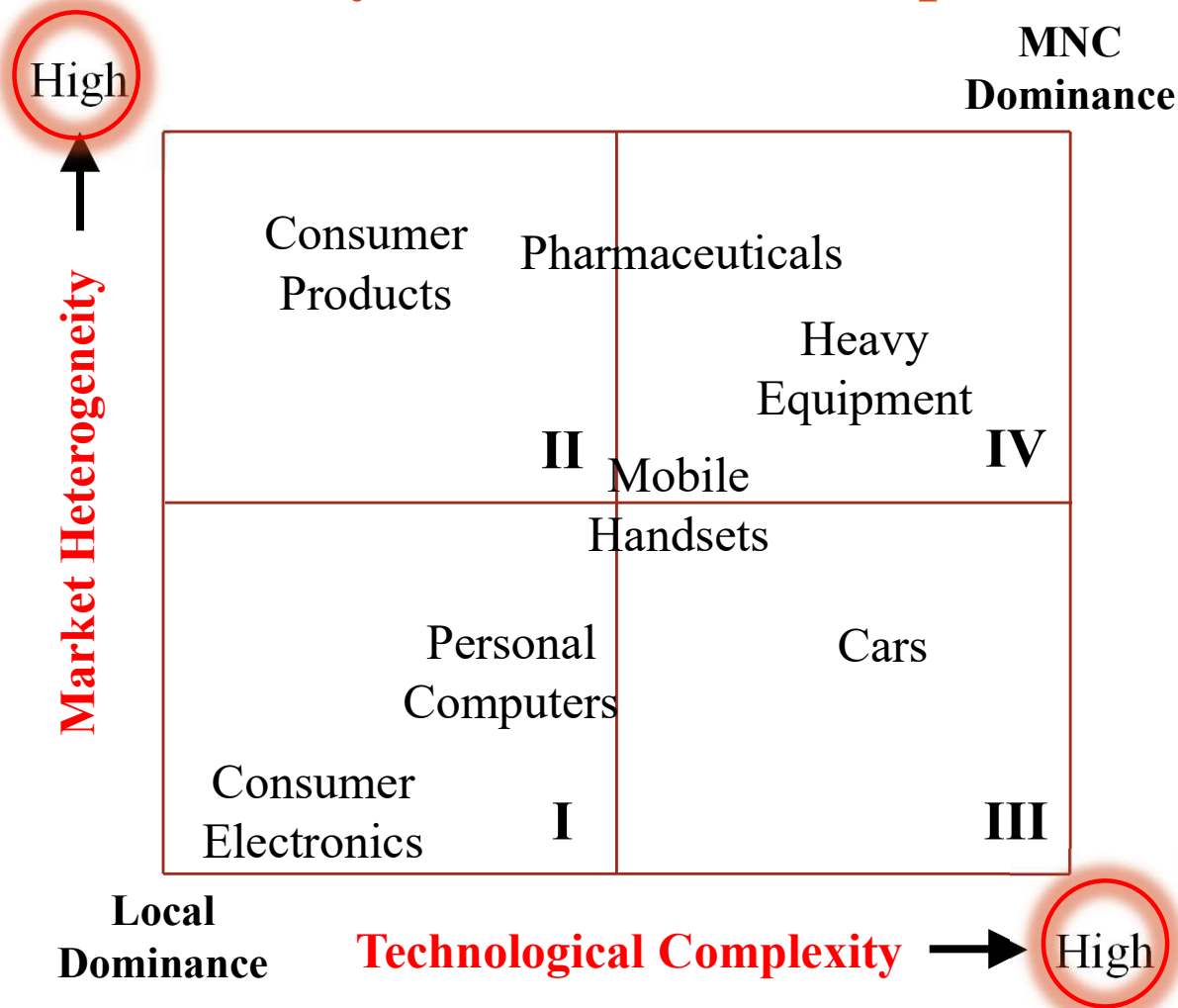


### COMMENTS

- > **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** vs. **Emerging locals**



## Industry Variation in Competitive Dynamics

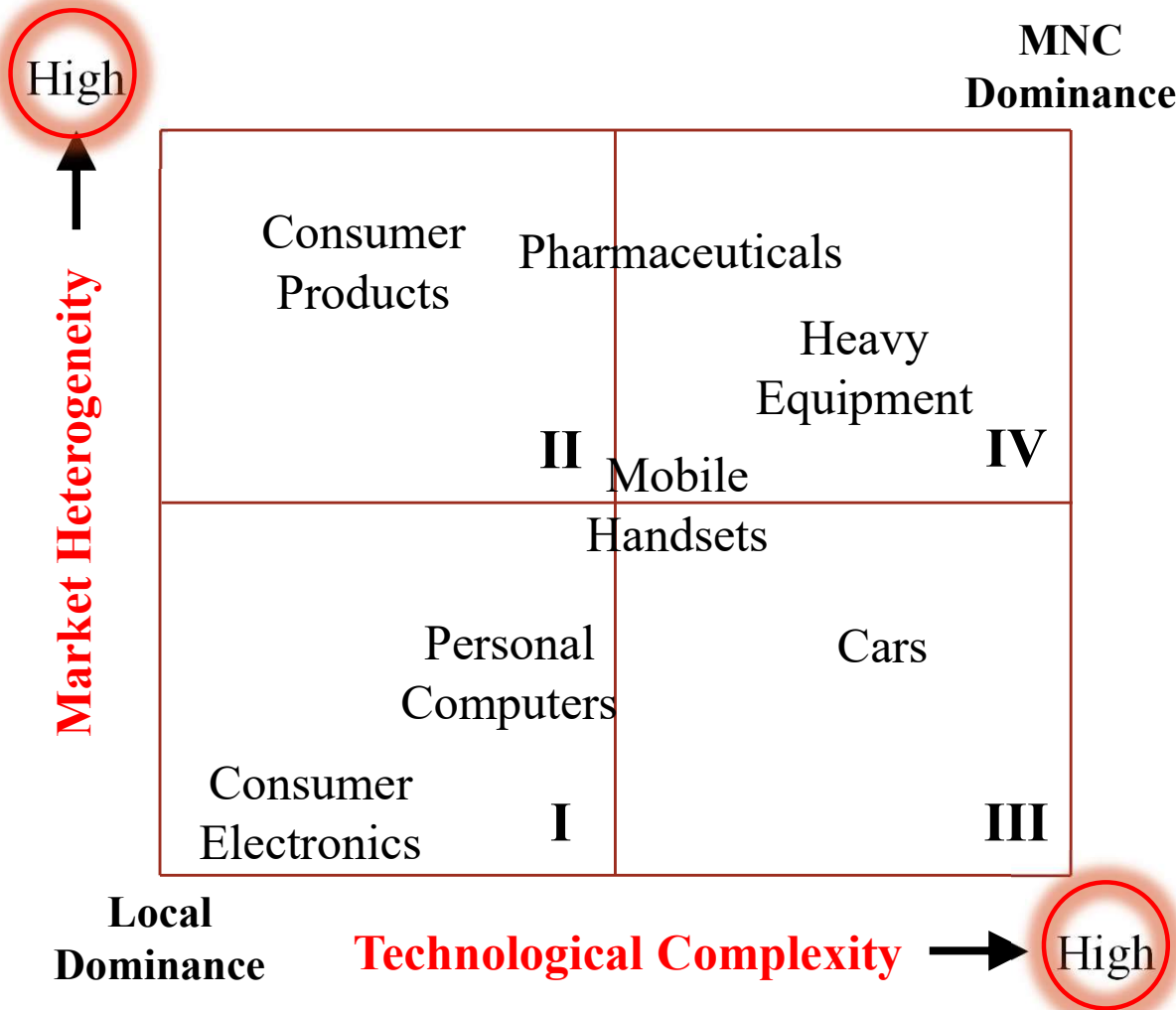


### COMMENTS

- > **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.

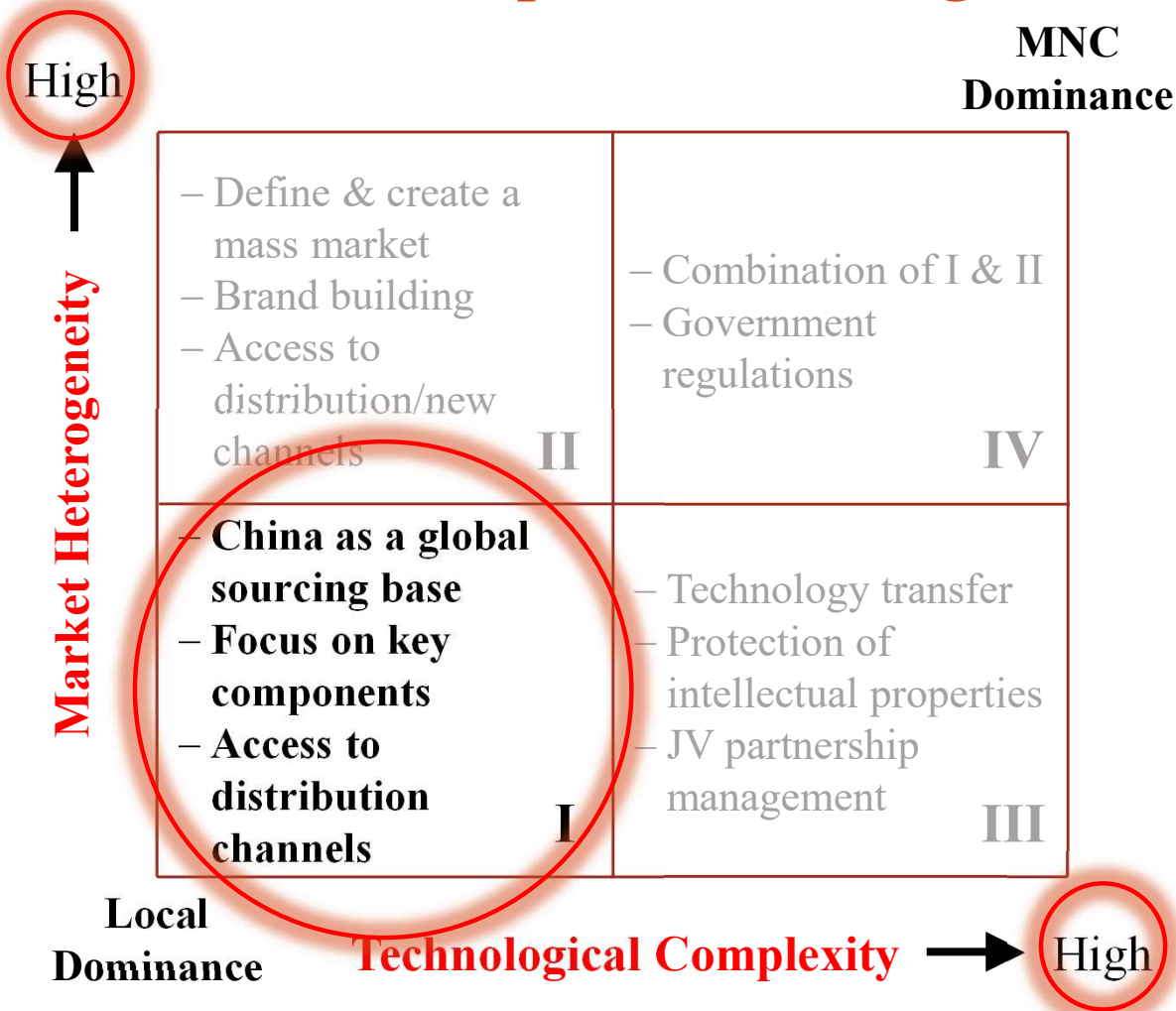


## ■ QUESTION: How to Compete against Emerging Locals?





## ■ Generic Competitive Strategies for MNCs in China

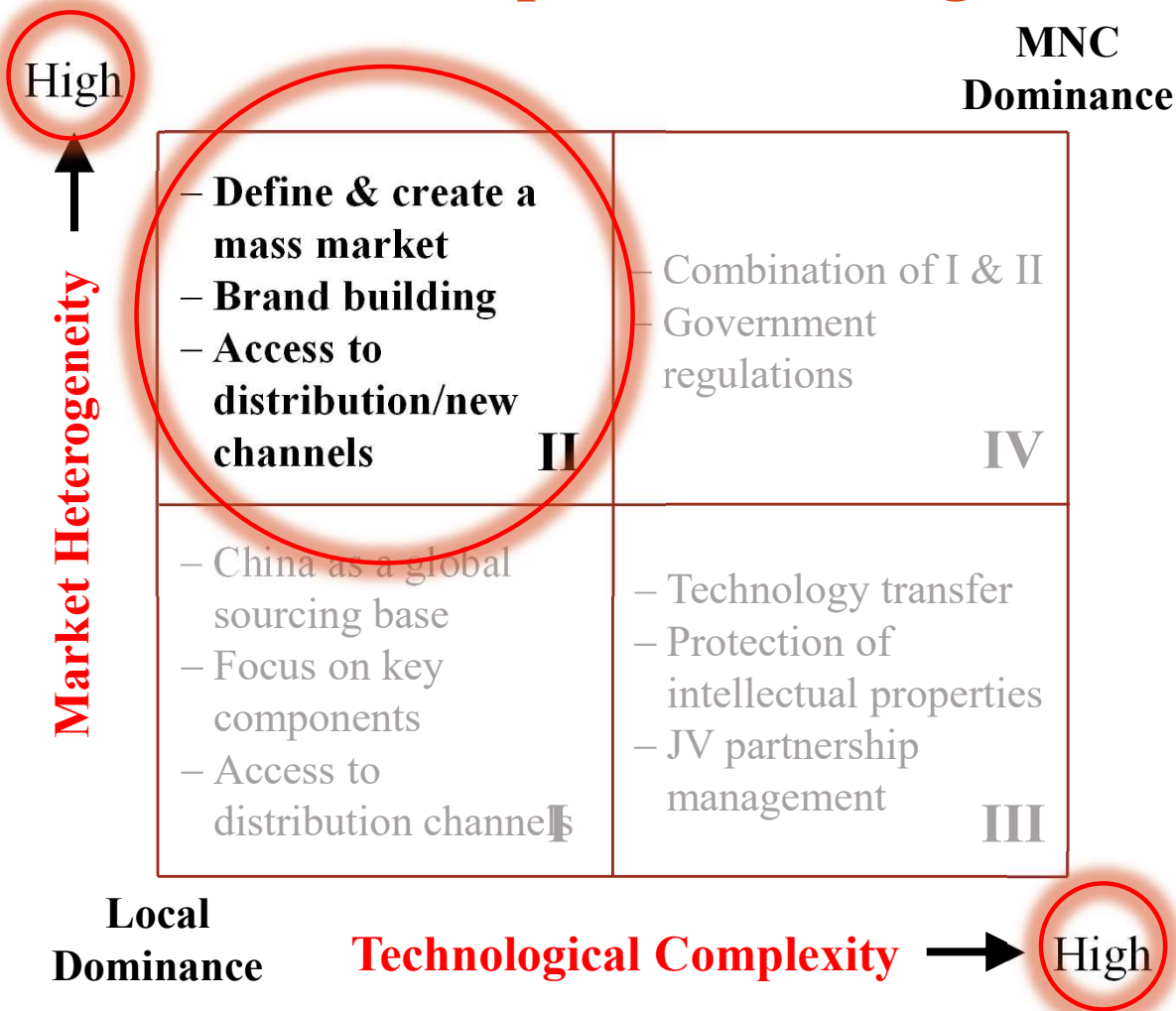


### COMMENTS

- > **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 ALSO 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

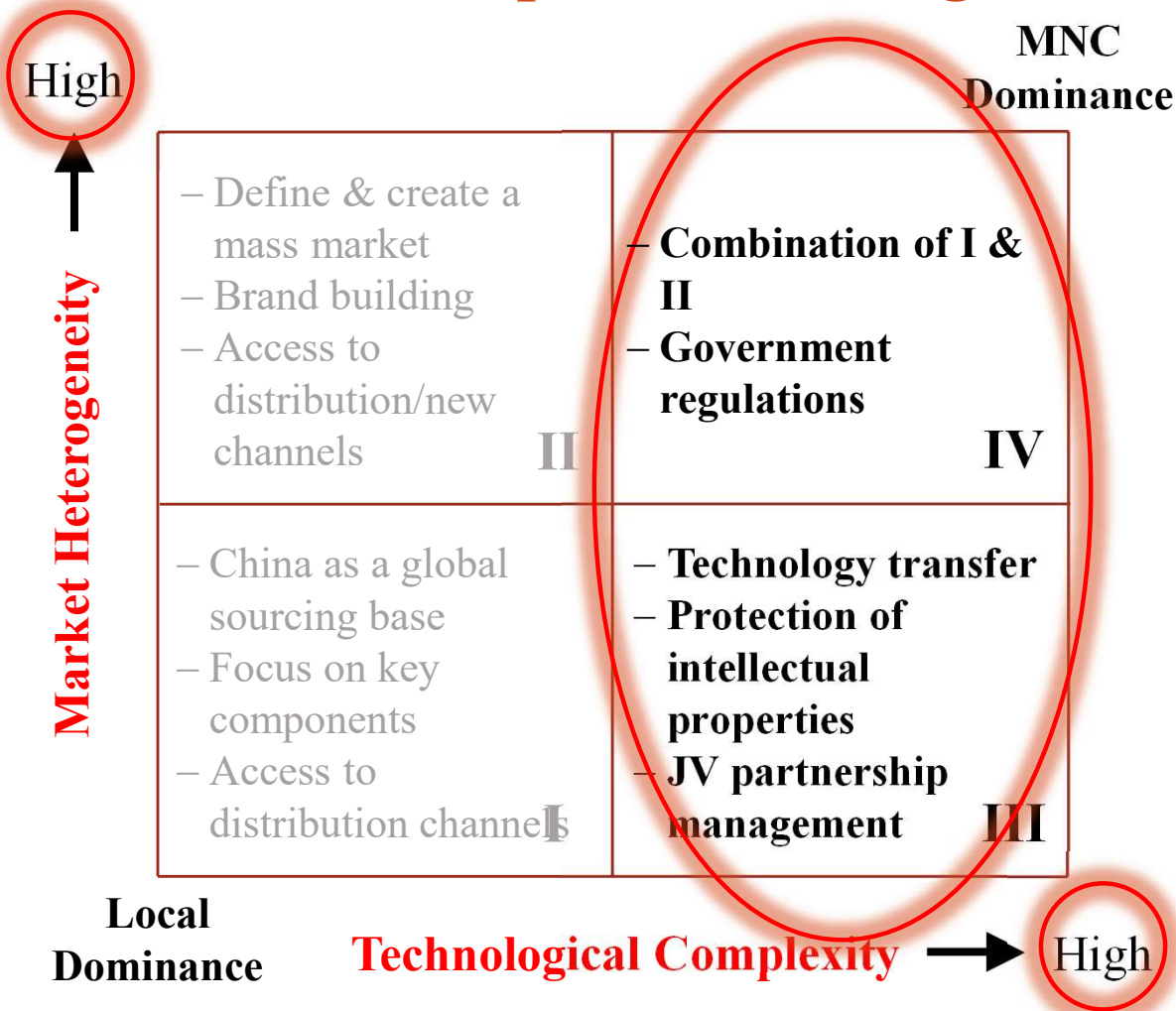


### COMMENTS

- > “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**: Employees' motivation (↑)

### ❖ Leading the Change !

- Drive the change by **bring the newest products, services & business models**.

### ❖ 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**.
- **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**.
- ❖ **1949-1978**: China had **a command economy** from 1949 to 1978.
- ❖ **The 1980s**: The reforms created **a new managerial culture** granting **more autonomy** in decision making to SOEs.
- ❖ **The 1990s**: The **separation of ownership & management** in SOEs was initiated with private ownership.
- ❖ **Social ties & political ties** are important, but their positive impacts 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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