

**INTERNATIONALISATION OF CHINESE  
FIRMS: STRUCTURAL LIMITATIONS POSED  
BY THE GLOBAL BUSINESS SYSTEM,  
1999-2015**

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**CHITRA NEGI**



**Chinese Studies Division  
Centre for East Asian Studies  
School of International Studies  
JAWAHARLAL NEHRU UNIVERSITY  
New Delhi – 110067**

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जवाहरलाल नेहरू विश्वविद्यालय  
CENTRE FOR EAST ASIAN STUDIES  
SCHOOL OF INTERNATIONAL STUDIES  
JAWAHARLAL NEHRU UNIVERSITY  
NEW DELHI- 110 067 (INDIA)

Phone : 91-11-2670 4346  
FAX : 91-11-2670 4346

Date: 25.07.2016


DECLARATION


I declare that the dissertation entitled “**Internationalisation of Chinese Firms: Structural Limitations Posed by the Global Business System, 1999-2015**”, submitted by me for the award of the degree of **Master of Philosophy**, is my own work. The dissertation has not been previously submitted for any degree of this University or any other university.

  
Chitra Negi

CERTIFICATE

We recommend that this dissertation be placed before the examiners for evaluation.

  
Professor Srikanth Kondapalli

(Chairperson)  
  
Centre for East Asian Studies  
School of International Studies  
Jawaharlal Nehru University  
New Delhi-110067

  
Professor Varaprasad S. Dolla

(Supervisor)  
  
Centre for East Asian Studies  
School of International Studies  
Jawaharlal Nehru University  
New Delhi - 110067

*Dedicated to My Parents*

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# Abbreviations

SOEs	State-owned Enterprises
M&A(s)	Mergers & Acquisitions
OFDI	Outward Foreign Direct Investment
MNCs	Multinational Corporations
UNCTAD	United Nations Conference on Trade and Development
ICF	Internationalisation of Chinese Firms
RBV	Resource Based View
JVs	Joint Ventures
CPC	Communist Party of China
MOFERT	Ministry of Foreign Economic Relations and Trade
SAFE	State Administration of Foreign Exchange
CITIC	China International Trust and Investment Corporation
PRC	People's Republic of China
UN	United Nations
GNP	Gross National Product
WTO	World Trade Organization
IMF	International Monetary Fund
WB	World Bank
MFN	Most Favored Nation

SCRES	State Commission for Restructuring the Economic System
R&D	Research & Development
MOFTEC	Ministry of Foreign Trade and Economic Co-operation
FYP	Five Year Plan
GATT	General Agreement on Tariffs and Trade
NTBs	Non-tariff Barriers
FDI	Foreign Direct Investment
HTML	Hypertext Markup Language
OECD	Organisation of Economic Co-operation and Development
WIPO	World Intellectual Property Report
IRI	Industrial Research Institute
NSB	National Science Board
CCPIT	China Council for the Promotion of International Trade
ICT	Information & Communications Technology
BOE	BOE Technology Group
SAIC	Shanghai Automotive Corporation Limited
IBM	International Business Machines
NPC	National People's Congress
COO	Country of Origin
B2B	Business-to-Business

# Chapter 1

## Introduction

### 1.1 Background

China's national economy is globalising dramatically at the corporate level. Chinese firms of both types of ownership, i.e. the State-owned enterprises (SOEs) and private firms are rapidly internationalising their operations. The conspicuous expansion of Chinese firms through joint ventures, overseas listings, mergers & acquisitions (M&A(s)), Greenfield investment, and other forms of outward foreign direct investment (OFDI) has led to the emergence of the phenomenon of *Chinese Multinational Corporations* (MNCs).

Chinese firms have joined the ranks of the largest and most successful corporate giants in the world. The number of Chinese companies in the "Global Fortune 500," has already overtaken Japanese and trails only the US. The number of Chinese firms based in China, including Hong Kong, in the 2015 Global Fortune 500 list stands at 98. According to the World Investment Report 2015 published by the United Nations Conference on Trade and Development (UNCTAD), investments by Chinese MNCs grew faster than inflows into the country, reaching a new high of \$116 billion in 2014.

Chinese MNCs such as, Haier, TCL, Huawei, Xiaomi, Lenovo, Tencent, Alibaba have become some of the internationally recognisable Chinese brands. International business community, international governments and the academic community are increasingly being drawn towards this phenomenon of international expansion of Chinese firms.

### 1.2 Literature Review

Based on the level of analysis, the literature on internationalisation of Chinese firms (ICF) is divided into four main sections: firm-level; industry level; transaction-specific and institutional level. Theoretically, first three levels of analysis belong to the *resource* –

*based view* (RBV) of the firm and the fourth level, as the name suggests, is associated with the domain of *institutional theories* (Deng 2012:413)

Different scholarly fields have contributed to the literature, such as business & strategic management, cross-cultural studies and area studies, all aimed at understanding China's rapidly increasing involvement in the global business, in terms of its motivations, patterns and mechanisms. Given below is a brief literature review with the main findings on ICF undertaken at various levels of analysis.

### ***1.2.1 Firm level analysis***

The analysis of ICF at the firm level represents the resource based view of the firm (RBV) and assumes that the engagement of Chinese firms in international activity is driven by the strategic motive of enhancing the value and competitiveness of firms, which in turn is dependent on firm-specific factors such as ownership, company size, international experience, and export intensity. The RBV of the firm is also one of the predominant theories used in the explanation of ICF.

- i) **Firm size** – The scholars who examine ICF at the firm level through the firm-specific factor of 'firm size,' which is measured by sales, assets, or market share, draw a positive relationship between the size of the firm and its ability to internationalize. For instance larger Chinese firms are more internationally active and firm size is an important driver of particular forms of ICF. These scholars evidently consider firm size a proxy for resources and thus consider it a measure of a firm's ability to internationalize. They also argue in similar vein that 'firms with greater financial and intangible resources are more likely to engage in international acquisitions or establish Greenfield investment projects alone and compete on a global scale, while those with fewer resources are forced to work collectively with others or rely upon network assets' (Deng 2012:6)
- ii) **Firm types and ownership** – Ownership of a firm and its level of diversification is also an important firm specific factor used in explaining ICF. On the basis of these two factors, Chinese firms have been characterized into SOEs (including transnational agents and commissioned specialists) and non-SOEs (including

niche entrepreneurs and world-stage aspirants). The two firm groups internationalize in a unique different way. Differences between SOEs and non-SOEs are also discussed in terms of their overseas investing behaviors. It is argued that the SOEs face higher country regulative institutional barriers as compared to those faced by non-SOEs which make them choose joint venture (JV) as the preferred mode of entry in order to exchange ownership for legitimacy in the host country. However, the state ownership is also seen as a firm-specific advantage for Chinese SOEs, since they are most likely to get speedy government approval for foreign investments and favorable state incentives and support from the home government. It is also argued that the decision to venture abroad by non-SOEs or private firms is shaped to larger extent by their desire to transcend the home-based limits to their growth posed by the state-intervention in industrial policy and the state support for monopolistic presence of large SOEs in certain sectors (Deng 2012:6-7).

**iii) Resources and capabilities** – This firm-level factor examines the impact of ownership advantages possessed by Chinese firms upon ICF. It is argued that Chinese firms enjoy ownership advantages which are mainly ‘network-based’ while it is also pointed out that these advantages are also ‘home country based.’ These ‘relational assets’ also provide an insight into the investment motives (i.e. to redress the competitive disadvantage) and intra-regional expansion strategy of Chinese firms (Deng 2012:7). It is claimed that in emerging economies networks form significant substitution for external markets. For instance, home country network ties prove really important in facilitating international venturing by Chinese firms. Network helps Chinese firms in transitioning institutional environment. Institutional relatedness is considered an essential asset for Chinese firms as it acts as a means to mitigating ‘information asymmetry’ overseas. Network assets are particularly helpful to small-to-medium sized Chinese firms in successfully venturing abroad early or at a rapid pace, as these firms are normally weak business organizations but with strong, locally based social networks (Deng 2012:7).

- iv) **Export intensity** –this firm-level factor explores the relationship between export intensity and ICF. It is argued that higher level of exports by Chinese firms is more likely to make them adopt an ongoing relational approach towards international expansion (Deng 2012:7).
  
- v) **International experience** – The firm-specific factors such as a firm’s international orientation and experience is also used to understand what drives ICF. It is argued that as a firm accumulates more and more international experience it is more likely to have large cross-border investments. International experience is also considered a proxy for constructs such as a firm’s visibility, reputation, credibility or intangible assets; all of which have been linked to the success of ICF’ (Deng 2012:7) The ‘international orientation of top managers’ is also said to be a driver for ICF. It is argues that managerial orientation may be more important than the number of other firm-specific resources in facilitating strategic decision such as OFDI.’ For instance, Chinese firms tend to use top managers’ domestic mindsets to scan international opportunities and a series of high-profile M&A deals by Chinese firms are influenced by the subjective and cognitive elements (Deng 2012:7).

### ***1.2.2 Industry Level Analysis***

The analysis of ICF at the industry level explains international activities of Chinese MNCs by concentrating on issues of industry size, structure, policy and competition.

- i) **Industry structure** – It is argued that the relative positions of firms within an industry also define their capability to engage in international activities. Domestic leading firms such as Haier, TCL and Lenovo are more likely to internationalize. Further, this argument is also supported by the fact that it is the highly profitable SOEs with officially sanctioned monopoly in major industries that have emerged as the biggest companies in China by their OFDI (Deng 2012: 8) .
  
- ii) **Industrial sectors and policy** – It is argued that firms in different industrial sectors show different international orientations, particularly for emerging economies (Deng 2012:8).

**iii) Industry Competition** – Examining the impact of domestic competition on Chinese firms’ international activity, it is argued that economic market liberalization plays a positive role in stimulating Chinese firms to pursue OFDI. However, this argument is countered by claims that it is to escape the intense domestic competition that leads to home market saturation and ruthless price wars that stimulates Chinese firms internationalize. Another way in which industry competition impacts the internationalisation process of Chinese firms is in the form of a tendency to simultaneously compete and co-operate for gaining favorable political outcomes or to offset the late-mover disadvantages in the global marketplace. Competitors regularly closely watch each other’s international patterns (Deng 2012:8-9).

### ***1.2.3 Institutional Level Analysis***

Institutional level analysis of ICF has explored the influence of formal rules and informal cultural norms and values in both home and host country upon the international activities of Chinese firms.

**i) Home country institutional context** – Considering the extent of state control over the Chinese economy it is argued that the institutional environment, particularly the role of the Chinese government, has had a strong influence over ICF. For this reason, the investment motivations of Chinese firms are also explained by focusing on Chinese government characteristics as it is believed that the latter may have laid the foundation of ICF. For instance, the strong government support for international acquisitions, including monetary support from state-controlled banks has helped many Chinese MNCs in building strong international competitive bases. Similarly, research also shows that Chinese OFDI till early 1990s was directed by the government to support exports, securing resource supply and acquiring high technology. In further support of the institutional role in setting the goals of ICF it is argued that China’s preference to invest in developing countries through SOEs indicates a unique model of investment behavior that arises from state policy. However,

some Chinese firms may face negative discrimination and regulatory constraints in China's institutional context defined by a transitional socialist market system. As a consequence non-SOEs invest overseas to escape the restrictive business environment in China (Deng 2012: 416-417).

**ii) Host country institutional context –**

According to the institutional theory, in the wake of highly restrictive host country regulations and cultural barriers, attainment of institutional legitimacy becomes an important concern for internationalising firms. This concern in turn has shaped ICF in various ways. It is argued that Chinese MNCs prefer acquisition of existing operations as the entry mode while attempting to venture into unfamiliar markets in another region because such an entry mode facilitates risk minimization, experience building and major subsequent investments in the host region. It is further argued that Chinese firms more likely seek investment opportunities in host countries that resemble their home environment as the experience of operating in a highly regulated and controlled domestic environment equips them with the special ownership advantages needed to be competitive there. Overall, Chinese firms while investing abroad adjust their internationalisation strategies to attain regulative and normative institutional legitimacy in host countries and simultaneously to comply with the rules set by the Chinese Government'. These strong dual impacts from both the host and home-country institutional environments are said to make Chinese OFDI unique in nature (Deng 2012: 417).

**iii) Cultural or other informal institutional factors –** Exploring the relationship between cultural factors in host countries and ICF it is claimed that more familiar cultures in host countries play a crucial role in the promotion of Chinese OFDI. It is shown in several studies that in earlier phases of internationalisation, Chinese firms show a preference for conducting OFDI in host countries containing ethnically based social networks. This variable of cultural proximity as a significant factor in ICF is also considered constant over time (Deng 2012:421).



#### ***1.2.4 Transaction-specific analysis***

Ad hoc and project or issue specific transactional factors also drive ICF, for instance, the importance of an investment project to the company is cited as a critical factor behind internationalization. It has been proved in several studies that Chinese firms gauge their international action largely by estimating its net impact on its competitive performance and strategy. For instance when the cost of crossing China's provincial borders exceeds the cost of crossing international borders, Chinese firms will internationalize at a relatively early stage of development (Deng 2012:9).

### **1.3 Definition**

The study operates at both levels of analyses i.e. the RBV as well as the institutional level. It traces the emergence of ICF into a national strategy under the name of the *going-out strategy* in 1999. This aspect of the study focuses on the specific role of the government in driving ICF to attain certain national development goal. The study then explores the impact of various firms, industry and transaction-specific elements upon the success of ICF as a national strategy. For this it examines the impact of the competitive challenges present in the global business system for late-comer firms, such as the Chinese firms.

### **1.4 Rationale:**

ICF was institutionalized by the CPC Central Committee, during the Tenth Five Year Plan into a national strategy under the name of *zǒu chūqù zhànlüè* (走出去战略) or the *going-out strategy* in 1999 . Since then Chinese firms have rapidly moved out to internationalize their business operations. As a strategy, ICF aims to create globally competitive and powerful Chinese firms which will contribute towards *fostering economic sustainable development of China*, which is one of the goal of China's 'Xiàndàihuà qiángguó zhànlüè' (现代化强国战略) or the *modernizing strong power strategy* (CCPIT 2007:2) . The rapid internationalisation by Chinese firms has led to both

fears and curiosity in the academia and the general public space. According to one estimate, in the scholarly field approximately 100 articles have been published on ICF in journals from multiple fields for the period of 1999-2010 (Deng, 2012). Simultaneously, the titles of scholarly works like *Is China Buying the World* by Peter Nolan, reveals a heightened level of concern among international governments regarding the motivations behind such a rapid internationalisation pace adopted by Chinese firms and its possible impact upon their own countries and their domestic firms. Thus, this study attempts to provide a balanced assessment of the capabilities of Chinese firms to make any real impact upon the global business as it exists.

### **1.5 Scope:**

The period from the year 1999 to 2015 has been selected as the time frame for the study. The beginning of the time frame coincides with the formal announcement of the going-out strategy or *zǒu chūqù zhànliè* (走出去战略) as a national strategy by the CPC Central Committee, during the Tenth Five Year Plan.

The study includes only firms whose country of incorporation is People's Republic of China (referred to as China in the study). However, it focuses on firms with both types of ownership i.e. Chinese SOEs and Chinese private firms.

### **1.6 Research Questions**

The study answers the following research questions:-

- I. What are the key objectives of ICF?
- II. What competitive challenges the global business system poses to ICF?
- III. What are the patterns (modes/strategies) of achieving the goals of ICF and what have been the current achievements?
- IV. Does the present structure of the global business system limit the goals of ICF? Are there any other factors that have a bearing upon the success of ICF?

## **1.7 Hypotheses**

The study proposes the following:-

- I. Internationalisation of Chinese firms has emerged as a significant development in the context of the deepening of globalization
- II. Successful internationalisation of Chinese firms is contingent upon overcoming the challenges of the global business system.

## **1.8 Chapters**

The study has five chapters in total. Chapter one provides the background and literature review on the subject of ICF. It further describes the purpose, rationale and the scope of the study.

Chapter two describes the policy regimes governing ICF which consists of rules on outward investments and transnational operations by Chinese firms set by the government authorities. It highlights the early motivations of the Chinese government in encouraging ICF. It then traces the evolution of ICF into a national strategy in 1999.

Chapter three examines the emergence of the present global business system by the end of 1990s and its implications for ICF. It begins with mentioning the major forces that triggered the restructuring. It goes on to discuss the competitive challenges posed by the structure of the current global business system to late comer firms entering the system and explains its implications for ICF.

Chapter four assesses the achievements made so far in reaching the goal(s) of ICF. It evaluates the performance of Chinese firms in overcoming the three major barriers to late comer firms in the global big business system i.e. core businesses, R&D and branding.

Chapter 5 provides summary of the findings and concludes with a focus on testing the hypotheses.

## Chapter 2

# Internationalisation of Chinese Firms: Policy Regime and Evolution

### 2.1 Introduction

The phenomenon of internationalisation of Chinese firms emerged in the 1980s. By the end of 1990s ICF evolved into a full-fledged national strategy. Since the beginning of ICF till its evolution into a national strategy, various government authorities formulated a set of policies concerning *outward investments* and *transnational operations* which constituted the *policy regime* for ICF. The chapter describes the evolution of this policy regime from 1979 till 1999 when ICF was institutionalised into a national strategy, known as the going out policy.

### 2.2 Policy Regime

The policy regime of ICF from 1979 to 1999 is said to be composed of two types of policies: 1) general policies and 2) particularistic policies (Zhang 2003:53).

#### 2.2.1 General policies

The *first policy* which allowed for ICF emerged from within the framework of China's economic reform programme. In December 1978 the Chinese government launched the national economic reform programme making a commitment to open the Chinese economy to the outside world. In August 1979, the State Council issued a document which included *investing to set up Chinese enterprises overseas* or *chūguó bàn qǐyè* (出国办企业) as one of the thirteen policies proposed to open the Chinese economy to the outside world. This policy is treated as the *point of origin* for the policy regime concerning ICF (CCPIT 2007:8, Zhang 2003:54). Following its announcement in the State Council document, the policy brought a sudden spurt in the internationalisation activities of several Chinese firms in the early 1980s. China's *national trading*

*corporations* opened up offices in Hong Kong and in several trading partner countries. The *pecially designated enterprises*, which specialized in engineering and construction services, established operations in the Third World and Socialist countries, particularly in Asia and Africa. At this stage, the policy of *chūguó bàn qǐyè* only allowed these two types of firms to engage in overseas investment activities, subject to approval from the State Council.

From 1984 to 1988, policies contained in the four official documents (See Table 2.1) released by the *Ministry of Foreign Economic Relations and Trade* (MOFERT) formed the *second set of policies* concerning ICF.

**Table 2.1 MOFERT Documents on Outward Investment**

<b>Date</b>	<b>Document</b>
19 May 1984	‘Approval Authorities and Principles for Opening Non-Trade Joint Venture Overseas as well as in Hong Kong and Macao’ (关于在国外和港澳地区举办非贸易性合资经营企业审批权限和原则的通知).
July 1985	‘Provisional Regulations Governing the Control and the Approval Procedure for Opening Non-Trade Enterprises Overseas’ (关于在境外开办非贸易性企业的审批程序和管理办法的试行规定).
July 1985	‘Approval Procedures for International Economic and Technical Cooperation Corporations to Set up Overseas Subsidiaries’
July 1988	MOFERT ‘Regulations Governing the Approval of Setting up Trade-related Enterprises Overseas’

**Sources: CCPIT 2007 (p.), Zhang Yongjin 2003 (p. 56)**

These policies performed the *twin functions* of simultaneously *encouraging* and *regulating* ICF. They made the important contribution of *liberalizing* the policy regime for ICF. As mentioned earlier, prior to 1984 only a select few firms (the national trading corporations and the specially designated enterprises) were permitted to engage in internationalisation through overseas investments. These MOFERT policies, however, granted the permission to apply for opening overseas ventures to *all economic entities*, provided they possessed their own financial resources, some technological advantage and

expertise, and a foreign joint venture partner to do so. Following the relaxation of the policy regime for ICF many township enterprises and the state-owned enterprises (SOEs) became engaged in outward investments and internationalised in the 1990s.

However, along with allowing more firms to internationalize, MOFERT policies also regulated ICF. For instance, the approval of an outward investment project was made conditional upon its fulfillment of certain *government specified requirements* (See box 2.1). The government approved application for outward investments only if they were guided by *market seeking, resource seeking or technology seeking purposes*.

### **Box 2.1 Government-Specified Requirements for Outward Investments**

Overseas investments must meet any of the following conditions:-

1. Help import advanced technology and equipment that are difficult to import through other channels.
2. Help provide a long-term reliable supply of raw materials needed for China's domestic economic development.
3. Help generate foreign currency income for China.
4. Is conducive to exporting Chinese machinery and materials and to the expansion of China's engineering and labor service contracts overseas.
5. Help provide the local markets with Chinese products needed and make foreign currency earnings.

**Sources: Zhang Yongjin 2003 (p.57)**

ICF was also regulated by putting the approval procedure for outward investments under complex *bureaucratic control*. The policies designed an elaborate process of application and troublesome bureaucratic procedures for screening and approval of outward investments. The authority to screen and approve outward investment projects was delegated to multiple government agencies such as the State Planning Commission, MOFERT and other relevant agencies at the provincial level.

Towards the end of 1980s, a *third set of policies* were included in the policy regime for ICF. The policies were contained in two documents released by the *State Administration of Foreign Exchange* (SAFE) in 1989 and 1990 (See Table 2.2).

**Table 2.2 SAFE Documents on Outward Investment**

Year	Documents
1989	‘Regulations on the Foreign Exchange for Overseas Investment’ (禁外投资外汇管理办法).
1990	‘Implementation of Regulations on the Foreign Exchange for Overseas Investment- Administrative Procedures’ (进外投资外汇管理办法实施细则).

**Sources: Zhang Yongjin 2003 (p.58)**

These policies were also *regulatory in nature* and required overseas investment projects to gain the approval of SAFE or related foreign exchange control authorities, for the purpose of exporting capital in foreign currency for overseas investment. They also regulated the remission of foreign currency earnings of overseas subsidiaries of Chinese firms back to China. In essence, the SAFE documents of 1989 and 1990 established the *foreign exchange control regime for overseas investment*.

### **2.2.2 Particularistic policies**

Apart from the above policies the policy regime for ICF also contains what are known as *particularistic policies* (Zhang 2003: 60) or *policy innovations*. These policies were examples of direct government intervention in fostering transnational operations. Through these policies the government established certain new firms and encouraged them to undertake transnational operations. These corporations are also known as the *purposely built multinational corporations* as their main business activities were specifically directed at transnational operations. It also encouraged specific existing firms to do the same. Prominent examples include the *international economic and technical corporations, China International Trust and Investment Corporation (CITIC), Sinochem*

and *Shougang*. Under particularistic policies these firms were extended *preferential treatment* (重点扶持) by the government in the form of management autonomy, financial and other support etc (Zhang 2003:61).

Since late 1979 to 1982, the State Council established 29 international economic and technical cooperation corporations or the specially designated enterprises which specialized in engineering, construction and labor services and operated in 45 countries. China State Construction Engineering Co. Ltd; China Civil Engineering and Construction Corporation, China Road and Bridge Engineering Co. Ltd and China Complete Set Equipment Import and Export Co. Ltd were the four pioneering firms of this batch that led the others to tap the international engineering and labor services market (Zhang 2003:88).

CITIC was established by the State Council in 1979 as a ministerial level organization and as an investment vehicle for the government. It operated both within and outside China and was given special permission by the State Council to engage in certain activities not allowed to other enterprises. It has many firsts to its name in terms of undertaking a variety of transnational operations, for instance it was the first entity from the People's Republic of China (PRC) to issue bonds after 1949 on the international capital market in Tokyo in 1982 to raise funds for a domestic industrial project (Zhang 2003:88).

Shougang Corporation had already been receiving high-level autonomy from the State Council for its domestic operations since the early stage of China's economic reform. The same autonomy was later extended to its transnational operations. Sinochem, on the other hand, was chosen as an experiment for ICF in 1987. It was later designated by the State Council to implement a pilot project for conglomeration and transnationalisation.

These government initiated experiments in transnational operations were highly significant in the sense that they succeeded in creating the *prototypes of Chinese multinationals*. In other words, due to these efforts, by the end of 1980s the Chinese firms had entered in the *embryonic stage of being multinationals* (CCPIT 2007:20, Zhang 2003:93).



### ***2.2.3 Nature of the policy regime***

The China's policy regime for ICF was marked by few specific characteristics. It had been described as *experimental, limited in scope, ad hoc* and *slow to emerge* (CCPIT 2007:14-16, Zhang 2003). Such a characterization can be attributed to several factors.

The policy regime for ICF was *slow to emerge* despite the establishment of PRC in 1949 due to the *ideological opposition* and *historical aversion* of *Revolutionary China* towards multinationals. This is why the first policy on ICF took almost thirty years, from the establishment of the PRC, to emerge in 1979. Prior to this, revolutionary China denounced multinationals as an *expression of neo-colonialism* and as a *tool of capitalism for the oppression and exploitation of the Third World*. They were seen as *important players within the capitalist-dominated international economic order* (Zhang 2003:49). These notions prejudiced China against multinationals and inhibited its understanding of the latter's role and operations in the world economy. The bias was also sustained by China's political and economic isolation until the 1970s which also meant China's intellectual isolation from the epistemic community of international economics thereby disconnecting it from the then flourishing literature on multinationals which could have otherwise helped in shattering the existing prejudice (Zhang 2003:50).

The situation only altered with China's membership of the United Nations (UN) in 1971 which introduced the country to UN's research material on multinational corporations. In fact, 1970s was a period marked by intensive studies being carried out on multinational corporations and transnational relations both within and outside the UN framework. China became particularly attracted towards the UN studies on the role of multinationals in economic development. In 1975 the government controlled elite publisher, the Commercial Press, translated *Multinational Corporations in World Development*, a publication of the UN Department of Social and Economic Affairs, into Chinese. This was a historical move in the sense that it launched China into understanding the role and transnational operations of multinationals. More importantly, it legitimized and opened discourses and debates on the subject of multinationals in China, which was earlier fraught with political hazard due to the aversion of the Chinese political establishment for multinationals. These discourses and debates overtime created a positive impression of

multinationals over the Chinese minds. They acknowledged the significant role multinationals played in the economic development of countries (Zhang 2003:50). This finally led the Chinese government to experiment with ICF in 1979 to benefit the economic development of China. However, despite the increased acceptance of internationalisation, the policy regime only began to take proper shape by the mid 1980s. This was due to the fact that the ideological legacies from the past were so strong that within the political circles some officials continued to make attempts to reconcile internationalisation with the principles of Marxism, Leninism and Socialism.

The policy regime for ICF is also described as *limited in scope*. This was due to some practical considerations regarding the *preparedness of the Chinese firms and China itself to undertake large-scale internationalisation* activities. For instance, the government's concern over the *shortage of capital* in China, especially its *foreign exchange reserves*, led to ICF being placed under regulation by formulating policies to administer the outflow of capital for overseas investment. Another consideration was the *incompatibility between the market environment in China and outside China*. ICF embodied a serious *contention between the centrally planned economy in China and the market-oriented economy outside China*. Chinese policymakers doubted the ability of the Chinese firms which were rooted in a largely command economy to successfully operate within a market economy environment. In addition, they also doubted Chinese firms on aspects such as *competitive advantages, managerial expertise* and other skills required for competing internationally. These doubts led the government to encourage internationalisation only in few select industries and nations where they were sure of their comparative advantages, competitiveness and other required skills. Another factor that contributed to the limited scope of the policy regime on ICF was the fact that the government was focused more at this stage on attracting foreign direct investments, technology, foreign skills etc into China rather than on searching for them by sending their firm outside.

Lastly, the portrayal of the policy regime as *ad-hoc* is attributable to ICF being driven by certain state developmental goals of the present time. As mentioned earlier the approval of outward investment projects was conditional upon meeting particular government

specified requirements aimed at boosting national economic development. For instance, outwards investment had to be market seeking, technology seeking etc, in nature.

## **2.3 Evolution of the Policy Regime**

The decade of *1990s* did not bring any additions in the policy regime for ICF. However, the decade saw the emergence of ICF into a full-fledged national strategy i.e. the *going out strategy* or *zǒuchūqù zhànliè* (走出去战略). The strategy was also known as the *strategy for internationalisation of (business) operations* or *guójì huà jīngyíng zhànliè* (国际化经营战略). ICF as a strategy explicitly encouraged more and more Chinese firms with some comparative advantages to make outwards investments and internationalize their operations. The strategy significantly *reformed the structure of China's opening up* to the outside world by becoming a complementary strategy to the strategy of *inviting in* or *yǐnjìn lái* (引进来), which was the initial focus of China's opening up aimed at attracting foreign investments, technology and businesses into China.

### **2.3.1 Economic acceleration and further opening-up**

Several factors drove the emergence of ICF as a national strategy during the 1990s. In early 1990s the Chinese leadership decided to further integrate China into the global economy for the purpose of accelerating the national economic development. In his report delivered to the 14<sup>th</sup> National Congress of the CPC in October 1992, Jiang Zemin, the then general secretary of the Central Committee of CPC, pronounced *economic development as the central task* of the Party for the 1990s. (Jiang 1992: 4)

The Party considered acceleration of economic growth as both an economically as well as a politically important subject. Following the political and ideological bankruptcy of the communist regime after the Cultural Revolution, economic development had emerged as the new basis for political legitimacy of the Party in China. Thus the achievement of rapid economic growth was essential for maintaining the long-term social stability in order to preserve this political legitimacy. Furthermore, drawing lessons from the modern Chinese history and the realities of the world as understood by the Party, economic

backwardness of a country was considered tantamount to creating opportunities for others to manipulate the country. The Party not only viewed other countries and regions, especially the neighboring countries, as speeding their development, but also perceived an alarming inequality in the developmental pattern across the world which could lead to serious negative implications for China in case it was to lag behind economically. It was particularly sensitive to the gaping inequality in the levels of economic development between high income countries and regions and the rest of the world. The developed countries accounted for an overwhelming share of the world's gross national product (GNP) but accounted for a small portion of the world's population. Due to their economically strong position within the world economy these countries enjoyed a controlling power over the formulation of international economic rules and regulations. The Party felt this could lead to discriminatory practices towards China by developed countries in the former's economic interactions with the world and thus threatened its national economic security (Cheng 2011: 34, Hui 2006:71, Jiang 1992:5).

To achieve the central task of realizing rapid economic growth the leadership proposed to increase China's integration with the global economy. In his 1992 report mentioned above, Jiang had described the *acceleration of reform and opening-up* as an indispensable condition for achieving rapid economic growth. He highlighted the need for Chinese people to emancipate their minds and rise above the abstract debate over socialism and capitalism, if they were to achieve superiority over capitalist countries. He urged them to embrace the idea of opening-up to the outside world without hesitation.

The firm belief of China's leadership in the economic benefits of opening China further to the global economy proceeded from an understanding of the wider opportunities available to an open interactive economy. For instance, in the past, opening-up had proved itself an important channel for accessing factors crucial for the process of economic development of China. It brought China in contact with foreign funds, resources, advanced technology and skilled personnel from the developed capitalist countries. The economic success of this outward-looking strategy since late 1970s had thus institutionalized and entrenched the idea of opening-up to the world in the minds of the Chinese leadership. Therefore, increasing interactions with the outside world was

considered an imperative for achieving rapid economic national development in the face of growing economic inequality (Hui 2006:71, Jiang 1992:8).

### ***2.3.2 WTO and the era of global competition***

#### **i) WTO: a double edged sword**

To further open China to the outside world, the leadership in China pushed for *joining the WTO* in the 1990s. This was prompted by two major factors. First, given the trend of China's opening up joining the WTO, one of the integral components of the 'economic UN, was the next natural step. China had already joined the International Monetary Fund (IMF) and the World Bank (WB) in the early 1980s. Second, WTO membership was calculated as a huge economic opportunity for China by the leadership (Hui 2006: 69). According to an estimate prepared by the Development Research Centre of the State Council about the economic impact of China's accession to WTO, the accession was capable of bringing the benefits of increased foreign investments in China and of expanded foreign trade with a special boost to Chinese exports. As a member state of the WTO, China could avail itself of the rights and privileges of the international trade regime. These rights and privileges, which included the principles of Most Favored Nation (MFN) & National Treatment and the right to access the dispute settlement mechanism of the WTO, held the prospect of reducing tariff and non-tariff barriers to Chinese goods and services and saving them from false allegations of dumping etc. in foreign markets. WTO membership was seen as an opportunity for 'providing China with a new base for continued growth and the development of the domestic economy' (Hui 2006:69).

However, China's accession to WTO was a *double-edged sword* (Cheng 2012: 38). On one hand it raised the prospect of increased economic growth while on the other hand it whipped up fears of increased competitive pressures on Chinese firms. Opportunities from WTO were conditional upon some other important factors.

China's entry into the WTO required the former to reciprocate by extending same membership rights and privileges to foreign players within China. It was expected to reduce domestic trade barriers to foreign goods and services and to improve the domestic

environment for foreign investments. This meant increased access to the Chinese market for foreign firms and increased competition for the Chinese firms from their foreign counterparts. Even outside China, the Chinese goods and services will be competing with foreign goods and services on various parameters of cost, quality conforming to international standards, durability etc., without the protectionist help from the national government. Therefore WTO was about to unfold an *era of global competition* for Chinese firms. It would put Chinese firms under huge competitive pressures everywhere i.e. within and outside China.

### **ii) Nature of global competition**

Chinese firms were clearly not prepared for such a massive onslaught of global competition. They suffered from several inadequacies which made them unfit to survive in the global competition, let alone to succeed.

The world economy had begun to globalize at a rapid pace since 1980s. National economies were becoming more interdependent as a result of continuously growing cross-border trade in commodities and services, cross-border flow of international capital and technology, and cross-border conduct of production and other activities etc. Markets were getting expanded and integrated and economic globalization became an irreversible trend.

Firms had played the key role in bringing about economic globalization and were continuing to drive it forward. They sat in the middle of this phenomenon engaging in transnational production and other activities, facilitating the movement of production factors, technology, commodities, services etc. across borders. These firms were known as *multinational firms* as their operations were spread out beyond their home countries.

Multinational firms enhanced their performance and maximized their profits by engaging in transnational operations. They entered foreign markets through various modes of entry including Greenfield investments, joint ventures, acquisitions etc. in order to access strategic assets, such as cheap labor, scarce natural resources, created resources ranging from research and development (R&D) capabilities, distribution networks, and sales channels to globally recognized brands etc. This enabled them to supplement their

*ownership advantages* with *foreign location-bound advantages* in strategic assets which were either completely unavailable or insufficiently available in their own home economies. In other words, through transnational operations, multinational firms *allocated global resources* which substantially *enhanced their competitive advantages* and *boosted their performance*. In a way transnational operations allowed these firms to emerge as *global economic powerhouses*. Thus, in the rapidly globalizing world economy, *global competition was being shaped by multinational firms* who were becoming more competitive and more profitable upon the strength of their transnational or internationalised operations.

Chinese leadership and academics called this the *new competition pattern* prevailing in the highly globalized world economy. The pattern described global competition as having become more economic in nature and being driven by multinational firms with formidable economic power. The characterization reverberated throughout the Chinese academia and the official establishment.

The executive summary of the historic centrally endorsed symposium, ‘A Symposium on Policies Concerning the Transnational Operations of Chinese Firms,’ held in Beijing in 1991 which boasted of participation from important government agencies such as MOFERT, the State Commission for Restructuring the Economic System (SCRES) and the State Council’s think tank, the State Council’s Research Office stated that under the new competition pattern, *‘the international economic competition in the 1990s and in the twenty-first century will take its main form in the competition between multinational corporations’* (Zhang 2003:70). In another description of the prevailing global competition, it was mentioned that *‘following the post war scientific and technological revolution, new industrial revolution and the acceleration of economic globalization, the nature of global competition had shifted in its focus from military power to high-technology based national economic power’* and *‘multinationals have emerged as a symbol of global competition and of national economic strength’* (Sun 2002:86). In yet another description it was mentioned that *‘as the economic strength of few foreign multinationals even exceeded that of several developing countries they could very well be seen as wealthy enemy states ( 可谓富可敌国) in their own right’* (Yang 2003: 16).

Thus, multinational firms not just emerged as drivers of corporate competition but also of competition between different nations which had become increasingly economic in nature. *Multinational firms defined and symbolized global competition in the increasingly globalizing world economy.*

Based on the above understanding, it became clear to the Chinese leadership that economic prosperity of China after joining the WTO will depend on the ability of the Chinese firms to survive the global competition. In other words, only Chinese firms which were as strong as foreign multinationals could succeed in global competition.

### **iii) Inadequacies of Chinese firms**

However, Chinese firms were suffering from myriad problems. Chinese firms largely catered to the domestic market, rarely functioned on market principles and as result were severely limited in competitive advantages required to compete at the global level.

Studies focused on the competitiveness of Chinese firms during this period produce a dismal picture. Few *enterprise level analyses* reveal that the Chinese firms, in general, suffered from problems of small scale, inferior innovation capabilities, absence of famous brands, lack of core competence etc. resulting in weak competing abilities vis-à-vis those of the foreign multinationals (Sun 2002:85, Yang 2003:34). More important were the *ownership based analyses* focused on SOEs. Being representatives of the state sector the SOEs were the natural choice of the national government to lead China's engagement with the global economy. Touted as the *pillars of the national economy* SOEs in reality suffered from problems of muddled ownership and management rights, huge welfare burdens, unclear incentives etc. all contributing to their non-performance. They became increasingly characterized as a '*heavy burden on the government*' and a '*potentially fatal trauma for China's economic system,*' which were even dragging down China's financial sector burying it under the massive pool of bad debts (Hui 2006:72-73). The Asian Financial Crisis which began in July 1997 ringed the alarm for the Chinese leadership by revealing dangerous similarities between China's SOEs and the firms of the countries affected by the Asian crisis. Most of these firms were from the emerging markets and had grown rapidly due to *crony capitalism*. Under crony capitalism firms receive substantial



benefits from their national governments in the form of preferential access to resources, capital etc. and more importantly in the form of protection from foreign competition. By doing so, governments take away the incentive for carrying out innovation and developing competitive advantages from firms. As a result, such firms possess a very fragile basis for competing with other firms. The Asian crisis highlighted this unsustainable nature of firms built on crony capitalism in global competition. They demonstrated organizational constraints as they internationalised. They did not have the governance structures and professional management skills to sustain foreign business operations. State-owned enterprises in China were also a result of crony capitalism characterized by close government support. The fact that SOEs were the chosen ones to lead ICF led to heightened concerns amongst the Chinese leadership regarding their capabilities to survive and succeed in the global competition. In fact, few Chinese firms which were already running internationalised operations during the 1990s showed lack of competitiveness in the global arena reflected by poor returns from most of their international operations (Hui 2006:74, Jones 2005:, Zhang 2003:77).

The problems of Chinese firms in general and the SOEs in particular cast a dark shadow over the prospect of success of Chinese firms in global competition post WTO entry. An urgent need arose to push domestic Chinese firms to adapt to the *dynamics of global competition* at the earliest.

### ***2.3.3 Adapting to global competition***

As the Chinese leadership and academia increasingly observed multinational firms competing successfully in the global economy by efficiently allocating global resources through their transnational operations which in turn allowed them to cultivate new and enhance existing competitive advantages *multi-nationality came to be understood as a source of global competitiveness*. This led Chinese leadership to adopt the cultivation of transnational operations by Chinese firm or ICF as a national strategic initiative. The leadership decided to encourage Chinese firms to internationalize on a large scale in order to become globally competitive. *Thus, ICF came to be associated with a new and more important goal i.e. the creation of globally competitive Chinese firms.*

In the late 1990s the various government authorities began urging Chinese firms to internationalize their operations. Firms with some comparative advantages were asked to engage in outward investments and establish transnational operations. The period of incubation to establish ICF as a national strategy is said to have begun in 1999 (Huang & Wilkes 2011:9). As a strategy ICF came to be known as the *going out strategy* or zǒu chūqù zhànlüè (走出去战略). Another name which is used alternatively in the Chinese language is the *strategy for internationalisation of (business) operations* or guójì huà jīngyíng zhànlüè (国际化经营战略) (CCPIT 2007:2).

In February 1999 the General Office of the State Council forwarded the *Suggestion Regarding Encouraging Enterprises to Develop Overseas Materials Processing and Assembly Businesses* to the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), the former State Economic and Trade Commission, and the Ministry of Finance in which it proposed the specific policy measures to encourage Chinese enterprises with comparative advantages in sectors like light industry, textile, household appliances and other machinery and electronics as well as garment processing to go overseas in order to develop the materials and processing businesses (CCPIT 2007:15; Huang and Wilkes 2011: 9).

In September 1999, in the Fortune Global Forum, *China: The Next 50 Years*, held in Shanghai, Jiang Zemin proposed that *Chinese firms must learn from the advanced experiences of foreign firms. They must enrich their experiences by going through the trials and hardships of participating in economic globalization and must strengthen their competitiveness* (CCPIT 2007:19). Finally, during the Third session of the Ninth National People's Congress, Jiang Zemin made the *formal suggestion of the going out strategy*. He called firms for actively participating in global competition, and exploiting both the domestic and international resources and markets in a better way (CCPIT 2007:19).

In October 2000, the Fifth Plenary Session of the 15th CPC Central Committee adopted the *Suggestion of the CPC Central Committee Regarding the Formulation of the Tenth Five Year Plan* (FYP) which made the going out strategy as one of the *Four New*

*Strategies* (along with the Western Development Strategy, the Urbanization Strategy and the Human Resources Strategy) (CCPIT 2007:20).

## 2.4 Summary

Thus, from 1979 to 1999 ICF underwent a dramatic evolution to emerge as a full-fledge national strategy geared towards cultivating globally competitive Chinese firms. The evolution also reflected a change in the perception of the Chinese leadership about the utility of the process of internationalisation of firms.

During the 1980s ICF was encouraged by the leadership to meet certain specific national development objectives. As the policy regime shows, the Chinese government encouraged ICF in order to boost Chinese exports in goods and services (engineering, labor and construction), to bring in advanced technologies and equipments to China, to secure the supply of raw materials, to generate foreign currency earnings, and to a lesser extent, to raise funds for domestic projects.

However, during the 1990s the prospects of increased competitive pressure on Chinese firms from foreign competitors, following the WTO entry, provided the Chinese leadership the context to appreciate the role of the process of internationalisation of firms in enhancing the firm's global competitiveness. The prospects of increased global competition combined with an acknowledgement of the weaknesses of Chinese firms forced China to observe the nature of the prevailing global competition in the global economy. The observation revealed how multinational firms had emerged as global economic powerhouses on the basis of their transnational or internationalised operations through which they efficiently allocated global resources and thus cultivated and enhanced competitive advantages. It dawned upon the Chinese leadership that *multi-nationality was a competitive advantage* in itself or in other words, internationalisation of firm's various operations could be used to enhance the competitiveness and profitability of firms. This new knowledge made the leadership see the process of internationalisation of firms in a new light and thus accorded much more significant role than before when it was being used in a very narrow sense.

Thus, the Chinese leadership formulated a new strategy based on a firm belief that the *internationalisation of domestic firms would be the perfect tool for cultivating globally competitive Chinese firms* which could successfully face the competitive challenges in the period following China's entry into the WTO. By the late 1990s various government authorities began to encourage firms with some comparative advantages to engage in outward investments and internationalisation of their operations. In 1999 the incubation period of establishing ICF as a national strategy was initiated. As a national strategy, ICF came to be known as the *going out strategy* or *the strategy for internationalisation of (business) operations*. In the year 2000 the government adopted going out strategy as one of the four new strategies for the 21<sup>st</sup> century.

## Chapter 3

# Global Business System: Competitive Challenges to the Internationalisation of Chinese Firms

### 3.1 Introduction

The multinational firms which became an inspiration and a model for emulation for the Chinese firms to build global competitiveness were a result of the global big business revolution during the 1990s. The revolution radically changed the prevailing business practice and philosophy of these firms. It changed the manner in which firms organized their businesses. By the end of 1990s, the revolution culminated in transforming these multinational firms into global big businesses which occupied a large portion of the global market power within their respective industries. These global big businesses that define the current global business system have embedded strong competitive challenges in the system for late-comer firms, including Chinese firms. Some of these competitive challenges hold serious implications for the entry and growth of late-comer firms in the system.

This chapter begins with a description of the specific developments in the mid-1980s and early 1990s that sowed the seeds for the global big business revolution. It then traces the evolution of the present global business system, highlighting significant changes in the prevailing growth strategy and business practice of firms prior to 1990s. The chapter then explains how the present global business system poses some strong competitive challenges for the late-comer firms to the system, focusing on three major barriers, of core business, R&D capabilities and branding, to the entry and growth of such firms in the system.

### 3.2 Evolution of the Current Global Business System

The current global business system, also known as *the global big business system*, is a result of the global big business revolution that triggered off in the 1990s, supported

by certain significant international developments beginning in the mid-1980s and 1990s (Nolan 2001: 97-100).

### ***3.2.1 Significant developments in the mid-1980s & 1990s***

These developments were related to global politics, society and technology and sowed the seeds for the formation of the current global business system. They included:-

#### **i. Trade liberalization**

Trade liberalization accelerated after mid-1980s when a worldwide trend towards *tariff reduction* came into being with the beginning of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). Many developing and developed countries made large reductions in tariffs. The fall in tariffs also coincided with an overall *reduction in many types of non-tariff barriers* (NTBs). Furthermore, the *scope of trade liberalization also widened* to include trade and foreign investments in services (Nolan 2001: 97).

This was a welcome change from the past decades since the First World War. During the *interwar years* (1914-1950), onset of the Great Depression in 1929 had led to the *collapse of the international trading system* when countries began to increase the tariff levels and to engage in the *beggar thy neighbor policy*. The picture remained more or less the same even after the end of the Second World War (Jones 2005: 28). From 1950s till 1980s *developing countries* in Latin America, Asia and Africa *became progressively closed to international trade*. By the end of 1960s, even in the US, the country that had inspired the drive for trade liberalization, the momentum for liberalization petered out as the *US balance of payments deficits* began to cause concern about the scale of foreign imports. Even the richest and most *developed countries* installed very high levels of *trade protectionism* (Jones 2005:32).

The massive reduction in trade barriers in the 1980s facilitated the resuscitation of trade and deepening of economic integration.

## ii. Liberalization of capital flows

International capital flows pertaining to both short-term and long-term capital also underwent progressive liberalization during the 1980s. Cross-border flows materialized with greater ease among the developed and the developing world. In the advanced economies, financial markets turned into a *global financial system*. Technological improvements stimulated financial innovation and created a multi-billion dollar pool of *internationally mobile capital* (Nolan 2001: 98).

*Before 1980s international capital flows were severely restricted.* During the interwar years *suspension of the Gold Standard* led to the rapid decline of cross-border capital flows. The emergence of *regional currency blocs* in 1930s also confined capital flows within these currency blocs and led to the *segmentation of the capital markets* (Jones 2005:28). After the Second World War *exchange controls* used by governments in most developing and developed countries as instruments to screen or monitor the foreign direct investment (FDI) came to restrict the international capital flows. Though a kind of international financial market had begun to develop with the advent of floating exchange rates in the 1970s it was mainly restricted to capital flows between rich countries (Jones 2005:32).

Therefore, in the 1980s, the international capital markets became less segmented and the capital could now move with greater ease across a broader geography.

## iii. Privatization

The privatized space broadened enormously during the late 1980s and early 1990s as *more regions and more sectors were opened to private capital* than before. *Previously, a vast swathe of economic activity was directly owned and controlled by the state.* In the interwar years, due to rampant political nationalism the *nationality of firms* emerged as a *controversial* issue. Restrictions on foreign firms increased. Governments *sequestered affiliates of enemy owned companies* in their countries. In 1930s many governments from developing countries had begun to question control of foreign firms over their natural resources. With the spread of Communism in *Eastern Europe* in the late 1940s and to *China* in 1949 privately owned firms, both foreign and domestic, were progressively

nationalized. In the post-war era till late 1980s a large part of economic activity in the recently *decolonized countries remained state-owned* due to aversion towards firms of the former colonial powers, and sometimes towards all foreign investments in these countries.

However, in the *late 1980s* as noted above, new areas including, large parts of Europe, former Communist countries and developing countries and new sectors which were previously state-owned were opened to the private capital. This had become possible due to the significant *shift from state planning and import substitution towards acceptance of the market-oriented policies and export-led growth model* in the former communist and emerging markets (Jones 2005:27-31; Nolan 2001:99).

#### **iv. Information technology**

Dramatic advancements were made in information technology in the 1980s and early 1990s radically. These developments *revolutionized communications*. The use of ‘geo-stationary’ satellites permitted *cheap data, voice and video links worldwide*. Optical fiber cables provided an alternative means of transmitting *bulk of information at very high speeds*. Personal computers (PC) appeared on the scene. The Worldwide Web was born in 1990 with the development of the hypertext markup language (HTML). In 1994 Internet became open to commercial activity when it formally separated from the US government’s patronage which triggered its rapid diffusion worldwide (Jones 2005:35-36).

#### **v. Migration**

Prior to 1980s the flow of migrants across borders remained constrained by immigration policies. In 1980s the numbers of migrants increased but they still accounted for only a miniscule percentage of the world’s population, remaining below three percent in the 1990s. However, *international migration, especially of highly skilled people* became a prominent feature.



### ***3.2.2 The firm-growth strategy and business practice prior to 1990s***

As one can see, all these developments succeeded a highly restrictive global environment where the cross-border movement of commodities, capital, people and information was prohibited by the radical political nationalism of the two World Wars and also by the lower levels of advancements in information and communications technology.

The organisation of business activities prior to the 1990s was a function of this restrictive environment. In the wake of high trade barriers, prohibitions on cross-border capital flows, sequestration of assets of foreign firms, nationalization of international and domestic firms and the technological inability to manage vast operations, firms naturally became confined to their home countries. However, some firms operating in countries other than their home country did exist, yet predominantly larger portion of firm operations were located within their own homes country.

In order to sustain their growth within the limits of their home countries firms adopted a *diversification strategy* in which they owned businesses in multiple economic sectors. They usually began by engaging in one line of business and then diversified their business model through mergers, acquisition etc. Diversification into multiple economic sectors was also considered an effective growth strategy as the firms thought that the simultaneous presence in multiple sectors could safeguard them against volatile economic shifts taking place within a particular sector at a given time. Losses from such economic shift in a particular sector could be compensated by continued performance in other stable sectors. In other words, diversification strategy also enabled firms to diversify their finances and spread risks. These firms came to be known as the *diversified national conglomerates*. Diversified national conglomerate were also *vertically integrated* i.e. their business operations also covered different stages in the production sequence of each product which they produced. For instance, they also owned different suppliers and/or distributors involved in the production of their numerous products in different economic sectors. Vertical integration supposedly extended several advantages to the diversified national conglomerates in terms of reduced costs, decreased transportation expenditure, quality maintenance of the production inputs etc. Therefore prior to 1990s most firms

were large-scale diversified national conglomerates, engaged in numerous businesses spanning multiple economic sectors.

However, by the 1960s the diversified conglomerate structure started showing *signs of distress*. Due to their huge size and product diversification in multiple economic sectors, they began suffering from the *managerial diseconomies of scale* (Jones 2005:30). Managers lost touch with customers in diverse product markets to which the conglomerate structure catered. They failed to catch-up with the distinct and constantly changing preferences and needs of such a diverse customer base and thus were left helpless before the challenges of specialized markets and rapid change (Jones 2005:30). Managers also faced communication problems while managing such a large-scale and complex firm structure. They lost touch with workers which impacted the efficiency and quality of their various business operations. Eventually, the diversified national conglomerates came to be marked by operational complexity, slow decision making and increased confusion which led to their failure.

The diversified conglomerate structure failed because firms had underestimated the management abilities needed to run such a complex and large creature. In the business community, management was largely understood as a universal concept with basic fundamental principles, instead of being industry specific. It was this understanding that had encouraged firms to enter into more and more multi-sector businesses without any hesitations. The failure of the diversified conglomerate structure finally enlightening firms that management was a function specific to a particular industry within an economic sector. It was based on the core competency of deeply understanding the industry in which a firm operated, which in turn was built upon years of experience.

Following the failure of the diversified conglomerate structure new ideas began to emerge in the field of business management advocating for the substitution of this kind of diversification strategy with a strategy in which firms would solidly rest upon the core competencies in operating a few core businesses in the same or related industries. New academic writings such as *In Search of Excellence* encouraged firms to stick to their knitting and do what they are good at rather than trying to create and manage diverse businesses.

### ***3.2.3 The new firm-growth strategy and business practice in 1990s***

The developments that unfolded in the mid-1980s and early 1990s played a crucial role in enabling firms to substitute the diversification strategy by a more favorable growth strategy. As a result of these developments, global environment had become more hospitable to foreign firms. Liberalization of regions, of industries, and of cross-border trade and capital movement along with technological advancements in information and communication technologies meant that firms could now grow by entering into new markets beyond the narrow confines of their home country. Furthermore, the knowledge about the benefits of sticking to few core businesses in same or related industries, drawn from their disastrous experience with the huge diversified conglomerate structure, made firms inclined towards focusing on a narrow range of businesses and developing industry specific competencies in managing these core businesses. These two elements were combined to formulate a new growth strategy for firms known as the *globe focused strategy*.

Thus in the early 1990s firms adopted a *new business philosophy and practice* represented by the globe focused strategy. Under this strategy firms came to focus upon a narrow range of businesses in similar or related industries at the global level. These businesses constituted the *core businesses* of firms. The limited resources and capabilities of firms were then devoted towards developing competencies in managing their core businesses. These competencies came to be known as the *core competencies* of firms.

Core competencies represent a pool of knowledge created by firms, which describes optimum methods of performing various stages of core businesses, ranging from procuring inputs, manufacturing, distributing, delivering after-sales services etc., within their industries. Core competencies are developed by firms only after accumulating a substantial amount of experience over the years in performing the various stages of their core businesses within the concerned industries. This is the reason why core competency is considered a strong competitive advantage.

The adoption of the globe focused strategy started the seeds for a global business revolution that eventually changed the way how firms organized their businesses. The

globe focused strategy was made-up of three main components: 1) *asset reorganization* 2) *cross-border M&A(s)* and 3) *organization of value-added activities*.

**i) Asset reorganisation**

The firms first began with the narrowing down of their *competitive scope*. Competitive scope refers to the range of products a firm produces, the type of buyers it serves and the array of industries in which it competes (Porter 1990:64). A massive asset-reorganization drive was initiated by the firms during which they sold-off their non-core businesses to select a narrow range of core businesses.

**ii) Cross-border M&A(s)**

In order to increase their global market share, the firms started a series of cross-border M&A(s). During M&A(s) existing firms combine with each other. They represent a *method of external growth* for firms through which the latter engages in an abnormally expansive behavior of *empire building* which allows them to establish monopolistic market positions, in the shortest possible time (Penrose 1959: 163). This is achieved as M&A(s) allow firms to generate *economies of scale* in various business functions such as procurement, R&D etc. and to absorb potential competitor firms within their industry.

During the 1990s, firms were geared towards establishing themselves as one of the top two or three firms in the global marketplace. It is said that the new mantra for firms had become: *If you are not number one, two or three in the world, you shouldn't stay in the business* (Nolan 2001:100-101). Thus, in order to build their empires firms unleashed merger frenzy during the 1990s. The value of M&A transactions rose from \$156bn in 1992 to over \$3300bn in 1999 (Nolan 2001:103). During these large-scale cross-border M&A(s) middle-sized firms were remorselessly squeezed out (Nolan 2001:104). Interestingly, some even compared this situation to the post-Westphalian absorptions and disappearances of various states (Chandler & Mazlish 2005: 3-4). To quote an interesting figure, of the Fortune 500 list in 1980s, 33 percent of the firms no longer existed autonomously a decade later, and by 1995 another 40 percent was gone (Chandler & Mazlish 2005: 3). In the early 1990s, many industrial and service sectors were moving towards becoming *oligopolies*, i.e. dominated by a small number of firms with significant

market power (Roach 2005: 32-33). By the end of 1990s a high degree of *firm-level concentration of global market power* could be seen in almost every industry, of almost every sector (Nolan 2001: 103).

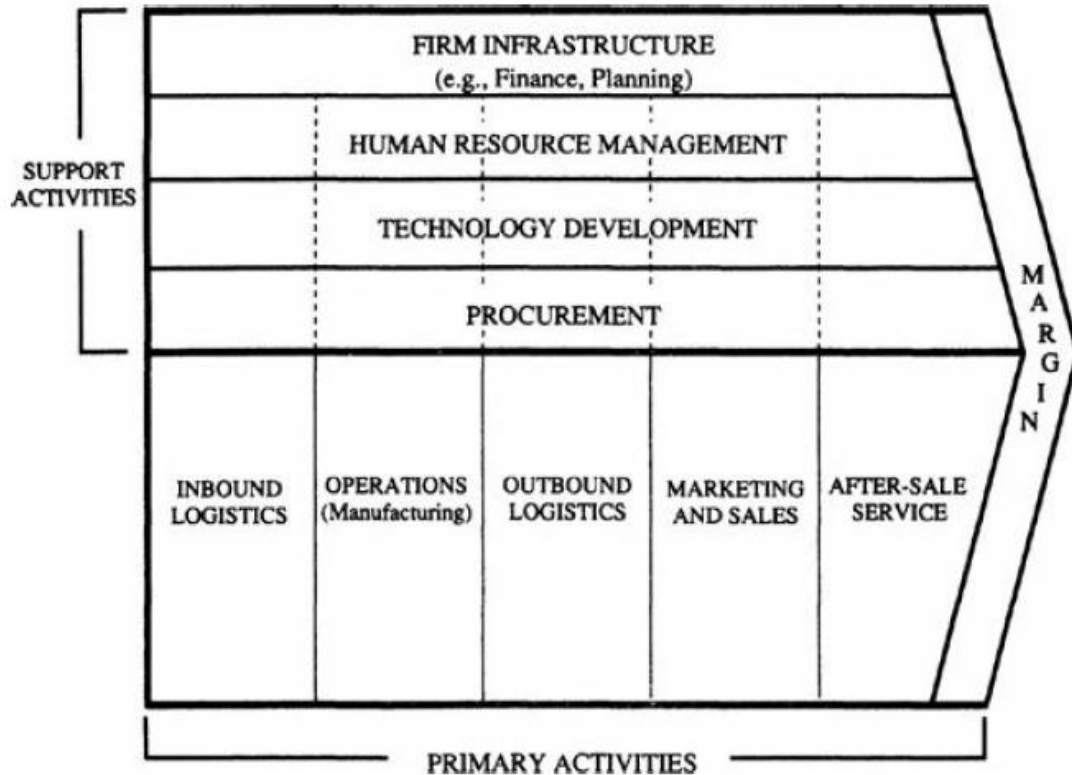
### **iii) Organisation of value-added activities**

Simultaneous to cross-border M&A(s), firms also carried out the organization of their value-added activities and developed their *global value chain*. As focus on narrow range of core businesses was the cornerstone of the globe focused strategy, firms subcontracted their value-added activities in which they did not have a specialization. These value-added activities were subcontracted to independent firms (external to the legal boundaries of the outsourcing firm) which had the specialization required to perform these activities. Firms retained their direct control only over certain high value-added activities such as R&D and marketing etc.

Within an industry while producing a good or a service, a firm engages in a series of discrete value-added activities that together make up the complete *production sequence* of the product which the firm is producing. These activities are broadly divided into *primary activities* i.e. activities including production, marketing, delivery and servicing of the product; and *support activities* i.e. activities securing inputs, developing technology, managing human resources etc. in order to support the primary activities (figure 3.1). Each activity creates value for the buyers, thus the name value-added activities. Together these activities make up the value chain of the firm (Porter 1990:65).

A firm's value chain in an industry is in turn embedded in a larger stream of activities called the *value system* (figures 3.2). The value system includes other actors such as, suppliers, distributors, marketing agents etc. who interact with the firm through their own value chain. For instance, suppliers provide inputs (raw materials, components, machinery and purchased services) to the firm's value chain. Similarly, on its way to the ultimate buyer a firm's product often passes through the value chains of distribution channels (Porter 1990:67). The effective exploitation by a firm, of its linkages with other actors in the value system can lead to the improvement of its competitive position within the industry (Porter 1990:67).

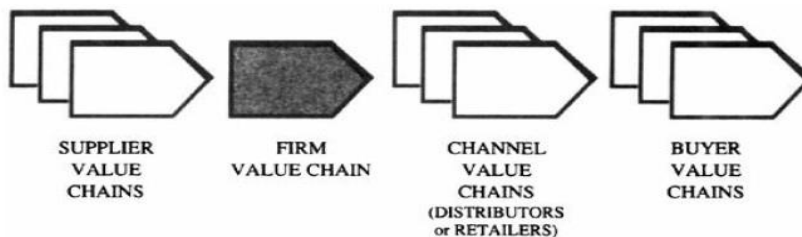
**Figure 3.1 *The Value Chain***



**Source: Porter 1990 (p. 66)**

Firms under the globe focused strategy effectively organized these linkages with independent actors in the value system to whom they subcontracted their value-added activities and cultivated competitive advantages for themselves.

**Figure 3.2 *The Value System***



**Source: Porter 1990 (p.68)**

They sat at the apex of their value chain and consciously planned and closely coordinated the vast set or network of value-added activities with their subcontractors within the broader value system of their industries. Owing to this specific function, the firms were also known as the *core systems integrators* (Nolan 2001:119).

The systems integrators became heavily involved with their subcontractors working in the different segments of the value chain. For instance, in the upstream segment of the value chain the systems integrators formed an intimate relationship with the first-tier suppliers. They carefully selected only the most capable suppliers who could work with them globally as their *aligned suppliers* or *long-term business partners* (Nolan 2001:103). These suppliers were large-scale firms, capable of undertaking R&D and of investing hugely in information technology. The relationship between systems integrators and their suppliers extended beyond a normal relationship based on price and was characterized by high levels of trust and synchronization (Nolan 2001:119). Systems integrators

and their suppliers planned their various activities collectively and the former influenced and controlled each and every decision of the latter, ranging from the physical location of their work, their R&D plans, the nature of their product development activities, their

**Box3.1**

**Coordination in the downstream segments of the value chain**

The locations of the plants of the suppliers were decided in relation to the core systems integrator's location. The aligned suppliers of goods and services increasingly produced or delivered services to the systems integrators by physically working within their premises. The R&D plans of the suppliers were charted out in close consultation with the projected needs of the core systems integrators and under the close control of the latter. Product development of suppliers was also closely coordinated with the system integrators. Precise product specifications were instantaneously communicated to the leading suppliers through newly developed information technology. The production and supply schedules of suppliers were comprehensively coordinated with the systems integrators to ensure that the required inputs arrived exactly when they were needed and the inventory of the systems integrators was kept to a minimum.

Owing to such a closely coordinated relationship with aligned suppliers huge cost advantages flew to the systems integrators.

**Source: Nolan 2001 (pp. 190-120)**

production and supply schedules etc. (See Box 3.1). Each of these aspects of the supplier's work was designed to meet the specific needs of the core systems integrators.

**Box3.2**

**Coordination in the downstream segments of the value chain**

In the downstream activity of distribution the core systems integrators generated cost advantages by closely coordinating the distribution process with specialist logistics firms. They usually also assigned their own experts to work closely with major retailing locations within the retail chain.

**Source: Nolan 2001 (p.120)**

The core systems integrators established similar relationships with independent firms in the downstream segments of the value chain as well where it coordinated value-added activities like distribution (see box 3.2).

The conscious organization, coordination and control of the relationships with their subcontractor firms allowed the core systems integrators to cultivate different type of advantages. For instance, system integrators were able to draw cost advantages all along the value chain, such as, low-cost product development, low-cost marketing, low-cost service provision (established a cost leadership) (Nolan 2001:120). These competitive advantages contributed towards strengthening the competitive positioning of firms within their respective industries.

Cross-border organization of the value-added activities was an effective method employed by firms to retain their focus on developing core businesses without being engulfed by the burden of performing all value-added activities themselves. As already discussed, firms directly performed only few high value-added activities, while subcontracting others to specialized independent firms. Further, the quality and the efficiency of the performance of the subcontracted value-activities were also upheld firstly, by selecting highly capable independent firms, and then by maintaining intimate and closely coordinated relationships with them throughout the performance of the value-added activities. The organization of value-added activities proved to be an effective method as it was based on a relationship between systems integrators and independent subcontractor firms which was rooted in mutual benefit. For instance, the subcontractor firms benefitted a lot from their relationships with the systems integrators. They became



long-term business partners of the systems integrators, received the latter's help in securing finances for their various operations and for upgrading their R&D capabilities etc. which kept them at the top in their business as well.

Collectively asset reorganization, cross-border M&A(s) and the organization of value-added activities extended different competitive advantages to firms which helped them in building and sustaining huge market power. Asset reorganization allowed firms to focus on a narrow range of related core businesses which allowed them to devote their resources to developing competencies in managing the core businesses. Cross-border M&A(s) extended the advantage of economies of scale to firms and enabled them to assimilate potential competitors along with their competitive advantages. The organization of value-added activities allowed firms to shed the direct burden of performing all the value-added activities in its value chain and instead to perform these activities indirectly through their relationships with independent and highly capable subcontractor firms without compromising on the quality of the end product. In fact, the firms even managed to draw competitive advantages of cost and differentiation from their organization of the value chain.

The manner in which businesses were organized by firms under the globe focused strategy to generate huge competitive advantages for themselves made the *structure of the global business system* extremely *concentrated* (Nolan 2001:223). In almost all economic sectors, a few firms came to occupy a large fraction of the total world sales, or global market power. These firms were called the *global big businesses* (Nolan 2001:187) and defined the global business system that emerged by the end of 1990s. Thus, the present global business system is sometimes also referred to as the *global big business system*.

### **3.3 Competitive Challenges of the Global Business System for ICF**

The concentrated structure of the global business system holds special consequences for firms who enter the system as late-comers. It represents an external environment for *late-comer firms* where they face extreme difficulties in relation to

competition from the global big businesses. It does not offer these firms a *global level-playing field* (Nolan 2001:187 & 216). Some of the competitive advantages of the global big businesses are so huge that they now form *serious barriers to entry and growth* for the late-comer firms (Nolan 2001: 138). Since the global big businesses are present in every economic sector, one or more of such barriers can be found in almost every sector. For instance, *effective R&D barriers* exist in high-technology as well as in certain segments of the mid-technology industries. Similarly, *branding barriers* exist in consumer goods industries (Nolan 2001:153). Even in the *relatively new knowledge-intensive industries* effective barriers have been put into place by the global big businesses (Nolan 2001:134).

### ***3.3.1 Major competitive challenges to late-comer firms***

The present global business system poses *three major barriers to any late-comer firms i.e. core businesses, R&D capabilities and branding* (Nolan 2001: 100). While the first two advantages have been transformed by global big businesses into effective barriers to potential new rivals through sustained and large-scale expenditure or outlays on R&D and brand-building (Nolan 2001:153); the third competitive advantage represents the most prevalent firm structure in the global business system which becomes an effective barrier to any firm (that does not follow it) through its function of enabling firms (who follow it, like the global big businesses) to develop core competencies.

#### **i) Core business**

The adoption of the globe focused strategy by firms in the 1990s was driven by the benefits of building a firm around a narrow range of businesses in same or related industries, known as the core businesses. The firm structure built around core-businesses as opposed to the diversified conglomerate structure prior to 1990s allowed firms to channelize their limited resources like capital, manpower, time etc. in a more effective manner leading to greater profitability. Under the new structure, since resources were focused upon a narrow range of businesses within same or related industries, it allowed firms to develop core competencies in managing the businesses which proved to be a

strong competitive advantage. In contrast, in the early diversified conglomerate structure which built around numerous businesses in unrelated industries firm resources failed to generate any strong advantages that would help firms to sustain themselves in the competition. This happened mainly because of the fact that under the conglomerate structure limited resources were spread thinly over a myriad of unrelated businesses. Firms suffered from shortage of resources to fully develop its numerous businesses. The situation was also worsened by the fact that since most of the businesses were in unrelated industries the conditions for developing these businesses did not match. Each business required a separate specialized pool of resources to develop. Distinct developmental needs ruled out any possibility of the shared use of available resources. The complexity and costliness of managing the conglomerate structure eventually led to its demise.

This is why firms became inclined towards developing a firm structure which would be built around core businesses in same or related industries. By the end of the 1990s, this new firm structure had become a *global best practice*. As mentioned earlier the firm sold off their non-core businesses to concentrate all their resources and capabilities upon the chosen core businesses. The subcontracting of value-added activities by firms as they developed their global value-chain was also driven by maintaining the focus upon core businesses. The performance of value-added activities which were not a part of the core capabilities of firms were subcontracted to other independent firms for whom these activities constituted their core businesses.

In this manner firms enabled themselves to develop core competencies in managing their core businesses by investing their resources in only acquiring and/or developing scientific knowledge, skilled individuals, supply systems, process technologies, customer relationship management skills, distribution networks, branding activities that were specific to the nature of their core businesses and industries to which they belonged. This led to greater customer satisfaction, larger customer base, greater profits and huge market share.

Thus, focus on core businesses due to its ability of generating the competitive advantage of core competencies acts as a strong barrier to firms which manage multiple unrelated businesses.

## ii) **R&D capabilities**

Research & Development is defined as *a creative and systematic work undertaken in order to increase the stock of knowledge - including knowledge of humankind, culture and society – and to devise new applications of available knowledge* (OECD 2015: 44). Within the framework of firm activities, the purpose of R&D is to undertake research into new and *advanced technologies* and into *distinct consumer preferences*, which varies from market-to-market, in order to *develop innovative production processes and products (goods & services)* that benefit both consumers and firms.

*Process-related R&D* is aimed at developing innovative production *processes which are more efficient* in terms of time, effort and capital; thereby enabling firms to earn higher profit margins than their competitors and even to replace the existing market leaders in some cases. The technologies leading to innovative processes are the sole proprietary of the R&D conducting firms.

*Product-related R&D* is aimed at developing innovative *products which are meaningfully differentiated* from other competing products. A product can become differentiated along two dimensions: *horizontal* and *vertical*. In horizontal differentiation, products are designed according to the differing tastes and aesthetic preferences of consumers. In vertical differentiation, products are enhanced in their quality. Differentiation benefits consumers by creative value for them. The value is created by offering them products with features or quality which they might not be able to obtain from other firms. Differentiation also benefits firms by enabling them to command premium price for products which offer customers relevant content and quality which is unmatched and unobtainable from elsewhere. This leads to superior profitability for firms. Furthermore, it diversifies and broadens the product offering of firms which allows them to tap into consumer bases with different purchasing powers. As a result, firms can generate sales from multiple sources.

*Proprietary process technologies* and *differentiated products* resulting from R&D are *high-order competitive advantages* in terms of sustaining a firm's competitiveness within an industry. Possession of such *sophisticated R&D capabilities* is considered an important *strategic asset* by a firm.

However, a firm's possession of superior capabilities in R&D depends upon its access to the *advanced and specialized factors of production*. *Advanced factors* include modern digital data communications infrastructure, highly educated personnel such as graduate engineers and computer scientists, and university research institutes in sophisticated disciplines. *Specialized factors* involve narrowly skilled personnel, infrastructure with specific properties, knowledge bases in particular fields, and other factors with relevance to a limited range or even to just a single industry (Porter 1990:92-94).

Advanced and specialized factors are in turn, created over time through investments in *human and knowledge resources*. *Human resources* can be divided into a myriad of categories, such as toolmakers, electrical engineers with PhDs, applications programmers, and so on. *Knowledge resources* include the nation's stock of scientific, technical, and market knowledge bearing on goods and services. A nation's scientific and other knowledge resources can be subdivided into a myriad of disciplines, such as acoustics, materials science, and soil chemistry (Porter 1990: 91).

However, the creation and existence of such factors alone does not guarantee a base for high R&D capabilities that spawn sustainable high-order competitive advantages. Continuous improvement in the state of knowledge, the state of science and the state of practice overtime, continually push the standards for what constitutes an advanced or a specialized factor upward. Thus, *factor pool is a depreciating basis for sustainable advantages unless it is constantly upgraded* (Porter 1990: 95). As a result, in order to possess R&D capabilities that bring about sustainable high-order competitive advantages firms must not only have access to the factor pool upon which these R&D capabilities are built but must also have access to substantially large investments to continuously upgrade the factor pool. Therefore, to cultivate sophisticated R&D capabilities firms not only require access to advanced and specialized human and knowledge resources but also require substantial capital to upgrade these resources.

Thus superior R&D capabilities pose effective barriers to the entry and survival of smaller and late-comer firms in global markets in two ways 1) in their ability to lead to higher-order competitive advantages of proprietary process technology and differentiated products and 2) in their requirement of substantial capital to both access and constantly upgrade the factor pool which forms the basis of R&D capabilities. This is why even after establishing global leadership positions in their respective industries, globally competitive firms at the helm of the current global business system continue to spend on a large-scale to further upgrade their existing R&D capabilities and to generate new ones in order to maintain their commanding status.

### **iii) Branding**

Branding is a tool employed by firms for communicating with consumers and influencing their purchasing decisions. The influence is generated by running a branding campaign that creates a favorable *reputation* and *image* for a firm's product among consumers. This in turn is achieved when product is differentiated from the product of a competitor firm. Differentiation comes from highlighting the innovative content of the product and/or from associating a specific imagery with the product (WIPO 2013: 122).

Innovation-based branding works by effectively communicating information that highlights quality, functionality, reliability and other attributes of the product to consumers. On the other hand, image-based branding, mostly done through advertising, first creates a *brand identity* by associating products/services with a particular image, for instance of luxury, trendiness or social responsibility which appeals to the *personal, subjective and emotional preferences* of a specific target consumer group (WIPO 2013: 125).

When a firm is able to create a favorable reputation and image for its products through branding it is able to encourage demand and the willingness to pay among consumers for its own products over those of its competing firms. Thus, branding extends a significant competitive advantage to a firm over its competitors by making its products differentiated and relatively more appealing to customer. Furthermore, cumulative branding efforts

overtime form stronger competitive advantages for firms by cultivating *consumer goodwill* or *consumer loyalty* towards their products. The consumer goodwill or loyalty brings great economic benefits to firms as it makes consumers willing to pay even premium prices for branded products. Consumer goodwill reflects an unshakable faith of consumers in the image and reputation of a particular firm's product.

In addition to aforementioned benefits branding also extends other competitive advantages to firms. For instance, the improved financial performance of a firm due to branding enables firms to put more funds into R&D and to upgrade the innovative content of their products to make them more differentiable and holding greater appeal for consumers. Similarly, financially better off firms are also capable of attracting and retaining talented human resource. Lastly, consumer goodwill also enables firms to draw their loyal consumer base towards new products in which it holds no previous experience.

Overall, overtime branding becomes a strategic asset for a firm that acts as a formidable barrier to the entry and survival of smaller and late-comer firms in global markets. Barriers from cumulative branding manifest themselves in two major ways: 1) high costs of establishing a brand and 2) difficulty of making consumers switch to a new brand from an already established brand.

Huge expenditures required for conducting a range of branding activities such as, brand promotion, advertising etc. to compete with established brands could cut down a smaller firm's profit margin sometimes, even causing them to exit the market. Similarly, it could also lead new firms to abandon their plans of making market entry at all. Owing to the existing consumer goodwill or loyalty towards established brands, new and smaller firms face great difficulties in making consumers shift from those brands to their own products. This is because strong reputation and image on which consumer goodwill or loyalty is built towards a particular branded product makes it un-substitutable in the perception of the consumers. This makes consumers less inclined to switch to competing brands even if the latter offers a better option in terms of cost or quality.

It is argued that in the present interlinked global economy rising world incomes are increasing the necessity of possessing strong brands (WIPO 2013:7). Firms are responding by making huge and sustained investments in building global brands. The available data for global expenditure on advertising, which only represents one of many modern branding activities, reveals that globally the advertising expenditure has become equivalent to about one-third of the global R&D expenditure (WIPO 2013:30). The firms are employing the globalised mass media; their vastly spread production centers; and other new channels of communication and marketing such as, the global marketing machinery including freezers, coolers and dispensing machines that distribute branded goods in close proximity to customers; in order to penetrate the consciousness of global consumers (Nolan 2001:101; WIPO 2013:8).

Therefore, since Chinese firms also fall in the category of late-comer firms, their success in emerging as globally competitive firms under the prevailing concentrated structure of the global business system heavily depends upon overcoming the competitive challenges the latter poses to such late-comer firms. *Thus the success of ICF, which is aimed at cultivating globally competitive firms, is indeed contingent on overcoming the competitive challenges of the current global business system.*

### **3.4 Summary**

Certain significant economic, social and technological developments in the mid 1980s and early 1990s liberalized the cross-border flow of capital, people and trade; opened new industries and countries to global capitalism and; took the information and communications technologies to new levels of advancements. Collectively, these advancements created a favourable environment for firms to pursue a globe focused strategy. As part of the globe focused strategy which was built upon the lessons drawn from the failure of firms to sustain highly diversified national conglomerates prior to 1990s, firms focused globally on a narrow range of core businesses as opposed to the earlier business practice.



Through the strategy, firms drastically changed the manner in which their business activities were organized and forged a strong competitive position within their industries at the global level. By the end of 1990s, these firms emerged as global big businesses, which occupied a large portion of the total world sales or market/business power within their industries. This marked the establishment of a global big business system. The concentrated structure of the global big business system, in which, in almost every sector of the global economy a small number of global big businesses occupied a large part of the global market power, posed grave competitive challenges for late-comer firms. The three major challenges to late-comer firms, including Chinese firms, arose in the shape of competitive advantages of global big businesses in core businesses, R&D capabilities and branding. These three advantages have been cultivated by the global big businesses into serious barriers to the entry and growth of late-comer firms in the global markets. Thus, the creation of globally competitive Chinese firms depends upon overcoming the competitive challenges posed by the concentrated structure of the current global business system.

## Chapter 4

# Current Patterns and Achievements within the Internationalisation of Chinese Firms

### 4.1 Introduction

In the previous chapter we concluded that within the present global business system the Chinese firms will be also be affected by the competitive challenges embedded in the system for all late-comer firms. A time period of fifteen years have passed since, the Chinese leadership announced ICF as a national strategy aimed at cultivating globally competitive Chinese firms. This chapter assesses the success made so far by Chinese firms in achieving this goal. It adopts the three parameters of core businesses, R&D capabilities and branding to measure the present levels of global competitiveness of Chinese firms. It focuses on the main strategies or patterns being pursued by Chinese firms to cultivate capabilities in the three chosen parameters and also challenges faced by them in attaining these capabilities which gives an idea of their current level of success.

### 4.2 Patterns and Achievements in the Internationalisation of Chinese Firms

It is argued that the structure of the global business system has massively outpaced Chinese firms in terms of competitive capabilities (Nolan 2001: 187). Chinese firms have entered the present global business system with relatively inferior competitive capabilities in terms of R&D, marketing, scale of operations, management expertise and financial capital. Thus, they are unable to compete directly with the global big businesses and are in an extremely vulnerable position within the global system (Nolan 2001: 91&193).

It is claimed that the absence of a *global level playing field* for late-comer firms in the current global business system provides a slim probability for only a few Chinese firms to survive in direct competition with the global big businesses (Nolan 2001: 231). Most

Chinese firms will either be possibly taken over by the global big businesses and be absorbed in the vastly spread operations of the latter (Nolan 2001: 91& 217) or will have to content themselves mainly by selling lower-end sophisticated products to other developing countries outside China. (Nolan 2001: 91).

In the wake of such arguments, to know the relative global competitiveness of Chinese firms vis-à-vis the global big businesses becomes important. Core businesses, R&D capabilities and branding, identified as major barriers to the entry and growth of late-comer firms in the previous chapter, form appropriate parameters to measure the present level of success of Chinese firms in attaining global competitiveness.

#### ***4.2.1 Patterns and achievement in core businesses***

Most Chinese firms are yet to adopt the global best practice in firm structure i.e. the firm structure which is built around a narrow range of businesses in same or related industries, known as the firm's core businesses. Several studies attest to the presence of a powerful tendency among Chinese firms to diversify into non-core businesses or pursue diversified undertakings (Fan et al. 2008:11; Nolan 2001:89; Steinfeld 2001:12). Moreover, the studies also confirm that the degree of diversification in Chinese firms far exceeds that in their non-Chinese counterparts.

##### **i) Patterns in core businesses**

Several reasons have been put forward to explain the popularity of diversification among firms in China. These reasons are continuing till date.

- a) In the late 1970s *massive diversification with vertical integration* was chosen as the structural pattern for firms by the Chinese government to expand a core group of industrial firms and turn them into China's *globally competitive national champions*. The decision was inspired by the national industrial policies in the US, Europe, Japan and South Korea that built huge diversified national conglomerates which, according to the Chinese leadership, girded

their power in global markets (Nolan 2001: 15; Steinfeld 2001:30-31). Further in the 1990s the prospects of increased foreign competition for Chinese firms in the post WTO scenario, further strengthened the government's resolve to build such diversified national champions so they can act as the backbone of the national economy and as the country's main force to participate in the global competition (Nolan 2001:17; Steinfeld 2001:30-31).

- b) Chinese firms also rapidly diversified into new unfamiliar industries during the period of robust economic growth in the 1990s to capture *new growth opportunities*. This rapid diversification was also helped by the absence of barriers to entry in domestic industries, such as scant enforcement of intellectual property rights and by the ideal conditions for business environment existing at the national level due to the government's reform and opening up policies (Fan et al. 2008:7; Jin 2009:12; Larcon 2009: 18). Prominent examples of Chinese firms that rapidly diversified into new industries around this time include Haier, Apollo Group and Chundu Group. These firms had started to do really well in the domestic market and in order to boost their growth further they diversified into new industries. Haier moved from their core businesses in electric appliances to new businesses in pharmaceuticals, mobile phone, logistics and finance industries. Apollo Group moved from health products into real estate, petroleum, international trade, hotels, cosmetics and computers. Chundu Group advanced from meat processing to biochemical pharmaceuticals, drinks, packaging materials, and feedstuff processing (Larcon 2009: 18).
- c) Diversification was also endorsed by the Chinese government authorities as a key method to meet the national social objective of *employment generation*. SOEs often entered entirely unrelated business lines, at the behest of local governments to generate employment and maintain social stability (Steinfeld 2001:12-13)
- d) Diversification also provided firms with a *hedging mechanism* to manage within a domestic environment, characterized by unequal levels of economic

and regulatory uncertainty prevailing across industries, through operating in different industries (Steinfeld 2011:12-13).

- e) Diversification into various sectors also enabled Chinese firms with *a steady cash flow* when the markets turned volatile. This proved extremely helpful as Chinese firms both private and to some extent, SOEs face severe liquidity constraints (Steinfeld 2001:12-13).
- f) Firms also followed diversification to *evade financial obligations*, such as, taxes, debts, dividend payments etc. Complex corporate structure and the opacity of property rights obligations in a diversified firm diminished the monitoring and enforcement abilities of owners and state regulators over firms (Steinfeld 2001:12-13).
- g) Diversification was also considered by firms as a rational response *to reduce the uncertainties of third-party relationships with subcontractors* responsible for performing various functions that supported their businesses, such as procurement of raw material, construction, transportation etc. These uncertainties included problems like non-payment, unclear rules, poor contract enforcement etc. To eliminate these uncertainties firms preferred to take the responsibility of these supporting functions themselves (Steinfeld 2001:12-13).

## **ii) Achievements in core businesses**

The studies also highlight the *adverse impact of diversification on the global competitiveness of Chinese firms*. It is argued that the current diversified structure of Chinese firms has relegated them to *low value and low margin activities* and competitiveness of such firms in the contemporary business environment is subject to considerable doubt. They remain vulnerable and easily replaceable (Steinfeld 2001:3&30). Studies that show the impact of diversification upon China's large firms, chosen by the government to become national champions, make the most powerful case against the continued diversification of Chinese firms. As mentioned earlier, China's large firms underwent massive diversification and vertical integration from 1970 onwards

in order to become globally competitive national champions, similar to the national conglomerates in the U.S., Europe, Japan and South Korea prior to 1980s. However, even after decades of diversification and unconditional government support the so-called national champions still lag far behind multinational firms, whose authority in global business they were suppose to challenge. At the surface, these diversified Chinese conglomerates produce *an illusion of a massive scale* but in reality they are nothing but a group of small core businesses and a sea of small-scale businesses, often far below the economic efficient scale necessary for survival and prosperity on the global level. Their myriad businesses exist without any significant capabilities in R&D, brand-building etc. Even their core businesses are of small scale (Nolan 2001:92).

In a nutshell, the diversified corporate structure of Chinese firms has prevented them from fully developing their core businesses. Both, their core businesses and secondary businesses operate at small scales. They are mostly engaged in low value and low margin activities which impact the value of their products as they lack quality and innovation. They also don't possess any strong competitive advantages in R&D, branding etc. This is in sharp contrast to what globally competitive firms look like. As discussed earlier, under the present global business system globally competitive firms are characterized by economies of scale, focus on high-value-added activities such as R&D and branding which produce high-order sustainable advantages in the form of differentiated products and proprietary technologies. Thus in comparison, Chinese firms remain dangerously vulnerable and easily replaceable amidst global competition, both at home and abroad.

If Chinese firms really want to become globally competitive they would have to adopt the current global best practice in firm structure, of being built around few core businesses. This would enable them to utilize their resources and capabilities more efficiently to develop core competencies and advantages which will make their businesses globally competitive and profitable. At present most Chinese firms are suffering from the inherent weaknesses of a diversified conglomerate structure which keep resources inefficiently invested in a large number of unrelated businesses with distinct development needs. As a

result, firms are unable to develop competencies and competitive advantages in any of their businesses.

Ironically, a firm's focus on core businesses is also a crucial condition that shapes its ability to pursue different businesses in unrelated sectors in the future, if it decides to do so. Though firms built around core businesses represent the global best practice, very few cases of huge successful diversified conglomerates like General Electric also do exist. However, these cases are extremely limited in number due to the challenges involved in managing a globally diversified conglomerate. If a firm wields a leadership position in few core businesses then the cash flows generated from the core businesses can also finance the development of new businesses in unrelated industries that can expand the firm's profits and diversify its risks in the future (Larcon 2009:18). However, if firms diversify into unrelated businesses before they establish a leading position in the core businesses, they will fail inevitably. Chinese firms experienced this in the 1990s. As mentioned earlier, during the 1990s lots of Chinese firms, encouraged by ideal economic and business conditions at home, undertook rapid diversification into unfamiliar industries to grow even faster. However, the dominance of most of these Chinese firms in their core businesses was still fragile. For instance, Haier, Apollo Group and Chundu Group which had started to do really well in the domestic market in their core businesses suffered huge losses within years of diversifying into unrelated businesses. In some cases, post diversification firms even lost whatever leadership they had managed to achieve in their core businesses. This is because post-diversification, the limited firm resources began to diminish rapidly as firms needed to develop the new businesses as well. Moreover, as all businesses were in entirely unrelated industries they had separate specialized developmental needs and there was no chance that all the businesses could share the resource pool effectively. Thus, the diversion of limited firm resources to new businesses impeded the further development of core businesses in which the competitive advantages and competencies of firms had still not fully developed. As a result, the firms lost out in even their so-called core businesses to other firms who were pursuing highly focused strategies.

Drawing lessons from their past experiences, more and more Chinese firms realized the consequences of pursuing diversification blindly. Instead of diversifying into unrelated businesses firms are now said to have become more inclined to develop competencies in managing their businesses such as to improve their management efficiency, technology, sales and clientele etc. (Jin 2009:12). Yet, this is merely a beginning. Even if some companies have started reducing their number of businesses and even if few companies have developed successful focused strategies surrounding a core business, diversification still remains the dominant pattern in the 2000s as shown by several studies. If Chinese firms really want to become globally competitive they need to cultivate a narrow focus on few core businesses.

#### ***4.2.2 Pattern and achievement in R&D capabilities***

Based on the statistics on China's R&D capabilities it is being claimed that the country is rapidly catching-up with the global innovation powers like the US and Europe. The data on country-wise concentration of the global R&D capabilities reveals that China is the world's *second-largest R&D performer* after the US, which accounts for slightly more than a quarter of the global R&D spending. In 2013 China accounted for about 20 percent (\$336 billion) of the global total, whereas, the US accounted for 27 percent (\$457 billion) (IRI 2016:4 & NSB 2016:40).

Over a decade from 2003 to 2013 Chinese R&D grew at a dramatic pace averaging 19.5 percent annually. This growth rate was several times that of the US (4.5 percent annually) and EU (5 percent annually) over the same time span. China's *exceptionally high R&D growth rate* has also been the principal driver behind the vigorous increase in global R&D. The global R&D grew almost two-folds over the decade from \$836 billion in 2003 to \$1.671 trillion in 2013 and China accounted for 34 percent (\$280 billion) of this global increase in R&D. The US accounted for 20 percent (\$163 billion) and the EU accounted for 16 percent (\$134 billion) (IRI 2016: 3; NSB 2016:40).



The data on *national R&D intensity* (R&D expenditure/GDP ratio) also points towards the potential dominance of global R&D by China in the near future. China's national R&D intensity almost doubled from just over 1 percent in 2003 to slightly above 2 percent in 2013. In comparison, for the EU the ratio rose only minutely from 1.7 percent in 2003 to 1.9 percent in 2013 and it actually fell for the US to 2.81 percent in 2012 (NSB 2016:43-45).

The volume of Chinese *patent applications* and the *volume of research degrees* published annually in China are also put forward as prominent achievements of China's R&D capabilities. The country's pace of applying for patents is often described as aggressive. The volume for patent applications filed with the State Intellectual Property Office of China was expected to double to 2 million by 2015 from 1 million in 2012 (Gupta and Wang 2013:2). Some figures suggest that it has already surpassed the innovation leader, the US, in patent applications. In 2013 China applied for 825,136 technology patents while the US applied for 571,612 patents (IRI 2016:23). In the international rankings for patents, the *Bloomberg Innovation Index* for the year 2015 also placed China in the 3<sup>rd</sup> position ahead of the US (Wei 2015:7). In the sphere of research output, China's output of papers indexed in the *Thomson Reuters' Web of Science* had increased from around 50,000 papers in 2003 to 200,000 papers in 2013. The output continues to grow at the same rate i.e. an increase of about 20,000 papers every year (IRI 2016:23). Similarly, the annual volume of doctoral degrees awarded in China exceeds that in any other country. The number of degrees awarded had increased from 12,000 in the year 2000 to 60,000 in the year 2012 (Gupta & Wang 2013:2).

In the corporate space, some Chinese firms like Huawei have also gradually increased their investments in R&D at par with the leading global firms by R&D expenditure. In 2014 world's top 20 firms by R&D expenditure spent an average of 12.5 percent (ranging from \$5.6 billion to \$15.3 billion) of their revenues on R&D (Jaruzelski et al. 2015:14). According to Huawei's annual report, the firm invested 14.2 percent (\$6.6 billion) and 15 percent (\$9.2 billion) of its annual revenue on R&D in the year 2014 and 2015

respectively (Huawei 2016; Truong 2015). Clearly the firm's annual R&D expenditure is at par with that of the firms leading in R&D.

**i) Patterns in R&D capabilities**

As we discussed in the last chapter, superior R&D capabilities rest upon the factor pool of advanced and specialized human and knowledge resources. Chinese firms have been accessing these resources through various channels. These include the *National S&T programmes, joint ventures with foreign firms, foreign R&D facilities and technology acquisition.*

**a) National S&T programmes**

National S&T Programmes are a part of the *National R&D Programmes System* run by the Chinese government (Yan 2011:52). The government started promoting the S&T Programmes in 1985 with the aim to realize a high-technology driven economic growth, economic transformation and national technological independence by enhancing China's overall R&D capabilities in key high-technologies, such as, biotechnology, new materials, space etc. and by improving its international competitiveness in innovation (Larcon & Barre 2009: 129).

The national S&T programmes are composed of regular, long-term programmes ranging from basic to applied research and involving prototyping of products. Some of the main programmes are the *Key Technologies R&D Program, Spark Program, 863 or National High Technology R&D Program, Torch Program and Innovation Fund for Small Technology Based Firms* etc. (Larcon & Barre 2009: 128 ;Yan 2011:52)

Since their inception, national S&T programmes have helped Chinese firms (mostly state-owned) immensely in building their R&D capabilities by providing them with a conducive ecosystem rich in advanced and specialized human and knowledge resources.

Chinese firms are the key implementers of national S&T programmes, along with various other Chinese public research institutes and universities. Their collaboration with these research institutes and universities under the S&T programmes, have enabled them to

draw upon the vast human and knowledge resources of the former. For instance, the *high-tech parks/clusters or the high-tech industry development zones* are a perfect example of physical spaces of creative collaboration developed by the government under the National S&T programmes, where research institutes, universities, Chinese firms and even foreign firms come together to work on various research projects. These parks or clusters are based on the existing models of *Silicon Valley* in the US, *Tsukuba* in Japan or *Hsinchu Science Park* in Taiwan (Larcon & Barre 2009: 131). They have enabled Chinese firms to build their R&D capabilities on the strength of human and knowledge resources of a diverse and vast pool of participants in the park. As a result, of these R&D capabilities many Chinese firms have managed to develop proprietary technologies and innovative products which have bolstered their performance in the market.

Hisense, a state-owned Chinese white goods and electronic manufacturer, has been one of many beneficiaries of the National S&T Programmes. The Hisense R&D Center at Qingdao is a recognized national industrial base under the 863 Programme and a software industrial base under the Torch Programme (Hisense). Its initial commercial success in China was the direct result of state R&D projects. In 2005, Hisense developed a new processing chip leading to a new product under the brand name of Hiview. The chip was the first industrial digital TV chip with independent intellectual property rights in China's audiovisual field, and had originated from a research project funded by the Ministry of Information Industry aimed at reducing China's dependence on foreign technology. The example of Hisense demonstrates how National S&T programmes have helped Chinese firms in developing their R&D capabilities leading to proprietary technologies and new marketable products (Larcon & Barre 2009: 139).

#### **b) Joint ventures (JVs)**

Joint ventures with foreign firms form another channel which Chinese firms have used over the years to source necessary resources to build their R&D capabilities. *Foreign firms* have been perceived as *repositories of advanced and specialized human and knowledge resources* in China for a very long time. This was one of the reasons why the Chinese government had facilitated the participation of foreign firms in the national S&T programmes as well. They had intended to use the advanced and specialized resources of

foreign firms to build China's capabilities in R&D. Under the national S&T programmes foreign firms were engaged in the key role of training and development of Chinese scientists, engineers and technicians. For instance, the subsidiaries, R&D labs and offices of many leading foreign firms such as Nokia, Hewlett Packard, Matsushita, Mitsubishi, Microsoft, Oracle, and Novartis etc. were set up within the Zhongguancun Science Park, in Beijing; where they conducted training and development activities (Larcon & Barre 2009:133).

Joint Ventures institutionalized the intent of the Chinese government to utilize the advanced and specialized human and knowledge resources of foreign firms for the enhancement of the R&D capabilities of Chinese firms. The government made establishment of JVs with local Chinese firms a policy condition for all foreign firms eager to set up business in China. JVs with foreign firms were specifically aimed at facilitating the transfer of advanced technologies and scientific know-how from foreign firms to their Chinese counterparts, which could then be utilized by the latter to create their own proprietary technologies.

### **c) Foreign R&D facilities**

Chinese firms are also engaged in the global R&D strategy of accessing *location-bound resources* by establishing R&D facilities abroad.

Since 1990s, firms all over the world have been increasingly spreading out their R&D activities to different locations across the globe (Dachs 2012:3). This is mainly because certain types of human skills and knowledge resources are location-bound i.e. geographically unevenly distributed. Therefore, firms secure those resources which are unavailable within their home countries by establishing R&D facilities in locations abroad where such resources are found in abundance. This type of global R&D strategy is *asset-seeking, competence-creating or home-base augmenting in nature* (Dachs et al. 2012:7). In the foreign R&D facilities, firms engage in what is called an *open innovation model* where they conduct R&D activities in partnership with relevant *knowledge partners*, ranging from universities, research organizations, industrial or high-tech clusters, clients, suppliers and even competitors (Dachs et al. 2012:7). Thus, firms build

their own R&D capabilities by hosting R&D collaborations with various knowledge partners within foreign R&D facilities and using their resource pool.

Huawei, a private Chinese firm and a global leader in information and communications technology (ICT) provides an excellent example of how firms in China are also effectively utilizing this kind of global R&D strategy to their benefit.

According to Huawei's website, the firm follows a *distributed innovation strategy* under which it has established R&D facilities in multiple locations around the world. At present the firm has 16 R&D centers in countries including Germany, Sweden, the US, France, Italy, Russia, India, China, Belgium, Ireland and the UK which account for more than 45 percent of the firm's total global workforce. The R&D centers host firm's close R&D collaborations with industry, academia and research institutes of the location where the centers are located.

Eight out of sixteen of Huawei's R&D locations are located in Europe (Belgium, Finland, France, Germany, Ireland, Italy, Sweden and the UK). The European R&D centers are playing an important role in boosting Huawei's R&D capabilities.

They have enabled the firm to access knowledge and information about the European market and about the preferences and attitudes of European consumers. This knowledge has enabled Huawei to develop differentiated products which specifically cater to the needs of its European customers. This is of crucial importance as Europe is a core strategic marketplace for Huawei and products which are meaningfully differentiated for European consumers help the firm with effective exploitation of the European market and reap larger revenues.

The European R&D centers have also provided Huawei with access to superior European knowledge and expertise in advanced technologies. Each of these centers is established inside *innovation clusters or centers of excellence* focused on a particular technological research. In other words, each of these *R&D centers has a specific innovation focus*. For instance, R&D sites in Northern Europe focus on mobile network, base technology development and mobile design. R&D facilities in Italy, Germany and the UK focus on optoelectronic research operations (Huawei 2013). The benefits of the highly advanced

and specialized knowledge offered by these R&D facilities to Huawei have been so great that collectively these facilities have become a *global competence centre* for the firm.

#### **d) Technology acquisitions**

Of late Chinese firms have become increasingly engaged in foreign technology acquisitions. Foreign technology acquisition is a fast method of bringing *key frontier technologies*, developed by target foreign firms over a long period of time through substantial investments, under the ownership of the acquiring firm. The acquired technologies boost the R&D capabilities of the acquiring firm by a large measure.

BOE Technology Group (BOE), Shanghai Automotive Corporation Limited (SAIC) and Lenovo are examples of few Chinese firms whose R&D capabilities got tremendous boost by acquiring foreign technologies. In 2003 BOE acquired the thin-film transistor liquid-crystal display (TFT-LCD) business of Korean company Hydis. Through the acquisition BOE became the first ever Chinese firm to gain access to the *core technology of TFT-LCD*. With the acquired resources BOE was able to significantly improve its TFT-LCD display devices and other products (Deng 2009:82; Larcon 2009:238). In 2004 SAIC purchased a controlling stake (48.9 percent) in South Korea's Ssangyong Motor, then number 4 in the South Korean market. With the SAIC-Ssangyong deal SAIC acquired the key *hybrid car technology* as well as *diesel engine and transmission technology* from the South Korean automaker which had been developed with the huge government funding. (Deng 2009:78; Li 2009:63; Williamson & Raman 2011:3).

In the same year, Lenovo also acquired IBM's PC business. The deal positively contributed to Lenovo's R&D intensity and innovative capabilities. IBM's PC business was powered by leading *enterprise-class PC technologies*. The deal also provided Lenovo access to IBM's innovative R&D activities involved in creating *advanced microprocessor* and *open software technology for the next-generation computing platform*. Overall, the deal eased Lenovo's advancement into leading-edge technology, differentiated products and sophisticated services necessary for global competitiveness (Deng 2009:82; Lenovo 2005)

## ii) Achievements in R&D capabilities

Despite various channels adopted by Chinese firms to enhance their capabilities in R&D the truth remains that an overwhelming majority of Chinese firms still operate with R&D capabilities which are much inferior to those possessed by globally competitive firms.

In the last chapter we discussed that superior R&D capability of a firm is determined not only by its ability to access advanced and specialized human and knowledge resources but also by its ability to continuously upgrade these resources to match the constantly changing standard of what constitutes an advanced or a specialized resource. In other words, *the quality of resources is as important as their availability*.

The reason why Chinese firms in general are still weak in their R&D capabilities is because most of them largely work with human and knowledge resources which are developed indigenously through various national institutions such as, educational institutes, research institutes, universities, firms etc. The institutions which engage in the development of advanced and specialized human and knowledge resource in a country are collectively known as the *factor-creating mechanism* of that country (Porter 1990:95). It is believed that the *social and political values and history of a nation influences the character of the institutional mechanism prevalent in a country for factor creation* (Porter 1990: 96).

In China, the government exercises an overarching influence over each and every aspect of life. It creates the social, political values and other values of the country and carries out their strict enforcement through several national institutions. Factor creating mechanism in China is no exception to this influence. Majority of participants in the national factor-creating mechanism are public or state-owned. It is believed that the *state-ownership* of the large majority of Chinese institutions involved in creating the indigenous pool of human and knowledge resources has *undermined the quality of these resources*.

Below we take the case of three types of resource-creating institutions in China – *educational institutions, firms and, research institutes* - to explain how these institutions, laden with the values of an authoritarian Chinese government, have negatively affected the quality of the resources they create.

Chinese government has a monopoly over the country's *higher educational system*. Although China has both state-owned and private universities, yet the latter holds a dismal position within the ranks of country's higher education institutes. Private universities not only lack funds and students but their degrees are also not recognized by the national laws on education. The *state-owned universities*, on the other hand operate under the tight bureaucratic control of the Chinese government. Within these universities, the government wields its *influence over the governing structures* of the universities through institutions like party committees and party secretaries. This bureaucratic presence robs the faculty members of any role in the governance of the universities and also of the freedom to pursue ideas. It is claimed that the *system of parallel governance* in China's state universities inhibits, rather than enhances the flow of ideas. The *bureaucratic control* is considered an embodiment of the political values of China's dictatorial government which believes in keeping everything under its iron grip, even ideas, which could lead to conclusions which might not always be in the interests of the government. These government-inspired political values are creatively fatal in the sense that they *reject an essential condition for innovation*, i.e. the *freedom of ideas* (Abrami et al. 2014:3). Even at the lower levels of *primary and middle-school education* in China, which is a state-run system of public education, the government suppresses freedom of ideas by emphasizing on *rote memorization*. Some claim that rote learning begins to undercut the country's innovation and entrepreneurial potential from the very start (Gupta and Wang 2013:3; Wertime 2014:3). Some like the founding president of *Google China*, Lee Kai-fu maintains that the government's focus on rote learning is responsible for China's inability *to produce creative and original thinkers as iconoclastic minds were either being forced into conventional thinking or they were being outcast* (Gupta & Wang 2013:3).



There is a consensus over how the government's *political value of control*, which disregards a culture of diversity, fails to encourage unconventional and original ideas and, compels people to fit into a *homogenous whole* has created a *creative deficit* in the country's human and knowledge resources (Gupta & Wang 2013:3, Wertime 2014:3). This government obsession of bringing everything under its purview and align everything with its own interests has also been cited as a reason for *talent exodus* from China involving talented and creative graduates leaving the country to study or research in richer and freer countries (Wertime 2014:5).

Chinese corporate space is characterized by a strong government support and preference for *state-owned firms*. The state-owned firms have been touted by the Chinese government as China's answer to the globally successful firms from the West for a very long time now. However, the *government's close association* with these major corporate players and resource-creating institutions is held responsible for having *taken away their innovation imperative*. Firstly, the state-owned firms enjoy *privileged access to inputs* such as funding, raw materials, protection from competition because of their state-ownership. Secondly, as state agencies they are also responsible for demonstrating the social values of the Chinese government. It is argued that *primary goal* of these firms is a socialist one i.e. *to create employment* to accommodate the burgeoning workforce rather being a capitalist one i.e. to make more profit and to maximize the shareholder value (Gupta & Wang 2013:2). Therefore, the state identity of these firms keeps them *less focused on R&D*, which does not form a top priority. As a result they play a less active role in creating resources that might lead to R&D capabilities strong enough to bring disruption in the global R&D landscape.

The national system of *research institutions* in China also suffer from government-related problems. It is claimed that *bad practices concerning allocation of resources* are rife in the government-run research institutions. Research funds to carry out R&D programmes are allocated more on the basis of the *grantee's connections within the government* rather than his research abilities and knowledge. This *creates resource wastage, stymies innovation and corrupts the spirit* (Economist 2015:2; Gupta and Wang 2013:2-3).

Knowledge resources coming out of such establishment cannot be relied up as holding international standards.

Most Chinese firms still work largely with this indigenous resource pool created under the influence of the social and political values of the authoritarian Chinese government which has seriously undermined its quality. Such resources are far behind in their level of specialization and advancement when compared to resources which are developed in freer environments which celebrate diversity and unconventionality that denote innovation. Thus R&D capabilities of most Chinese firms remain curtailed in global competition. To deal with the inability of indigenous resources to generate R&D capabilities at par with those possessed by globally competitive firms some Chinese firms are investing in foreign R&D facilities and conducting foreign technology acquisitions, as discussed earlier. However, it is still a fairly recent phenomenon, besides being an expensive strategy as well.

Overall, the verdict on the global competitiveness of current R&D capabilities of Chinese firms is not very encouraging. Various products from Chinese R&D, such as, innovation, patent applications, research degrees etc. reveal a relatively weak R&D capacity. For instance, Chinese firms are largely seen as engaged in *iterative innovation* (Gupta & Wang 2013:2) or *fit-for-purpose innovation* (CEIBS 2015). This type of innovation involves R&D which merely builds up on a preexisting product idea to adapt it to the domestic market preferences. The resulting products are considered nowhere near globally mature products which offer superior quality and novel features, which can only be developed through intensive R&D. An interesting study prepared by the *McKinsey Global Institute*, entitled *The China Effect on Global Innovation* that gauged the impact of China's innovation capabilities on Chinese firms reasserts the lack of global competitiveness of Chinese firms in delivering more challenging innovation (Woetzel et al. 2015:5).

Chinese *patent applications* are considered another significant indicator of R&D capabilities. Vast majority of Chinese patent applications are for *utility model patents*.

Although these are called patents they differ significantly from a proper patent in terms of their innovativeness. While patents represent absolute novelty or innovativeness, the inventive step in a utility model patent is either missing or has a considerable low threshold. In fact, absolute novelty is not even a requirement for granting such utility model patents. It is for this reason that not all countries in the world, such as the US, grant such patents. The contribution of China-based inventors in the total volume of patents granted by leading patents offices outside China also confirms the *low innovative content of Chinese patents*. For instance, in the total number of patents granted by the *US Patent and Trademark Office* and the *European Patent Office* the share of China-based inventors was a mere 1.8 percent and 1.2 percent respectively (Gupta & Wang 2013:2). The argument that China's aggressive patent application activity is a sign of its innovation productivity loses further ground when the fact that half of the patents that originate within China actually belong to the subsidiaries of foreign multinationals, is taken into account (Gupta & Wang 2013:2).

Chinese firms have a long path ahead of them, embedded with serious challenges to developing truly competitive R&D capabilities, which they need to overcome before any claims of their having caught up with the global leaders in R&D can be considered with some seriousness. Firms like Huawei which are considered R&D leaders in corporate China, although investing increasingly in R&D capabilities are still a rarity in China.

#### ***4.2.3 Patterns and achievements in branding***

Some Chinese firms have made substantial achievements in their global brand-building efforts. They are pursuing different strategies to create global brands

##### **i) Patterns in branding**

The brand-building strategies currently pursued by the Chinese firms can be broadly categorized into two main categories: 1) *the internal brand-building strategy* and 2) *the external brand acquisition strategy*.

### a) **Internal brand-building strategy**

The internal brand-building strategy is a long and painstaking process undertaken by a firm internally to brand its products and includes activities aimed at creating *brand awareness* and building *brand credibility*.

Brand awareness involves *brand positioning* and *brand recognition*. Brand positioning refers to *choosing a distinct image* by a firm for its brand which the firm wants to establish in the minds of the consumers to make its brand differentiable or distinct from competing brands. This image conveys the benefits of owning the brand to its prospective customers. The brand can be given a technologically novel image or an image that appeals to the specific personal interests or preferences of the targeted audience for instance, image of luxury or eco-friendliness. Brand recognition refers to the creative, frequent and consistent *promotion of the brand* through platforms, that would draw maximum attention from consumers, such as through internet marketing, event sponsorship, trade exhibitions, television advertising etc. The aim is to make brands readily available to the memory of consumers.

Brand credibility refers to *securing the ability to deliver the brand image* promised to consumers during the brand positioning phase. This involves investing in R&D capabilities to sustain the quality, innovativeness and changing standards of customer relevance of the brand promised to the consumers. The ultimate motive is to deliver on the promise made and earn the trust of the consumer which over time cultivates *consumer loyalty and goodwill*.

Haier and Huawei are few Chinese firms which have created globally recognised and acceptable brands by pursuing internal brand-building strategy. The Chinese household appliance brand Haier was created in 1984 by Zhang Ruimin. Since its inception, Haier nurtured global aspirations and aimed at capturing the mature developed markets of the West. The necessity of competing with established global brands such as GE, Matsushita and Philips in these markets made the possession of an equally strong brand

indispensable. It began with creating a Western brand image by choosing a German sounding name i.e. Haier to imply the technology competence of the brand (Ille & Chailan 2011: 87). To convince the Western consumers about the technologically competent and qualitatively superior image of Haier, the firm invested in R&D to upgrade their technological capabilities, to understand the perception of consumers concerning Chinese products and to understand their specific needs, all in order to develop products that held value for consumers. Its European headquarters was staffed with local executives. It also engaged in strategic promotional activities to create brand recognition. For instance, it is said that Haier's global recognition was strongly boosted by its sponsorship of the 2008 Beijing Olympics (Ille and Chailan 2011:87).

Huawei, the global information and communications technology (ICT) solutions provider, whom we discussed under the section of R&D as well, also managed to build a globally recognized brand through internal brand-building strategy. It built its brand image around innovative, quality products catering to the changing consumer preferences. Like Haier, Huawei also invested in R&D, as is evident from our previous section. Huawei drew upon local knowledge to increase the consumer relevance of its brand and thus to deliver on one of the aspects of its promised image. While creating a global brand it has focused on local traditions and has become involved in a kind of *glocalization/globalocalization* i.e. thinking global, acting local (Ille & Chailan 2011: 88). For instance, to integrate with the foreign culture, Chinese expatriates from Huawei in India adopted Indian customs which is claimed to have been successful while competing with giants like Cisco or Ericsson (Ille & Chailan 2011:88).

#### **b) External brand acquisition strategy**

External brand acquisition strategy, as the name suggests, is an *external method of generating branding advantages* without carrying out any of the above mentioned internal brand-building activities. An external brand acquisition strategy has been possible for firms due to the existence of a *market for brands* which enables firms to buy and sell brands at the national and international level. In this kind of strategy, a firm

acquires a well-recognized and long-established brand from another firm to benefit its own products. Brand acquisition strategy is famous with firms because of two main reasons. Firstly, it allows firms, which do not possess global brands as part of their own core strategic assets, an easy access to brand-building competencies. Secondly, it is a faster method for firms to secure global recognition for their products, as building reputable global brands through internal strategy is a long process that demands persistent and enormous investments in various branding activities. In other words, brand acquisition strategy provides an excellent method for firms to secure strategic brand assets in the shortest time possible without having to invest substantially over a period of long time, to build capacities that create strong brands.

Chinese firms are also increasingly carrying out global brand acquisitions. In fact, acquisition of established international brands, mainly from the developed markets, is one of the main reasons behind the current overseas M&A drive by Chinese firms. The trend of Chinese firms acquiring global brands is said to have gained momentum after the 2008 Financial Crisis. The financial crisis adversely affected the economic outlook of many global business giants. Many reputed Western brands made negative earnings and their assets were undervalued. Leading Chinese firms with sufficient financing and ambitions for global expansion were quick to perceive this as a favourable opportunity. Thus, Chinese firms began acquiring well-known international brands which were struggling in the post-crisis period. A prominent example is of the Ford Motor's Volvo car unit which reported a decline in its total revenue and production volume in the years 2008 and 2009 and was eventually acquired by Zhejiang's Geely Holding Group which is one of China's top 10 auto manufacturers.

In the year 2011, the brand acquisition strategy also secured the *official support* of the Chinese government. At the Fourth Session of the Eleventh National People's Congress (NPC) in Beijing on March 7, 2011 China's Commerce Minister Chen Deming stated that the government supports "*Chinese companies to license or acquire famous global brands in order to obtain global recognition and improve the image and competitiveness*" (China Daily). On 14<sup>th</sup> March 2011, the idea of competent Chinese firms to acquire overseas

brands was included in the country's 12<sup>th</sup> FYP (2011-2015). Since then, apart from firms which are industry leader in the Chinese market, even small and medium-sized enterprises have joined in the race for acquiring well-recognized brands.

Lenovo is cited as an example of how brand acquisition strategy has been utilized by Chinese firms to become globally more competitive. It is claimed that Lenovo's current global brand position is based on its 2004 decision to purchase IBM, an existing world famous brand in the PC business (Ille & Chailan 2011: 86). Created in 1984 originally under the name of *Legend*, Lenovo was successful in China but practically unknown outside. It was in 2004 that it switched its name from Legend to Lenovo and simultaneously bought the PC business from IBM to strengthen its brand image. The deal which allowed Lenovo to execute a co-branding strategy that put the Lenovo-IBM logo on its products for five years resulted in major competitive advantages. The deal also gave Lenovo the permanent ownership of the IBM's brand *Thinkpad* (Ille & Chailan 2011: 86).

## ii) Achievements in branding

Firms in China do realize the importance of branding. China is investing more in branding today than high-income countries did when they were at a stage of development comparable to China's present stage (WIPO 2013:7). However, a lot still needs to be done. Most international brand rankings show that majority of Chinese firms still lag far behind their global competitors in possessing globally recognized brands. *Huawei* and *Lenovo* were the only Chinese firms in the reputed *Best Global Brands* report for 2015 by *Interbrand*, a brand consultancy which ranks top 100 international brands based on their brand value on an annual basis. Both brands are still positioned quite low in the global ranking, with Huawei standing at 88 and Lenovo at 100. Additionally, in another prestigious annual brand listing for 2015, *Top 100 Most Valuable Global Brands*, published by the British multinational market research firm *Millward Brown*, it was concluded that only a meager 22 percent of consumers outside China can actually name a Chinese brand (Doland 2015).

Many reasons have been put forward to explain the lack of globally recognized Chinese brands.

*Country of Origin* or the *COO effect* is the most cited problem which affects branding efforts of Chinese firms (Doland 2015; Ille & Chailan 2011: 85; Roll 2013; Wang 2015:3). The COO effect comes into play when a brand's *place of origin influences the perception of consumers* about the quality of that brand. The country of incorporation is considered a part of a firm's image and this makes it a key factor in the consumer's decision to purchase a brand from a particular country (WIPO 2013: 27). In fact, consumer's response to a brand depending upon the country of its origin and the perceptions associated with the country has gained so much importance that countries are investing a lot these days in developing strong *nation brands*. In case of Chinese firms the COO effect comes into play when overseas consumers, especially in the developed markets equate Chinese brands with low price, low quality, low safety standards, counterfeit products, etc. Chinese brands are not seen as innovators or developers. Moreover, Chinese brands sometimes also suffer from the political orientation of China. Consumers outside China have little faith in Chinese goods and services. This negative brand image, some suggest, represents the biggest challenge for Chinese firms especially because such image does not represent the entire truth. *Firstly*, such negative perceptions about Chinese brands discount the fact that for decades, highly valued Western brands bought by consumers all over the world have been actually manufactured in China. *Secondly*, they fail to acknowledge that over time Chinese brands have tremendously improved upon the quality of their products (Wang 2015:4). In reality, as we discussed in our previous section on R&D, some Chinese firms are indeed churning out proprietary technologies and innovative products through global R&D efforts.

China's *traditional industry focus* is a factor which is put forward to explain the scarce availability of internationally recognized Chinese brands. Low-cost manufacturing industries and asset-intensive industries have remained the traditional focus of Chinese companies. For such companies it is difficult to mentally adapt to the need of investing time and money for selling their products in foreign markets (Doland 2015). For



instance, many Chinese firms started out as manufacturers for other firms' final products rather than for consumers, i.e. they were mostly engaged in a business-to-business (B2B) scenario. Although, a large number of these firms have now shifted to producing directly for consumers yet they still find it difficult to adjust to the need of branding their products which is extremely crucial for attracting consumers.

The nature of *China's economic system* also aids the understanding of the current state of brand-building efforts by Chinese firms. Having gone through a long period of planned economy, Chinese firms discovered marketing, which subsumes branding activities, only in the 1990s. In other words, Chinese firms began developing brands quite late in comparison to firms from market-oriented economies. Even brands like Haier and Lenovo which can be considered as pioneers of branding within China and which are internationally recognizable, are still far behind Western brands in terms of marketing maturity. This lower level of marketing maturity is understood to be a prohibitive factor in carrying out effective branding strategies by Chinese firms.

As a result of both, China's traditional industry focus and its economic system Chinese firms are currently engaged at a very preliminary stage of branding.

*Government erected barriers* to marketing efforts is also another factor that is cited to explain the present state of branding by Chinese firms (Roll 2013:3). Sometimes domestic political decisions negatively impact the brand-building efforts of Chinese firms, for instance, the official censorship by the Chinese government of global social media sites such as, Twitter, Facebook and Youtube has been quite detrimental to Chinese firms in terms of limiting their marketing effort. Overtime these sites have emerged as highly effective channels for generating global brand recognition by bringing brands closer to a vast sea of global consumers.

Chinese firms still have a long way to go in order to acquire branding capabilities required to become globally competitive. As Chinese firms increasingly move into new geographies they cannot expect to win in global competition simply by improving the technological content, quality and customer relevance of their products through effective R&D. In fact they need branding to actually realize these competitive gains from R&D

activities. Without the help of branding activities that generate awareness about products among consumers, even the best products will remain unknown. In such a scenario firms risk losing a lot as R&D is an expensive activity. If products will remain unknown, it will affect the sales of the firms making them unable to even recover R&D costs, let alone increase profits. Moreover, in the case of Chinese firms, as noted above, products already suffer from a strong negative image due to the COO effect. Therefore, branding as a tool that communicates with the consumers is extremely vital for fledgling Chinese firms in global markets.

### **4.3 Summary**

Chinese firms are still far behind in overcoming each of the three major barriers to the entry of the late comer firms into the global business system. With respect to core businesses, majority of Chinese firms are yet to adopt this global best practice in firm structure. Most Chinese firms remain highly diversified with their limited resources stretched over myriad of unrelated businesses, the adverse impact of which reflects in their small-scale operations, low R&D and branding capabilities etc. In the case of R&D capabilities, China's R&D figures produce an illusion of rapid catching-up with global innovation leaders such as the United States and some European countries like Germany. Firms are building R&D capabilities through various channels like the National S&T programmes, joint ventures, foreign R&D facilities and technology acquisitions. However, despite the inflated R&S figures and firm strategies aimed at building capabilities in R&D, for most Chinese firms their competitive advantages remain relatively inferior to the globally competitive firms. One of the major reasons cited for this is that the influence of the political and social values of the authoritarian Chinese government, such as the suppression of the freedom of ideas, emphasis on rote learning etc, over China's factor creating mechanism that creates the country's indigenous human and knowledge resources. It is believed that this influence is responsible for the low innovation content of China's indigenous human and knowledge resources which form the basis for conducting R&D for the majority of the Chinese firms. Such resources do not conform to the international standards of what constitutes advanced or specialized.

Very few firms are able to conduct expensive R&D building strategies such as establishment of foreign R&D centers and foreign technology acquisitions which are capable of bringing a vast pool of much more advanced and specialized human and knowledge resources to Chinese firms. With respect to branding also, Chinese firms are still far behind, although some successful globally recognized brands like Haier and Huawei do exist. Chinese brands are judged badly due to China's traditional image as a low-manufacturing country. This image of the country of incorporation severely hampers the acceptance of Chinese brands in the global market. The brand-building efforts sometimes also get impeded due to certain government decisions such as those related to the censorship of social media sites which global brands hugely exploit as a highly effective platform for generating brand awareness and conducting brand promotional activities.

Overall, on the three chosen parameters Chinese firms continue to be relatively weak. Though, some firms are really doing well in terms of pursuing strategies aimed at building their capabilities. However, it will still be a long journey before Chinese firms can come at par with the globally competitive firms of the global big business system. An important finding is that along with the barriers posed by the global business system the process of the development of globally competitive Chinese firms also facing obstruction due to the Chinese government. For instance, in core businesses the Chinese government still prefers the outdated strategy of building diversified national conglomerates that were the dominant actors prior to 1990s. This strategy has become obsolete in the wake of global business revolution that started in the 1990s culminating in a new global business system dominated by highly focused global businesses. Similarly, in R&D, Chinese firms are forced to work with relatively inferior indigenous human and knowledge resources created by the government influenced national factor creating mechanism. In the case of branding as well, the brand-building strategies get stuck due to the government policies on media censorship. Thus, along with the competitive challenges posed by the global business system, the challenge posed by the Chinese government is equally decisive in building globally competitive Chinese firms, or for the success of ICF.

## Chapter 5

# Conclusion

The internationalisation of Chinese firms was institutionalised by the Chinese government in 1999 in the form of a national strategy known as *the going out strategy* or *zǒuchūqù zhànlüè* (走出去战略). Through the strategy, the government aimed at motivating more and more Chinese firms which held comparative advantages in certain businesses to internationalise their operations.

During the 1990s ICF had come to assume a new meaning for the Chinese leadership. The prospects of increased competitive pressure over Chinese firms from foreign competitors in the post-WTO era and the glaring weaknesses of the Chinese firms in handling such pressures shifted the focus of the Chinese leadership towards the operations of foreign multinationals. These large multinationals were seen by the leadership as building competitive advantages through their transnational or internationalized operations which enabled them to allocate global resources in a more efficient manner. Their strong competitive positioning at the global level in turn caused their emergence as economic powerhouses. Thus, the leadership came to view multinationality or the conduct of transnational/internationalized operations by firms as a competitive advantage in itself for improving global competitiveness.

As the leadership had already come to realize that the economic success of China in the post-WTO scenario depended upon its possession of globally competitive firms, they adopted internationalization of Chinese firms in order to achieve this goal. In other words, the institutionalization of ICF into the going out strategy by the leadership in 1999 was aimed at creating globally competitive Chinese firms.

However, the success of ICF in achieving the strategic objective of creating globally competitive firms depended upon another major factor i.e. the competitive business landscape in which Chinese firms decided to enter by internationalizing their operations.

The internationalized operations of the foreign multinationals had carved out a global business landscape, which was embedded with strong *barriers to entry and growth of late-comer firms* like Chinese firms. The landscape was known as the *global big business system* in which the *global big businesses* referred to the multinational firms. The global big business system was a highly *concentrated business structure* where on the basis of their competitive advantages the *global big businesses had come to occupy a large share of the total world sales* in almost all sectors of the economy. Some of the competitive advantages like core businesses, R&D and branding overtime had become so strong that they put effective barriers to the entry and growth of potential new rival firms, like the Chinese firms, within the global big business system.

Thus, the cultivation of globally competitive Chinese firm, or the success of ICF, came to depend upon these competitive challenges embedded in the global business system for late comer firms. This proves the *second hypothesis* of this study which claimed:-

***The successful internationalization of Chinese firms is contingent upon overcoming the challenges of the global business system – (Hypothesis 2)***

Chinese firms do realize the significance of surmounting these barriers as many of them are engaged in overcoming the competitive challenges from the global big business system through various strategies. For instance, with respect to the barrier of core businesses, Chinese firms now understand the significant role played by the firm structure which is focused on a narrow range of core-businesses in extending competitive advantages to firms. Similarly, the firms are also making tremendous efforts to building their competitive advantages in *R&D capabilities* and branding. To enhance their R&D capabilities, the Chinese firms have sought *several channels* such as, the *National S&T programmes, joint-ventures with foreign partners, foreign technology acquisitions* and

*foreign joint R&D facilities*. In order to boost their capabilities in branding, the firms are pursuing *internal and external strategies* to acquire the benefit of possessing global brands. Through the internal brand-building strategy, Chinese firms have become engaged in all the *brand-building activities*, usually performed by a global firm that owns a reputed globally recognized brand, ranging from brand positioning, creating brand recognition and maintaining brand credibility. Through the external brand acquisition strategy the Chinese firms are taking short-cuts to secure global branding capabilities by acquiring already established well-known brands of foreign firms.

*Certain modes of building R&D and branding capabilities* adopted by the Chinese firms bring them in contact with foreign workforce specialized in R&D and branding activities. Such methods at building competitive capabilities rest upon the nature of collaboration and active interactions between foreign human and knowledge resources. For instance, in *Huawei's foreign R&D facilities in Europe*, Chinese experts collaborate with their European knowledge partners and in *China's high-tech parks or the high-tech industry development zones*, foreign multinationals play the key role of transferring their knowledge and expertise by training the Chinese workforce of engineers, scientists and technicians in their subsidiaries and R&D labs located within the parks. Similarly, the foreign mode of building branding capabilities i.e. the foreign brands acquisition strategy also works on the principle of collaboration and interaction between various foreign knowledge partners. For instance, the *Lenovo-IBM co-branding strategy* embodied the joint efforts of the brand-building teams from both the firms. Moreover, branding in itself is a process that involves communicating and working in close proximity of the target consumers who could be located anywhere in the world.

Thus, such modes of building capabilities are characterized by a *constant and vibrant cross-border flow of information, technology, and people along with their specialized knowledge and expertise*. This proves the first hypothesis of the study that claimed:-

***Internationalization of Chinese firms has emerged as a significant development in the context of the deepening of globalization—(Hypothesis 1)***

Not only the competitive challenges posed by the global business system determine the success of creating globally competitive Chinese firms through ICF to a large extent, but moreover, these challenges hold the same relevance for Chinese firms today as they did 15 years before when the firms were in the early stages of ICF. As shown by the assessment of Chinese firms on the three chosen barriers to the entry and growth of late-comer firms in Chapter 4, they continue to lag behind the global big businesses substantially.

One of the most important conclusions of the study is that the *Chinese government does play a significant role in determining whether or not Chinese firms will be able to overcome the competitive challenges of the global big business system*. The government was found to be contributing to sustaining all the three barriers to the entry and growth of Chinese firms. For instance, while discussing the barrier of core businesses it is found that government plays an important role in *encouraging Chinese firms to diversify in a number of unrelated economic sectors to support the social goal of employment generation*. This eventually results in a lower priority given by firms to innovation which is a major source of firm competitiveness. Similarly, we found that the *influence of the political and social values of the authoritarian Chinese government over the national factor creating mechanism*, which includes the public educational institutions, research institutions and state-owned firms, is a major reason for the inferior of R&D capabilities of Chinese firms which is still largely built upon indigenously created human and knowledge resources for most Chinese firms. While discussing the brand-building efforts by Chinese firms we encountered yet another example of the manner in which Chinese government is sustaining the barriers to the entry and growth of Chinese firms in the global big business system. The *state-enforced censorship on global social media websites* like Twitter, Facebook etc. prevents Chinese firms from utilizing highly strategic platforms for creating brand awareness and carrying out brand promotion.

Thus, it is not just the competitive challenges arising out of the present structure of the global business system which limits the success of ICF in achieving its goal of creating

the globally competitive Chinese firms, but it is also the Chinese government which plays an important role in sustaining these limitations.



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