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# China's Branding Disadvantage

*An investigation into China's need to establish global brands, challenges faced when developing these brands, and alternative strategies available.*

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# Abstract

The Chinese firms are producing a major part of the world's manufactured goods and China is currently the third largest exporting nation in the world. At the same time Chinese firms are only responsible for a minute number of well-known global brands. It is this disproportionate representation that has been coined as China's branding disadvantage.

Using a broad range of theories and research, this project aims to give a comprehensive overview of this branding disadvantage. Firstly, arguments will be presented as to why the lack of Chinese brands is actually a disadvantage. Secondly, the causes of this disadvantage, as well as current obstacles to future global brand development in China, are discussed. Thirdly, the two main strategies available to Chinese firms wanting to overcome the disadvantage are evaluated. Finally, a new third alternative strategy is described and recommended as more suitable than the other two.

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# 1. Introduction

As the global economy develops and business markets evolve, competition amongst global corporations grows ever fiercer. Advantages that firms once had by adopting a specific manufacturing approach or technology, are now being imitated by competitors and what was once a competitive advantage quickly becomes industry standard. As a result of this fierce imitation of best practices, companies are looking to differentiate themselves using assets that are not easily imitated by their competitors. The asset that firms are increasingly turning to in their search for a "sustainable" competitive advantage is their brand. Global corporations are investing huge amounts of money on advertising their brand and the value assigned to their brands is immense. For example, Interbrand's 2005 list of top global brands estimated the value of the Coca Cola brand at $67.5 billion and that of Microsoft at $59.9 billion. (http://www.businessweek.com)

Brands can act as a competitive advantage in that every time a consumer sees a certain brand it evokes certain associations. Keller (2003; pg 68) defines brand associations as informational nodes linked to the brand node in memory that contains the meaning of the brand for consumers. Therefore if the associations evoked by a brand are positive then the brand acts as a competitive advantage. For example, if a consumer sees a BMW logo on a product he might instantly associate that product with superior quality and leading technology. These positive associations are what might convince the consumer to choose the higher-priced BMW product over other alternatives, which might be technically just as good.

Detailing the intricate processes that firms go through to build a strong brand (customer-based brand equity) lies outside the scope of this paper. Nonetheless it is important to note that establishing a strong brand, which entails creating brand awareness and developing a favourable brand image in the mind of the consumer, is a complex task. Building a strong brand (i.e. increasing brand equity) requires a thorough understanding of ones customer segment, repeated exposure to this segment, and message consistency in order not to confuse and thus anger consumers. Many of the brand associations are rooted in the subconscious and each encounter with the brand can introduce new positive associations, strengthen existing ones, or even create negative detrimental associations. As a result of the complexities involved with establishing a strong brand, imitation by competitors is almost impossible and in extreme cases illegal, therefore brand names are often seen as one of the firm's main "sustainable" competitive advantages.

Since brand names are seen as a vital source of competitive advantage for multinational corporations, we would expect nations with large consumer markets and a high volume of exports to be responsible for a variety of well-known global brands. This is not far from the truth. If you think of the world's biggest exporter, Germany (Child and Rodrigues; 2005, pg 381), one can instantly draw-up a long list of well-known global brands: Siemens, Mercedes-Benz, Adidas, BMW, SAP, etc. Similarly for the world's second biggest exporter, USA (Child and Rodrigues; 2005, pg 381), we can also draw on a long list of global brands: McDonalds, Nike, Coca Cola, Disney, Marlboro, Microsoft, etc.

However, as the world's third largest exporter (Child and Rodrigues; 2005, pg 381), China has few well-known global brands to boast about. In the previously mentioned Interbrand ranking of Top 100 Brands in 2005, there was not one single Chinese brand present, whereas there were 9 German brands and even more American ones. Furthermore, one of the first steps to building positive brand associations is establishing brand awareness. If you were to asked an average western consumer to name a few global Chinese brands they would most likely struggle considerably to name more than one. Have you ever heard of Lenovo, TLC, or Guangdong Galanz? Probably not, but each of these brands are dominant players in their respective markets. Lenovo is the worlds third-largest computer maker after Dell and Hewlett-Packard (Barboza; 2005), TLC is the worlds biggest television set maker (Barboza; 2005), and Guangdong Galanz produces one out every three microwave ovens in the world and has captured a 40% share of the European market (Zeng and Williamson; 2003). These are large corporations yet the majority of consumers outside of China have never heard of them.

China's[1] branding disadvantage is an issue that is of increasing importance and will be the broad focus of this paper. The aim is to provide a comprehensive overview of the topic and thus answer a few crucial questions: *Does the lack of strong global brands pose a problem for Chinese firms? Why has China been so slow to develop such global brands? What strategies can Chinese firms adopt in an attempt overcome this disadvantage?* The majority of China's exports are durable consumer goods (www.intracen.org) such as electronics, toys and apparel, therefore firms within such industries will be the focus of this paper. Furthermore, focus is placed upon Chinese firms entering western markets (eg. USA & EU) because these are the world's largest and most developed consumer markets and therefore contain many valuable lessons for Chinese brands. This project will be dealt up into four main sections:

In the first part of this paper attempts will be made to outline the importance of China developing global brands and the problems it might face in the future if it does not develop globally competitive brands. One could argue that China has not developed global brands in the past yet it has been Asia's fastest growing economy over the last 20 years (http://web.worldbank.org), so where is the need? A major reason why the Chinese economy is growing at such an astounding rate is because of its competitiveness as a manufacturing destination, which is due to an abundance of low-cost labour and continual market liberalization. However, is this competitive advantage sustainable in the long-run? If not, the Chinese economy will have to make use of competitive advantages besides low-cost labour, in order to maintain the level of growth they are accustomed to.

Furthermore, as the most populous country in the world with 1.3 billion (www.cia.gov) potential consumers, one might argue that the Chinese market is big enough to sustain large domestic corporations and that they need not rush to establish a presence in foreign markets. However, the joining of the W.T.O. in 2001 further guaranteed that China will continue to

[1] Mainland China, excluding Hong Kong and Taiwan

open its doors to foreign firms. These global brands are no longer in China just to manufacture goods for export, but are actually competing against local brands for domestic consumers. Figures show that although local brands are still the most popular, foreign brands are posing a real threat. As the average income of Chinese consumers continues to rise it will attract even more foreign firms, which will result in intensification of competition in local markets.

Lastly, the importance of China establishing global brands was further confirmed by the Chinese Ministry of Commerce as a report they produced stated that "*we need to cultivate a group of independent famous brands that have international influence*". (Barboza; 2005) Furthermore, incentives are in place to encourage local brands to establish an international presence.

In the second part of this paper I will investigate why China has not developed global brands in the past and what obstacles it faces in establishing such brands in the future. As far as why China has not yet produced any true global brands, the reason lies mostly with the past political orientation of the country. In a planned economy system there is no importance given to markets or international expansion and hence different competitive strategies are not explored. Four phases of governance are outlined, which demonstrate how private enterprise was eradicated and free thought forbidden.

Even though the government has now realized the need for local firms to establish brands there are a variety of obstacles that lie in their way. The liberalization of the economy is on its way but still has some way to go. The government still has majority stakes in a number of large domestic corporations and there are controls in place to restrict the ability of private firms to sell equity shares in the capital market and thereby raise capital. (Zeng and Williamson; 2003) Moreover, subsidies and preferential procurement contracts have been offered to firms that align themselves with government goals. (Child and Rodrigues; 2005, pg 388) Conventional theory says that corporations can only become truly competitive in free-markets with little-to-no government intervention, and only when firms are truly competitive will they be willing to spend substantial resources on an intangible asset, like their brand, in hope of gaining a competitive advantage.

The 23 provinces in China are historically very independent and there exists an element of rivalry between them. A main reason for this high level of independence was that in case of attack on a specific province, the other provinces could sustain themselves and would not be dependent on the province under attack. However, this issue of regional solidarity and provincial competition has had a substantial affect on Chinese enterprise.

The lack of experience in competitive strategies and brand building means that the Chinese firms must quickly learn what has taken their western counterparts decades. One part of this learning process entails getting to know your customer, which is vital for effective and successful brand building. However, customer research has been almost non-existent in China. In addition to infrastructure not accommodating traditional research methods, the Chinese culture is not very conducive to ordinary surveys. Moreover, getting to grasps with the "typical" Chinese consumer is difficult due to the size of the population and the strong focus on provincial independence which we mentioned earlier.

Western consumers represent the largest, most developed, and potentially most profitable target market for Chinese brands. This creates an additional problem for Chinese brand managers because the western consumer is very different from the Chinese consumer. Whereas the western consumer has undergone a sort of homogenization process over the last decades, the Chinese consumer has not been subjected to the MTV and Coca-Cola culture that has moulded the consumers in the west. This gives a western brand an automatic advantage in the majority of western markets, not just their home market. As a result, even though the Chinese brand managers may eventually understand their Chinese customers, it gives them little insight into how their western customers may behave.

Another substantial barrier that Chinese firms will face when trying to establish positive associations with their brand is something called the "country of origin" effect. This is when the nation where the firm originates from evokes strong association in the mind of the consumer. For example, when something is made by a German firm it is seen as robust and technologically sound, similarly if something is made in Italy it might be viewed as fashionable. The "country of origin" effect for China is mainly not positive, with the exception of perhaps herbal medicine and tea. Hence, the "country of origin" effect is another obstacle in the way for Chinese firms that are attempting to build a global.

The lack of enforcement of Intellectual Property Rights is another reason why building a brand in China maybe more troublesome than elsewhere. Piracy is common and brand names are often stolen. This considerably reduces the incentive for local firms to invest in branding since other businesses can reap the gains on their branding expenditure. Furthermore, if customers have a negative experience with a "stolen" brand, the negative associations that are established towards this brand directly affects the original brand producer.

In the third part of this paper I will briefly discuss the two main differing routes that a Chinese company can take to establishing a global brand. I will attempt to highlight the main possible benefits and challenges of each of these routes, as well as try to give examples of Chinese firms that have undertaken such strategies. On the one end, Chinese firms may decide to go it alone and proceed to setup parts of their organization in some of their main western markets. This route one can label an Organic expansion strategy. Naturally, this option will avoid a majority of the management integration conflicts that are associated with acquiring a foreign competitor. Nonetheless, organic expansion is a delicate procedure and establishing a brand this way will require a long time period.

The other route that a Chinese manufacturer may take is buying a competitor that already has established a presence in the target market. This route one can label an Acquisition strategy. The benefits of this strategy are that one established a brand presence simultaneously, since you can use the established brand to sell your products. However, one would most likely target foreign brands that are well established and evoke positive associations in the mind of the consumer, therefore the brands that should be targeted will be costly to acquire.

Having outlined two opposite routes a Chinese firm can take when trying to establish a global brand; I will in the fourth part of this paper suggest a possible third route. The third route is establishing a branding alliance, which can be explained as "*the short- or long-term association or combination of two or more individual brands, products, and/or other distinctive proprietary assets. These brands or products can be represented physically or symbolically by the association of brand names, logos, or other proprietary assets of the brand.*" (Simonin, et al; 1998, pg 30) In accordance to the make-buy-ally matrix cited by Child & Faulkner (1998) one could argue that ally option (i.e. brand alliance) is the most appropriate course of action in comparison to the make (i.e. organic route) or buy (i.e. acquisition) options.

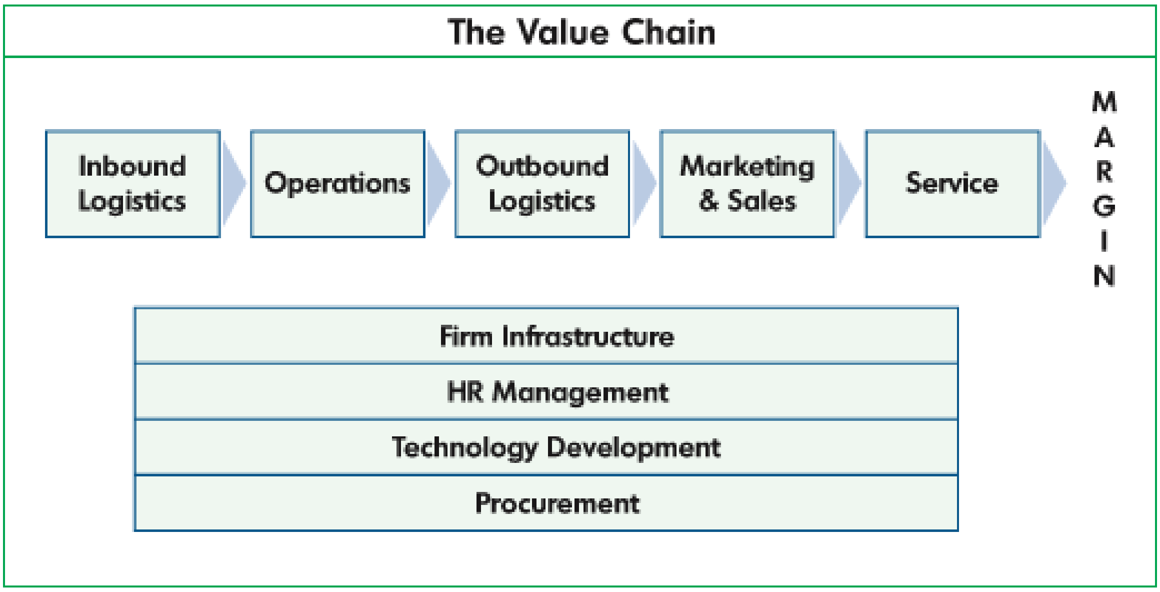
It will be discussed how a branding alliance may increase the strength of a Chinese brand. Initially the branding alliance works as a signal to customers that the product in question is of substantial quality and reduces associated risk. Furthermore, research has shown that branding alliances can result in spillover effects. This means that customers will eventually develop positive associates to the Chinese brand and not just the product which was co-branded. Following this path we will look at what conditions are conducive to beneficial spillover effects. Lastly, the possible costs and benefits of a brand alliance will be discussed and compared to the two previously mentioned global brand establishing routes. As a sort of mid-ground between the two previous routes, a branding alliance may enable firms to gain the benefits expected from either route while at the same time limit their disadvantages.

The conclusion will summarise the previous chapters, as well as the contributions that should be noted by Chinese firms. Finally, a brief recommendation is offered to Chinese firms.

# 2. The need to establish Global Brands

## 2.1 The global Value Chain

A value chain can be described as "*the set of activities that a company employs in order to design, produce, and deliver the value proposed to the customer.*" (Lasserre; 2003, pg 52) The value chain is generally depicted as is seen below (http://www.trumpuniversity.com):


The Value Chain
Inbound Logistics
Operations
Outbound Logistics
Marketing & Sales
Service
MARGIN
Firm Infrastructure
HR Management
Technology Development
Procurement

As trade barriers have fallen and transportation infrastructure improved, firms have spread their value chains over many countries in order to exploit cost advantages. What we are witnessing these days is a Global Value Chain (Gereffi and Memedovic; 2003) where the activities in the developed world tend be concentrated within the Marketing & Sales or Service segments of the value chain, whilst the activities in the less developed world are focused on the generally less profitable segments of the value chain such as Logistics and Operations, basically manufacturing. This holds true for China as they are the world's third largest exporter but have virtually no famous global brands that they market or sell. "*China's Ministry of Commerce reported this month that even though China's exports are dominated by consumer products, few famous Chinese brands are involved in the export trade. Most goods are being shipped abroad with foreign brand labels.*"(Barboza; 2005) Essentially they are "*the world's factory floor*" (www.bbcnews.com) for the global brands.

Economic growth and development over the past 20 years has been phenomenal for China and this has happened on the basis of increasing amounts of manufacturing, so why change the focus? As the cheap labour-pool from the countryside in China starts to dry up, slowly wages will begin to rise and so will other input prices. When the increase becomes unsustainable for foreign multinationals they will look to cheaper locations to manufacture their goods and without much hassle transfer production facilities there. As a result China will then have problems maintaining its current growth levels. We are already witnessing a rapid rise in average income (see Chapter 3) and there are signs that investors are looking to move their Chinese manufacturing plants to neighbouring countries such as Bangladesh and Vietnam in order to cut costs. (Tor Olav Mørseth; 13/08/2006)

China could attempt to compete with Bangladesh and Vietnam to maintain the lion share of world production by reducing corporate taxes and minimizing manufacturing regulations, essentially cutting costs for producers. Engaging in this type of strategy would place China in "*The Race to the Bottom*" (Chan; March-April 2003), where less developed countries compete against each other for foreign capital. The result is a progressive dismantling of regulatory standards and an unsustainable competitive advantage since global corporations will simply move their production to the country which is least well off. In other words, this is not a viable long-term option.

Another, much more feasible, option China has is to try and sustain their current growth by shifting the focus onto the other segments of the value chain. By taking ownership of the other activities in the value chain and thereby establishing their own brands, Chinese firms will eventually be able to exploit a more embedded competitive advantage that is easier to sustain. After establishing global brands Chinese firms will themselves be in the driving-seat and no longer have to take orders from foreign multinationals. In addition, with the control over a strong brand, firms can justify a premium price and no longer compete on price alone, which is the case with unbranded products. As Interbrand Chairman Rita Clifton stated "*He who owns the brand owns the wealth.*" (Stones; 2003, pg 23)

## 2.2 The need for “Global” brands

Given that China understands the need to focus on the other sections of the value chain and thus establish brands, why should they be concerned with building global brands and not just focusing on their domestic market? After all, their domestic market is potentially the biggest in the world with 1.3 billion consumers. One reason is that China is still a developing country and in 2004 the GNI per capita was only $1,500 versus USA’s $41,440 (worldbank.org). This implies that solely focusing on the amount of consumers in the market will give us a distorted picture of its profit potential since the average Chinese citizen has a very limited purchasing power.

Gupta and Govindarajan (2000) state five main reasons why it is a necessity for firms to become global:

1. The Growth Imperative

Here the authors point to the constant need for firms to expand and grow if they are to satisfy the capital markets and attract the best employees. The concern with pleasing capital markets is not as applicable to Chinese firms because their capital markets are still in the infancy stage and not many private firms raise money that way. However, going global may be a good way of attracting the leaders of tomorrow to your company, which seems to be a challenge in China since the availability of highly educated and experienced personnel is limited. (Dayal-Gulati and Lee; 2005, pg 95)

2. The Efficiency Imperative

This is more or less the profitability of the market we discussed at the start of this section. It claims that domestic corporations may not have adequate potential customers in order to reach critical economies of scale. Furthermore, now that the Chinese markets are opening up to competing global brands, due to the W.T.O. accession in 2001, they will feel an increased pressure to expand their operations abroad in order to exploit economies of scale similar to those that their competitors enjoy.

### 3. The Knowledge Imperative

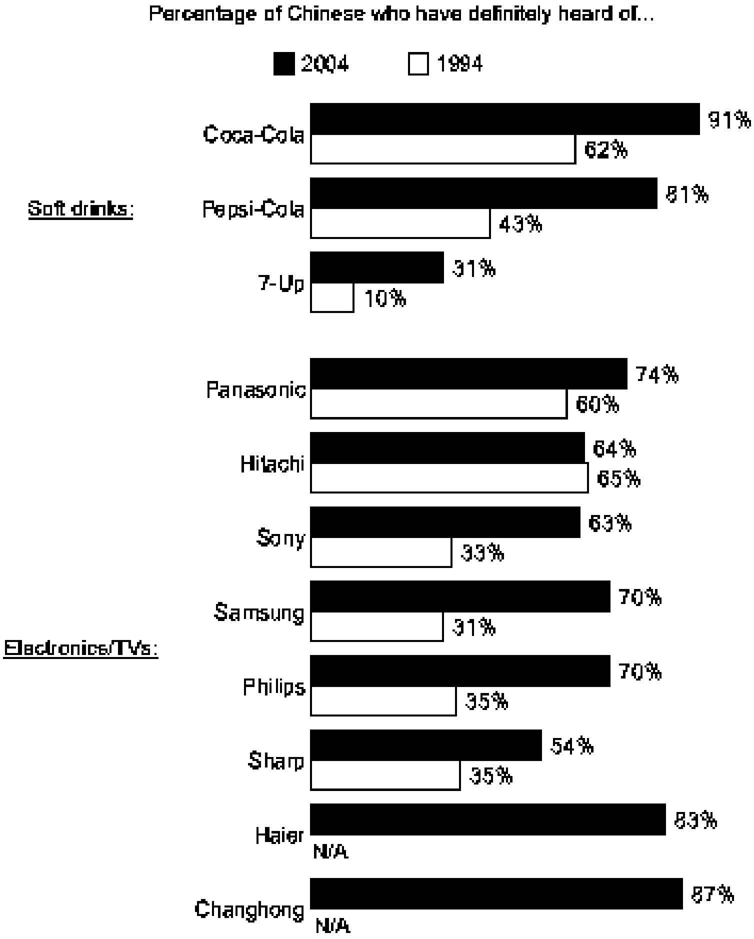
When firms enter foreign markets there are always differences in products, distribution channels, and sales/marketing techniques that the company must adapt to. Being subjected to these differences and adapting to them is often a valuable learning experience that can benefit the firm in all other markets. The more developed and competitive the markets are the greater the learning experience, hence entering western consumer markets (eg. USA & EU) will provide the greatest learning opportunity. Obviously not all they learn abroad is applicable in their home-market, but major gains can be made in many fields such as innovation, customer service, and not at least branding.

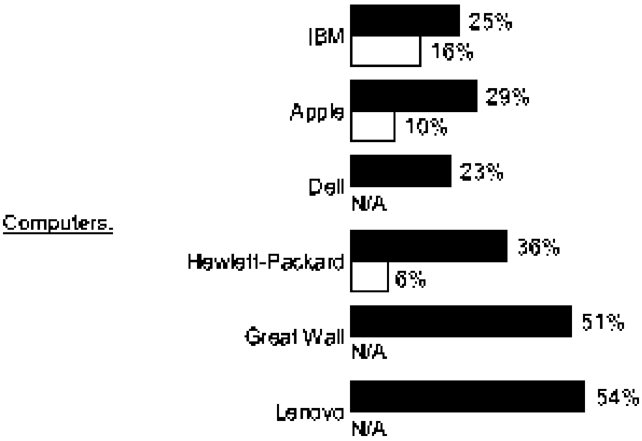
### 4. Globalization of Customers

With the onset of globalization companies are becoming increasingly global and doing business in a diversity of countries, also individuals are travelling more frequently. When doing business with these growing customer segments, firms must have a presence in multiple countries in order to offer their clients consistency and security of supply. As Chinese individuals become more affluent and Chinese firms try to sell to foreign companies, having a global presence will be of mounting importance. Furthermore, globalization has led to the development of converging tastes and needs in regions of the world (Gooderham and Nordhaug; 2003, pg 149), making it easier to appeal to a broad segment of the world population.

### 5. Globalization of Competitors

If your competitors are present in a variety of countries and you are not, "*they can use multi-market presence to cross-subsidize and wage a more intense attack in your home markets.*" (Gupta and Govindarajan; 2000, pg 46) Now that the Chinese market is opening up we see an influx of foreign firms, not just to manufacture in China, but also to try and use their global brand to capture a sizable segment of this growing market. As the graphs below demonstrate, foreign brands are making headway (William J. McEwen; 2005, March 8):





The graphs above measure brand awareness, which is only one of the required steps towards becoming a dominant brand in the market. However, the dramatic increase in foreign brand awareness demonstrates how seriously these multinationals are targeting the Chinese market. Over the past 10 years Phillips and Samsung have both doubled their brand awareness in the electronics and TV segment, currently boasting a 70% rating, while the local market leader Changhong lies only slightly above at 87%. In the market for computers Hewlett-Packard has managed to increase their brand awareness 6-fold over the last 10 years and is now only 18% behind the local market leader Lenovo.

The reasons given by Gupta and Govindarajan for going global are all valid, but it is the knowledge imperative and the increasing attack from foreign firms which constitute the main reasons for Chinese firms to quickly go global.

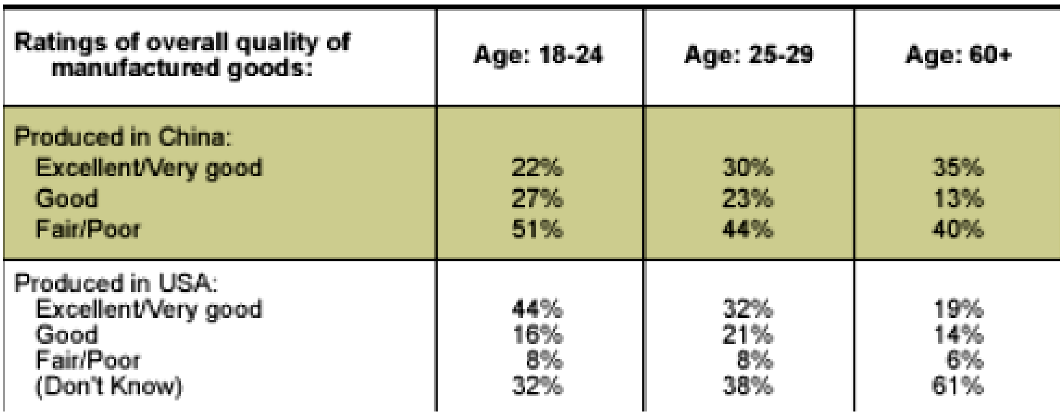
## 2.3 The prestige of being Global

Recent research has suggested that brands with a global image are preferred over local competing brands, even if they are not superior in quality or value. The study carried out by Steenkamp, Batra and Alden in 2003 investigated how being perceived as a global brand can add value, where global brands are defined as "*brands that consumers can find under the same name in multiple countries with generally similar and coordinated marketing* *strategies.*" (Steenkamp, Batra and Alden; 2003, pg 53) They tested consumers from Korea and the U.S.A. with global and local brands from different product categories such as food/beverages, personal care products, and consumer durables. What they found was that perceived "*globalness*" is in fact positively related to brand prestige and perceived product quality. So the more a brand is seen as global, the more consumers will associate it with quality and prestige.

Interestingly, the local brand's icon value was also positively related to prestige, but there was no significant relationship between local icon value and perceived quality. Hence the overall effect of perceived brand globalness on purchase likelihood was greater than the overall effect of local icon value on purchase likelihood. This implies that establishing a global brand, which consumers perceive as highly global, can act as a source for competitive advantage and increase the likelihood that consumers choose your product over one with a more local brand. This opinion is echoed by Johansson and Ronkainen in their article "*The esteem of global brands*" when they state that "*globality should be used as an important ingredient in building a sustainable competitive advantage.*" (Johansson and Ronkainen; 2005, pg 354)

The affect of global branding on purchase likelihood will tend to vary according to which product group we are discussing, but all in all "*globalising a brand is a sound strategy in many product categories*". (Johansson and Ronkainen 2005, pg 353) An aspect one could dispute with this research is that it only takes into consideration two consumer cultures, Korea and U.S.A., and if applied to Chinese consumers results would not be as convincing. However, surveys demonstrate that Chinese consumers are growing less fond of domestic goods. William McEwen, Xiaoguang Fang, et al (2006) claim that Chinese consumer preference for domestic goods has over the last five years decreased from 78% to 67%. Furthermore, their survey claimed that Chinese consumers are increasingly concerned about the quality of domestic durable goods and a total of 37% feel it is only fair, while a whole 8% believe it to be poor. This makes going global a highly effect strategy for local brands to try and overcome their unfavourable quality association, since they may be seen as more global than domestic.

In the future, being perceived as more of a global brand than a domestic one will be of greater benefit since the younger population of China is increasingly positive towards western goods and more sceptical towards domestic ones. The below table, taken from William J. McEwen (2005), demonstrates this trend:



| Ratings of overall quality of manufactured goods: | Age: 18-24 | Age: 25-29 | Age: 60+ |
|---|---|---|---|
| Produced in China: | | | |
| Excellent/Very good | 22% | 30% | 35% |
| Good | 27% | 23% | 13% |
| Fair/Poor | 51% | 44% | 40% |
| Produced in USA: | | | |
| Excellent/Very good | 44% | 32% | 19% |
| Good | 16% | 21% | 14% |
| Fair/Poor | 8% | 8% | 6% |
| (Don't Know) | 32% | 38% | 61% |

It comes as no surprise that the younger segments of the population are markedly different from those over 60, what is interesting is the significant difference between those aged 18-24 and those aged 25-29. Even though there is only an age gap of approximately seven years between the two segments, we see a clear increase (44% → 51%) in the percentage of respondents who feel goods produced in China are either of poor or fair quality. Similarly, there is a decrease (30% → 22%) in the percentage of people who feel goods produced in China are of very good or excellent quality.

In addition, there is a larger percentage of the youngest segment (44%) that considers goods produced in the U.S.A. to be of very good or excellent quality than of the next youngest segment (32%). Going global will not make a Chinese brand American, but one could argue that many American brands tend to be seen as more international since their operations are spread all over the globe, rather than simply American. Therefore if Chinese brands join this rank and become more global than domestic, it will increase their perceived quality, which is in line with the findings of Steenkamp et al that we discussed previously.

Theoretical research as well as the survey statistics both point to the benefits of establishing a global brand as opposed to remaining a local one. Naturally, remaining a local brand has its advantages due to being able to adopt a more domestically focused marketing strategy, enabling it to tailor its brand to a more specific consumer segment and responding quicker to changes in local tastes. Nonetheless, the increasingly poor quality association to local brands and increased favourability towards international brands, especially within the younger segment of the population, makes going global a necessity for the majority of Chinese manufacturers.

## 2.4 Government initiative

The need for Chinese brands to venture abroad is further confirmed by the Chinese government. The government in China has implemented a strategy called "*Going Global*" which aims to encourage firms to embrace both domestic as well as foreign markets. One priority under this scheme is to create "*large multinational firms with globally recognised brands able to compete in the international marketplace.*" (Lunding; 2006, pg 6) The strategy is not just an official policy but does have significance and makes the idea of investing abroad more attractive for domestic firms. Child and Rodrigues (2005, pg 404) stated that "*Those familiar with China rightly emphasize the support that its government is giving to the globalization of its leading firms*"

The type of support that the state provides takes different forms. One such form was when the State Administration of Foreign Exchange (SAFE) reduced the foreign exchange controls in 2003. Previously, SAFE had prevented numerous foreign firm acquisitions by Chinese enterprises. (Lunding; 2006, pg 6) Another form of support from the state comes via offering favourable loans and credit to help firms finance overseas activity. The example given by Lunding (2006, pg 6) was the recent decision by the China Development Bank to extend Huawei, a leading telecoms manufacturer, a $10 billion line of credit to help fund its overseas expansion. Given the Chinese government's active involvement in trying to encourage large domestic firms to go global, it is clear that there is urgency for Chinese firms to establish their brands abroad.

## 2.5 Summary

Throughout this chapter arguments have been presented that clarify the need for Chinese firms to establish global brands. The global value chain demonstrated that in order for Chinese firms to exploit more sustainable and profitable competitive advantages they need to expand more into downstream segments. The more generic benefits of going global were outlined using theory from Gupta and Govindarajan (2000) and then applied to the case of Chinese firms. Furthermore, research was presented that showed being a global brand has advantages in itself and that the prestige associated with it is of particularly benefit in the current Chinese consumer environment. Lastly, the need to develop global brands was reiterated by the initiative implemented by the Chinese government.

Although the need for Chinese firms to go global is established, building a internationally recognized brand is not an easy process and Chinese firms seem to be at a particular disadvantage. The unique challenges that Chinese firms face will be outline in the next chapter.

# 3. Obstacles and challenges for Chinese branding

## 3.1 Historical factors (1949 – 1978)

For many centuries China was a civilisation at the forefront of development. It lead the world in innovation and progression within science, medicine, and the arts. However, during the 19th and early 20th century China was "*beset by civil unrest, major famines, military defeats, and foreign occupation.*"(www.cia.gov) Scientific and academic progression halted and focus was given to national security and coping with food shortages. After World War II the sovereignty of the country was again secured and the People's Republic of China was officially established on October 1, 1949. The country was to be governed by the Chinese Communist Party under the chairmanship of Mao Zedong and Beijing was declared the national capital. In an attempt to gain an overview of the communist era prior to the onset of the free-market reforms starting in 1978, we can divide the period up into four phases of "*Chinese industrial governance*"(Child; 1994, pg 35):

1. Central planning (1953-57)

This was a period of massive transition to socialism and saw the implementation of China's first five-year plan (1953-7). The five-year plan stressed a centralized planning system and followed a Stalinist Soviet approach. Banking, Industry and Trade were all nationalised. Production plans were established by municipal and provincial planning authorities, which then simply handed these down to the factories. Collectivisation of agriculture also took place and by 1956 it was said to be 90% completed.(www-chaos.umd.edu) Private enterprise practically ceased to exist in China.

In the summer of 1956 the government loosened up the political environment in an attempt to encourage Chinese intellectual and cultural figures to discuss the Communist Party and its programs. This was termed the "*Hundred Flowers Campaign*" and was named after the motto that was used to promote the discussion: "*Let a hundred flowers bloom: let a hundred* *schools of thought contend.*"(www.wikipedia.org) At first the invitation was met with scepticism but by mid-1957 the public increasingly voiced their criticism. This came as a surprise to government leaders and was of great embarrassment to Mao. In July 1957 Mao declared the campaign over and blamed it on the high level of unhealthy political criticism. In a further reaction to the unexpected criticism, the government implemented an Anti-Rightist Campaign and many of the critics were either punished or killed.

### 2. Decentralisation and the Great Leap Forward (1958–61)

In 1958 the Chinese Communist Party launched "*The Great Leap Forward*", which signaled a break away from the Stalinist Soviet model previously followed. The belief was that if people were more ideologically motivated and national resources were utilized more effectively, then economic and technical development would be greater than during the first five-year plan. Large agricultural cooperatives (communes) were established and ideological instruction was increased. Furthermore, bonus payments to industrial workers were substantially reduced, while technical and managerial staffs were not eligible for bonuses. The Great Leap Forward was an economic failure and many died due to shortage of food.

During this period the government also engaged upon a path of administrative decentralization. The control over the majority of industrial firms was passed from the central government and on to the provincial governments. Factory directors were also given slightly more decision power, with the number of mandatory targets imposed decreasing from twelve to four.(Child; 1994, pg 36) Also, foreign relations with Russia started to deteriorate and in mid-1959 Russia withdrew all their advisers and reduced or cancelled their economic and technical aid.

### 3. The period of readjustment (1962-65)

The period of readjustment was born out of the reduction in agricultural output in the three years leading to 1962. In addition, industrial output also declined substantially in 1961. The readjustment that occurred was mainly an increase in central planning. There was more emphasis placed on the hierarchical structure within factories and the division of tasks amongst employee. However, factory directors were made more responsible for plant operations, but their actions were now more directed by the central government than before.

In an attempt to prevent the apparent capitalist trend, Mao Zedong implemented the Socialist Education Movement. The Movement was started in order to reinstate the public's belief in the virtue of Socialism. It was in essence a type of work-study program where schooling was reduced and replaced by work in the communes and factories. It even forced intellectuals to contribute with manual labour as a means to teach them that aims of the party were more important than their individual areas of expertise.

### 4. The Cultural Revolution (1966-76)

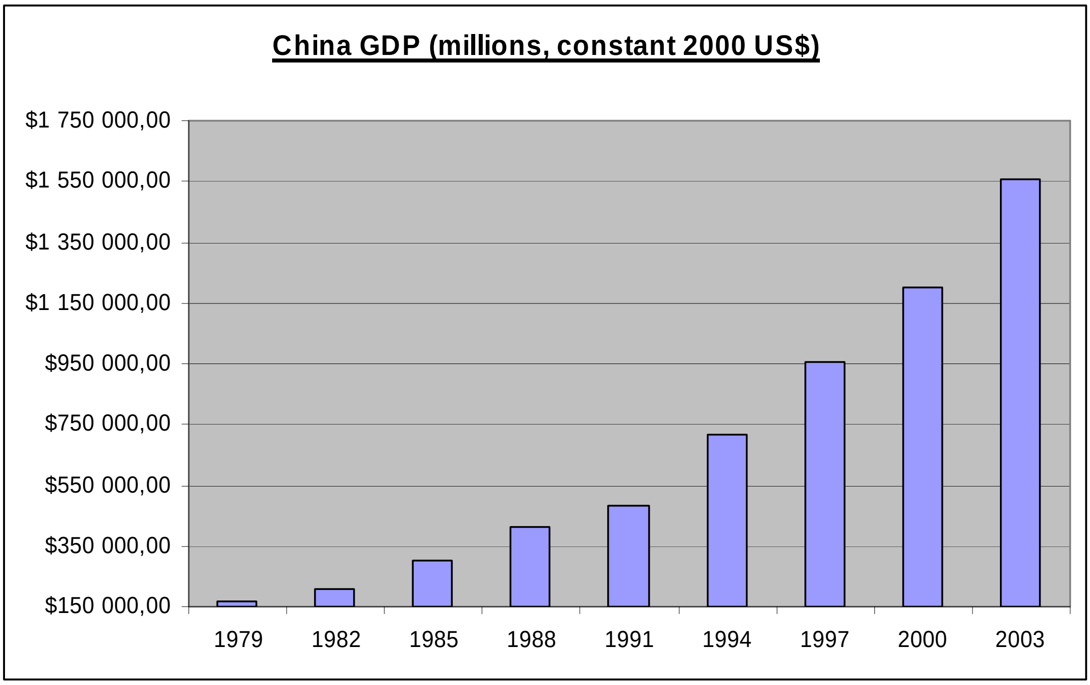
The Cultural Revolution was a period where Mao Zedong proceeded to regain the power and influence he once had, mainly by trying to discredit anyone who did not support him fully. The importance of ideology and politics was greatly stressed and had an increasing effect on the economy and industry. "*Piece wages and bonuses were sharply reduced or eliminated altogether. Competitive, individual and material incentive was rejected in favour of co-operative, collective and moral incentive.*" (Child; 1994, pg 37)

After the souring of foreign relations in the previous periods a greater sensitivity was assigned international relations. China attempted to improve relations with the west and in particularly with the USA. The result of these initiatives was witnessed in 1972 by the visit of President Richard M. Nixon. Diplomatic ties were even developed with Japan in September 1972.

It is clear to see that the above time periods describe an era that was in no way conducive to the development of branding expertise in China. Due to the lack of private businesses and hampering of free-thought, there was no need for products to be branded commercially nor was there the chance to build knowledge on the subject. Even foreign assistance and know-how was squandered. In the meantime firms in the west were being exposed to markets and gradually learning how to deal with competition. However, eventually China realised the benefits of private enterprise and international trade and began reforming the economy.

## 3.2 Opening up and market reform

After the death of Mao Zedong in 1976 and witnessing the unsatisfactory performance of the economy during the previous decades, Deng Xiaoping launched economic reforms and open-door programs in 1978. After more than 20 years of reforms and opening up to foreign businesses the Chinese economy has undergone impressive economic growth. The below graph clearly demonstrates the huge growth that China has experienced. (www.worldbank.org)



The growth and reforms have had a great impact on Chinese businesses. They are now able to trade more easily with the outside world as well as within China. Furthermore, between 1978 and 2001 China's GDP per capita grew on average by 8.1% on an annual basis.(Wang; 2003, pg 4) This means that Chinese consumers have more cash to spend, which means the market is much more profitable and attractive for firms to enter. As a result of the increasing competition in the marketplace and being subjected to the practice of foreign companies, Chinese firms are starting to see the benefits of branding.

In addition, the infrastructure and characteristics of the Chinese consumer are becoming more conducive to branding campaigns. The table below highlights some of the developments that have taken place which make it easier for firms to reach consumers (Wang; 2003, pg 8):

| **ITEMS** | **1978** | **2001** |
|---|---:|---:|
| Urbanization | 17,9 | 30,4 |
| Rural Annual Per Capita Net Income (US $) | 78,6 | 285,7 |
| Urban Annual Per Capita Disposable Income (US $) | 185,9 | 828,5 |
| Number of TV sets in Rural Areas (per 100 households) | 0 | 105,2 |
| Number of colour TV sets in Urban Areas (per 100 households) | 0 | 120,5 |
| Number of Personal Computers (per 1000 people) | 0 | 15,9 |
| Number of Internet Hosts (per 1000 people) | 0 | 9,8 |
| Access to Mobile Phones (sets per 100 persons) | 0 | 11,4 |
| Access to Telephones (sets per 100 persons) | 0,45 | 14,5 |

The economic developments since 1978 have been favourable for business development. The ability for firms to govern themselves and invest as they see best has improved remarkably. Also, being subjected to businesses from foreign nations has given domestic firms an insight into how global firms conduct business. The rise of competition and increase in business independence, along with the developments of consumer characteristics, are all factors that promote the establishing of brands. However, there are still regulations in place in the Chinese economy that hinders the development of private businesses, and thus reduces the likelihood of the development of efficient global brands.

### 3.2.1 Current obstacles

A main obstacle for free market competition that is cited in various articles is the large number of State-Owned Enterprises (SOEs) in China. These enterprises work under special conditions and thus distort the market for privately-owned businesses. The OECD *Economic Survey of China 2005* claimed that more than 35% of all state-owned companies were not earning a positive rate of return. Nakagane (2000, pg 4) listed four main reasons why Chinese state enterprises tend to be so inefficient:

- Lack of enterprises' autonomy
- "*Soft budget constraint*", SOEs are protected from bankruptcy by the supervising governments.
- "*Historical legacies*" and social burdens borne by SOEs. For example, it is extremely difficult to dismiss workers employed by the state.
- Low quality of enterprise managers, because they are selected based on their position in the bureaucratic hierarchy and not business ability.

Even though the number of SOEs in China has been reduced since its WTO accession in 2000 (Dayal-Gulati and Lee; 2005, pg 12), they still play a vital role in the economy. According to *Fortune* magazine the government still owned 98 out of the 100 biggest Chinese firms in 2002.(Zeng and Williamson; 2003, pg 94)

Within the Chinese financial system there are also certain features that limit the development of private enterprises. One of these features is the lack of privately owned financial institutions. Unlike the transition economies of Eastern Europe that privatised their banks at an early stage, in China "*only very limited parts of the banking and financial sector have so far been opened to international firms.*" (Child and Tse; 2001, pg 10) The lack of privately owned banks can be witnessed in credit allocation, where the vast majority of loans are supplied by the four main state-owned banks. According to the OECD (www.oecd.org) these institutions supplied 90% of all the loans provided by the banking industry, and almost 75% of all loans to businesses in 2000. Naturally, such a high concentration does not reflect positively on the level of competition in the market.

Another feature of the Chinese financial market that seems unfavourable is the high concentration of loans that go to SOEs. The OECD (www.oecd.org) predicts that at least 80% of the loans from the main state-owned banks, and almost 75% of the loans from commercial banks go to SOEs. SOEs also tend to enjoy preferred access to equity and bond market financing. The damage to competitiveness that this loan allocation causes is, as previously mentioned, further exacerbated by the fact that more than a third of all SOEs do not earn a positive rate of return. These statistics demonstrate the favourability that SOEs receive from the Government.

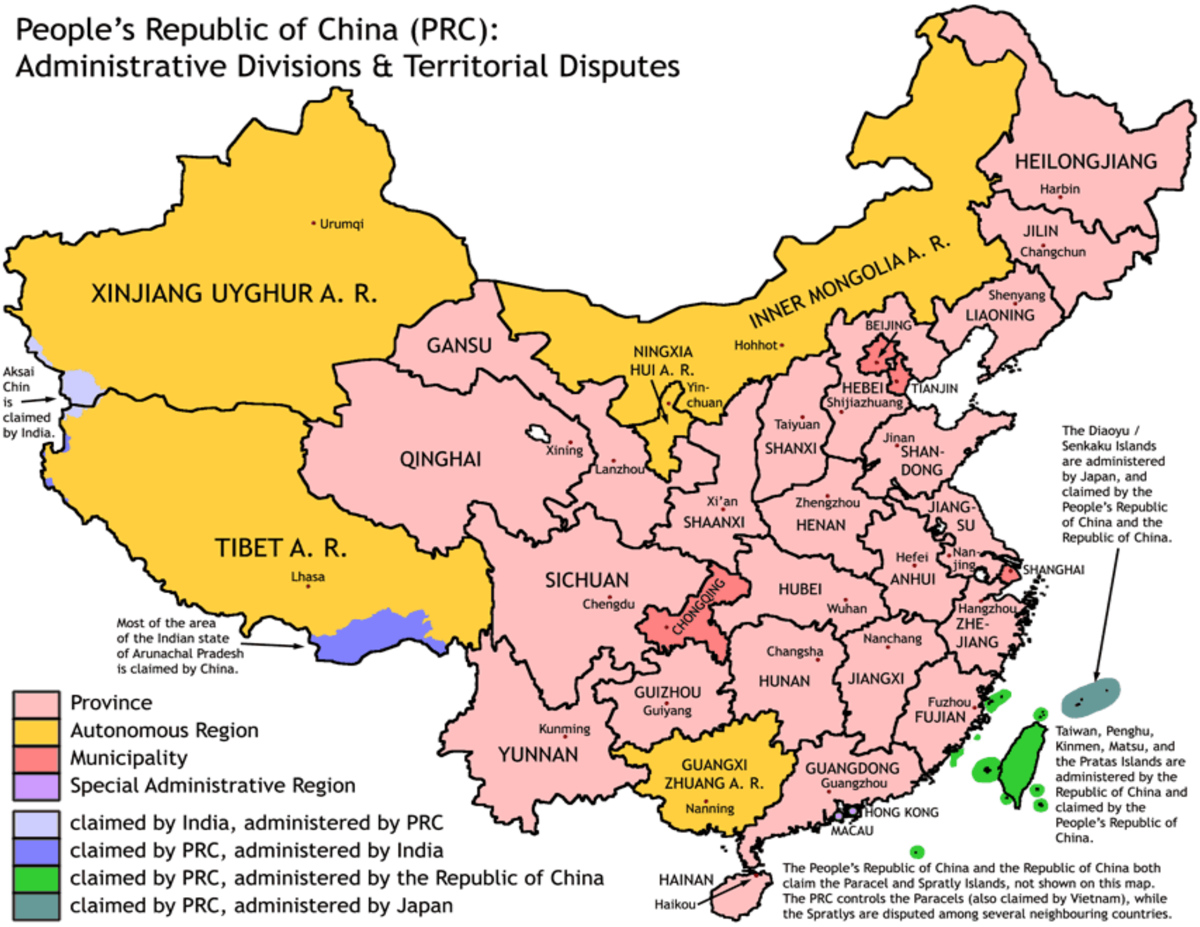
The Chinese government has in the past exercises a fixed-exchange rate policy, pegging its value to the US Dollar. The official value of the Yuan has fluctuated a fair amount the last couple of decades, starting at 1.5 to the dollar in 1981 and equalling 8.28 to the dollar in mid-1995 (Lardy; 2005, pg 43). Since 1995 the Yuan has not been revalued and complaints arose, mainly from the USA because of the expanding trade deficit they were experiencing with China. However, in 2005 the Chinese government decided to implement a "*managed, floating exchange rate system*"(http://news.xinhuanet.com) and on July 21st they modified the exchange rate changing it by 2% to 8.11 Yuan to the dollar (www.money.cnn.com). The USA welcomed the change but said it was only a small step in the right direction. Their argument is that the Yuan is 40% undervalued and its artificial low value acts as a subsidy to exporting firms in China because it makes their products cheaper and more competitive in the US market.

Seeing as China entered the WTO in 2001 it is in theory not allowed to provide subsidies to businesses. However, as we have demonstrated above, SOE favourability and the fixed exchange rate can work as subsidies. There are also other instances where the subsidies to businesses are more direct and as a result have been met by objections from importing nations. For example, the EU has in April this year (2006) started to impose a 20% duty on shoes imported from China because it claims it has "*identified clear evidence of disguised subsidies and unfair state intervention to the leather footwear sector in China*".(www.news.bbc.co.uk) Even though the Chinese businesses will benefit initially, the subsidies will either be reduced in accordance to WTO rules or opposing actions will be taken by importing nations, and then the competitiveness of Chinese businesses will suffer.

In order for branding to fully flourish and develop, the Chinese government must attempt to establish an atmosphere within which private firms can prosper and reap the gains of their competitive advantages. Although the Chinese government is slowly deregulating its markets and has stated it aims to establish a "*market system with socialist characteristics*" (Child and Tse; 2001, pg 8), it still has a way to go and at present the economy is better described as a socialist system with market characteristics.

## 3.3 Provincial differences

The below map outlines the different provinces and divisions within the Chinese state (www.wikipedia.org):


People's Republic of China (PRC):
Administrative Divisions & Territorial Disputes
XINJIANG UYGHUR A. R.
Urumqi
TIBET A. R.
Lhasa
GANSU
QINGHAI
Xining
Lanzhou
NINGXIA HUI A. R.
Yinchuan
INNER MONGOLIA A. R.
Hohhot
HEILONGJIANG
Harbin
JILIN
Changchun
Shenyang
LIAONING
BEIJING
TIANJIN
HEBEI
Shijiazhuang
Taiyuan
SHANXI
Jinan
SHANDONG
Xi'an
SHAANXI
Zhengzhou
HENAN
JIANGSU
Nanjing
Hefei
ANHUI
SHANGHAI
SICHUAN
Chengdu
CHONGQING
HUBEI
Wuhan
Hangzhou
ZHEJIANG
Nanchang
Changsha
HUNAN
JIANGXI
Fuzhou
FUJIAN
GUIZHOU
Guiyang
Kunming
YUNNAN
GUANGXI ZHUANG A. R.
Nanning
GUANGDONG
Guangzhou
HONG KONG
MACAU
HAINAN
Haikou
Aksai Chin is claimed by India.
Most of the area of the Indian state of Arunachal Pradesh is claimed by China.
The Diaoyu / Senkaku Islands are administered by Japan, and claimed by the People's Republic of China and the Republic of China.
Taiwan, Penghu, Kinmen, Matsu, and the Pratas Islands are administered by the Republic of China and claimed by the People's Republic of China.
The People's Republic of China and the Republic of China both claim the Paracel and Spratly Islands, not shown on this map. The PRC controls the Paracels (also claimed by Vietnam), while the Spratlys are disputed among several neighbouring countries.
Province
Autonomous Region
Municipality
Special Administrative Region
claimed by India, administered by PRC
claimed by PRC, administered by India
claimed by PRC, administered by the Republic of China
claimed by PRC, administered by Japan

As a result of China's vast size and population the country has been divided into different provinces, whose boundaries were mainly formed during the Ming Dynasty. The division of China into provinces was initially implemented not only as a means to keep order over the large nation, but also to break up large ethnic groupings and thereby reduce the chance of a organised uprising against the central power. In addition, provinces were encouraged to become self-sufficient so that in case one province was lost the other provinces would not be deeply affected with the reduction in trade possibilities (Zeng and Williamson; 2003, ).

Today the self-sufficiency of provinces is not a primary goal, but strong provincial borders still exist. The differences between the regions can still clearly be seen today if one looks to the economic performance of the various provinces. In general it is the provinces of the South-East coastal region that tend to be more industrialized and perform better than the other provinces.(Golley; 2002, pg 771) Economic inequality amongst the provinces has meant that the infrastructure present in each province varies widely. While a well developed province like Guangdong may have well maintained distribution networks, reliable sources of input materials, and widely spread power supply; other provinces like Gansu may lack such infrastructure. These differences in infrastructure have a direct effect on the manner in which business is carried out. These differences can act as barriers to inter-regional trade because firms are forced to drastically adapt their business approach to each region they do business in.

The large distances between the various provinces, economic inequality, and focus on self-sufficiency has contributed to a significant difference in culture amongst these provinces. Every nation has different regional cultures, but in China's case the differences are very substantial. These cultural differences can also act as barriers to trade between regions. Firstly, a province may have an unfavourable view of another province and hence will be reluctant to purchase goods originating from that province. Secondly, the cultural differences will affect what the consumers in specific provinces look for in products or find appropriate in marketing. Therefore firms are forced to further adapt their business approach according to region.

However, the greatest barrier to inter-provincial trade is the decentralisation and fiscal autonomy given to the individual provinces. Administrative decentralisation also occurred during the Great Leap, but the fiscal contracting system that was introduced in the early 1980's had a greater effect. The system was such that "*each province was responsible for collecting tax revenues in its region and then entitled to retain a high proportion of the marginal tax revenue.*" (Li; 1998) This naturally leads to an economic rivalry between provinces and resulted in significant barriers to trade.

An example of such a barrier is the implementation of production standards for taxis, which are manipulated to ensure that only local factories fulfil the required specifications. (Walters and Samiee; 2003, pg 101) Another example of such a barrier is the requirement for businesses to present the local government with all their capital purchasing plans. The local officials in turn frequently demand that preference be given to regional suppliers. (Shirk; 2002) Furthermore, local governments impose taxes on products that are not manufactured in their specific region. (Zeng and Williamson; 2003)

The existence of the inter-provincial trade barriers and economic rivalry that I have outlined above can go a far way in explaining the slow development of large national corporations in China. Firms have been discouraged to venture outside their provinces and their ability to exploit economies of scale has been limited. This also explains "*why there are many regional brands but few national brands in the country.*" (Zeng and Williamson; 2003, pg 93) This is another factor contributing to why Chinese firms have been so slow to establish global brands.

## 3.4 Lack of consumer research

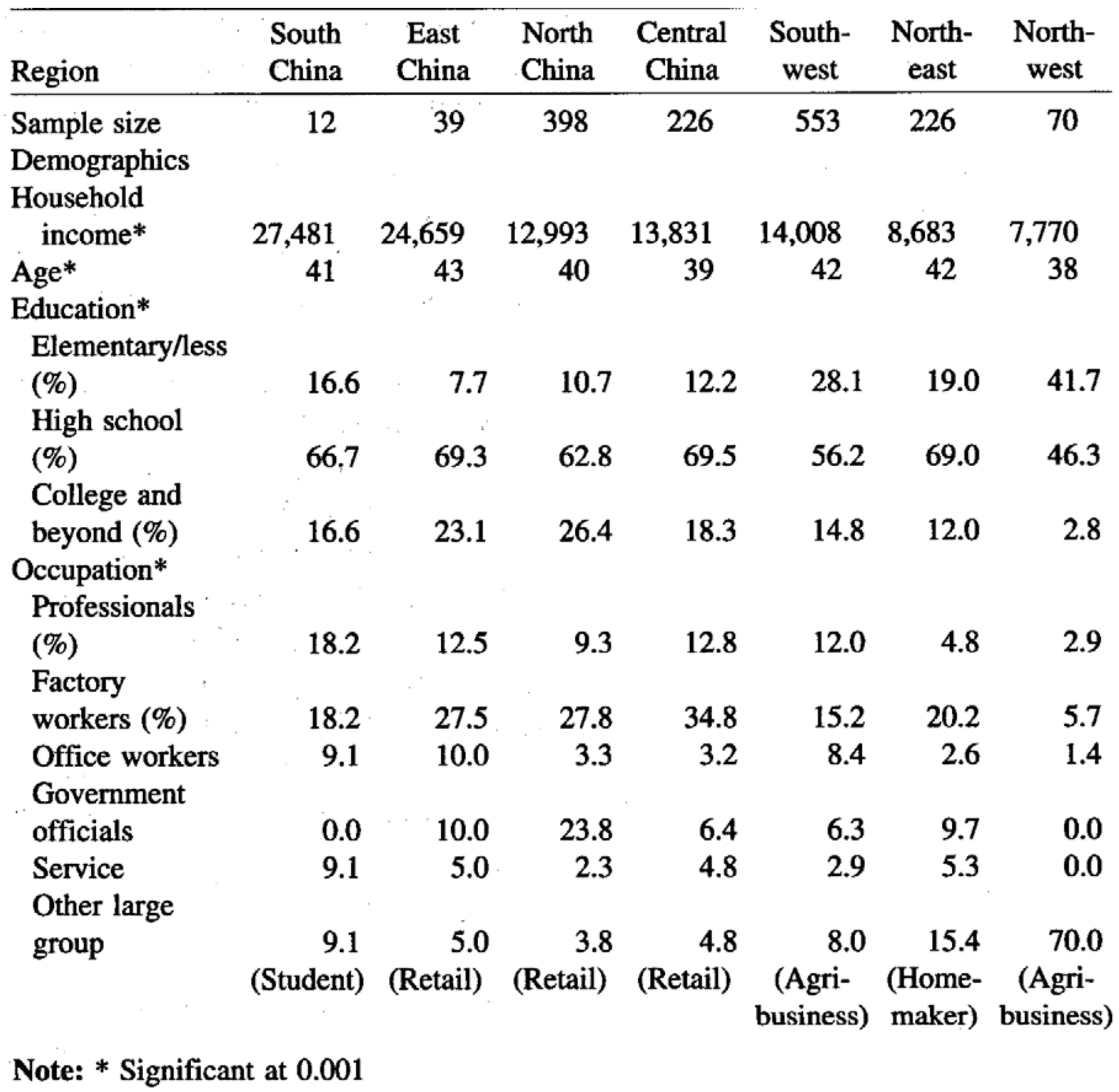
Consumer research is a vital part of branding because knowledge of the consumer is what makes a branding strategy successful. Before the start of the "*reform and opening up*" period, China had no marketing research. Even basic information regarding the economy in general was often not up to date or reliable. The first marketing research company to be established in China was the Guangzhou Market Research Company, which emerged in 1988 as part of the state-run Guangzhou Soft Science Company. (Lee and Saklani; 2002) The first privately owned marketing research firm was established in 1990 and was called South China Marketing Research co. Ltd. Already by 2002 there were approximately 400 domestic marketing research companies in China and the majority of top global marketing research firms had a presence there. (Lee and Saklani; 2002)

Regardless of the rapid growth and promise of the marketing research industry in China, it has a long way to go to reach the standard of the research companies in the west. One big obstacle that marketing research firms face in China is the lack of infrastructure to carry out surveys. For example, whereas in developed markets research firms rely heavily on mail surveys, in China this type of research is nonexistent due to unreliability of the postal system. Similarly, the telephone is also not used frequently when conducting surveys because many respondents do not have a phone.

The majority of surveys are conducted face-to-face in central locations or by going door-to-door. This presents a problem when trying to conduct quantitative research because this method is not very cost-effective. The internet presents a good channel to conduct cost-effective quantitative marketing research, but the internet penetration rate in China is still very low. In 2005 the CIA fact book (www.cia.gov) ranked China 43rd in the world according to the total number of internet hosts, which in relation to its population size is not impressive. Iceland, with its minimal population of less than 300,000, still had more internet hosts than the whole of China.

As far as qualitative marketing research is concerned there exist cultural obstacles. The Chinese culture, like many east-Asian cultures, places a great importance on the issue of face-saving. This is the belief that not agreeing with, or criticising someone is a severe insults and will result in "*loss of face*". This breeds a situation where the respondent will agree with the majority of what the interviewer is saying and will rarely criticise a brand or product. Furthermore, in focus groups the Chinese tradition of silence will pose another obstacle as it is believed that "*those who know do not speak, and those who do speak do not know*". (Walters and Samiee; 2003, pg 100)

Other major obstacle to marketing research in China includes its geographic size and diversity of markets. As mentioned previously, provinces in China vary immensely in everything from income level, infrastructural development and cultural values. The stark contrast of the average consumer can clearly be demonstrated with the below table, which was constructed using findings from a 1997 Gallup Research Company Ltd survey (Cui and Liu; 2000, pg 62):



| Region | South China | East China | North China | Central China | South-west | North-east | North-west |
|---|---|---|---|---|---|---|---|
| Sample size | 12 | 39 | 398 | 226 | 553 | 226 | 70 |
| Demographics | | | | | | | |
| Household income* | 27,481 | 24,659 | 12,993 | 13,831 | 14,008 | 8,683 | 7,770 |
| Age* | 41 | 43 | 40 | 39 | 42 | 42 | 38 |
| Education* | | | | | | | |
| Elementary/less (%) | 16.6 | 7.7 | 10.7 | 12.2 | 28.1 | 19.0 | 41.7 |
| High school (%) | 66.7 | 69.3 | 62.8 | 69.5 | 56.2 | 69.0 | 46.3 |
| College and beyond (%) | 16.6 | 23.1 | 26.4 | 18.3 | 14.8 | 12.0 | 2.8 |
| Occupation* | | | | | | | |
| Professionals (%) | 18.2 | 12.5 | 9.3 | 12.8 | 12.0 | 4.8 | 2.9 |
| Factory workers (%) | 18.2 | 27.5 | 27.8 | 34.8 | 15.2 | 20.2 | 5.7 |
| Office workers | 9.1 | 10.0 | 3.3 | 3.2 | 8.4 | 2.6 | 1.4 |
| Government officials | 0.0 | 10.0 | 23.8 | 6.4 | 6.3 | 9.7 | 0.0 |
| Service | 9.1 | 5.0 | 2.3 | 4.8 | 2.9 | 5.3 | 0.0 |
| Other large group | 9.1<br>(Student) | 5.0<br>(Retail) | 3.8<br>(Retail) | 4.8<br>(Retail) | 8.0<br>(Agri-business) | 15.4<br>(Home-maker) | 70.0<br>(Agri-business) |

**Note:** * Significant at 0.001

The table shows that in North China 26.4% of consumers have a college education or beyond, while in the North West only 2.8% have that level of education. These types of disparities represent a real challenge when trying to gain a unified overview of the Chinese customer.

As is demonstrated above, the challenge faced by marketing researchers in China is by no means small. In addition to the fact that tested and proved western research methods can not be directly adopted in China (due to linguistic, cultural, and infrastructural differences), the Chinese consumer is changing so rapidly that companies are in need of ever more marketing information. (Lee and Saklani; 2002) The infancy of the marketing research industry in China poses a significant challenge to Chinese firms when they try to establish Global brands because they are not accustomed to either gathering, or interpreting marketing research data.

## 3.5 Cultural differences

Culture can be defined as "*the way in which a group of people solves problems and reconciles dilemmas*." (Trompenaars and Hampden-Turner; 2003, pg 6) Culture is a very broad concept and it is impossible to pin-point exactly what or where it is. However, culture, to a certain degree, dictates the way in which a group of people interpret certain situations and what actions they feel are appropriate in these situations. Therefore it seems obvious that culture will have a immense effect not only on marketing research as discussed before, but also on the way consumers relate to brands and how best to establish positive associations towards a brand.

If the Chinese culture is very far removed from the cultures of the main western markets, which happens to be where branding theory is most developed, then not only will Chinese firms have to modify the existing brand theory when applying it to their home country, but also they have to establish an understanding of an entirely different customer base when entering western markets. Getting to know your customer is the most important aspect of effective branding and therefore cultural differences present a substantial obstacle when attempting to establish a global brand.

Evaluating individual cultures is impractical because everyone is influenced by a certain culture and maintaining objectivity is impossible. However, comparing different cultures on various dimensions is more feasible. This is exactly what the Dutch researcher Geert

Hofstede did and using his findings we can show that the Chinese culture is indeed very far removed from that of the main western economies. For the purpose of this comparison I have chosen to use USA, Germany, and the United Kingdom since they are the largest economies in the western world.(www.worldbank.org)

Hofstede (2005) developed 5 dimensions upon which he ranked different nations:

- Power Distance

Power distance relates to the extent to which individuals in a culture accept an unequal distribution of power within the society. The Malaysian culture ranked first on power distance meaning they are comfortable and often predisposed to certain individuals being more equal than others. The Austrian culture ranked last on power distance, which implies that they believe inequalities should be minimized and hierarchies should only be established for convenience.

- Individualism

The degree to which individual decision-making is valued and the responsibility individuals feel towards their groups are what define this aspect. Individualism ranks highest in the USA and it implies that the interest of the individual often prevails over the interest of the group. The Guatemalan culture scores lowest on the individualism ranking and is therefore a collectivist culture where great importance is placed on close ties with ones extended family and communities.

- Uncertainty Avoidance

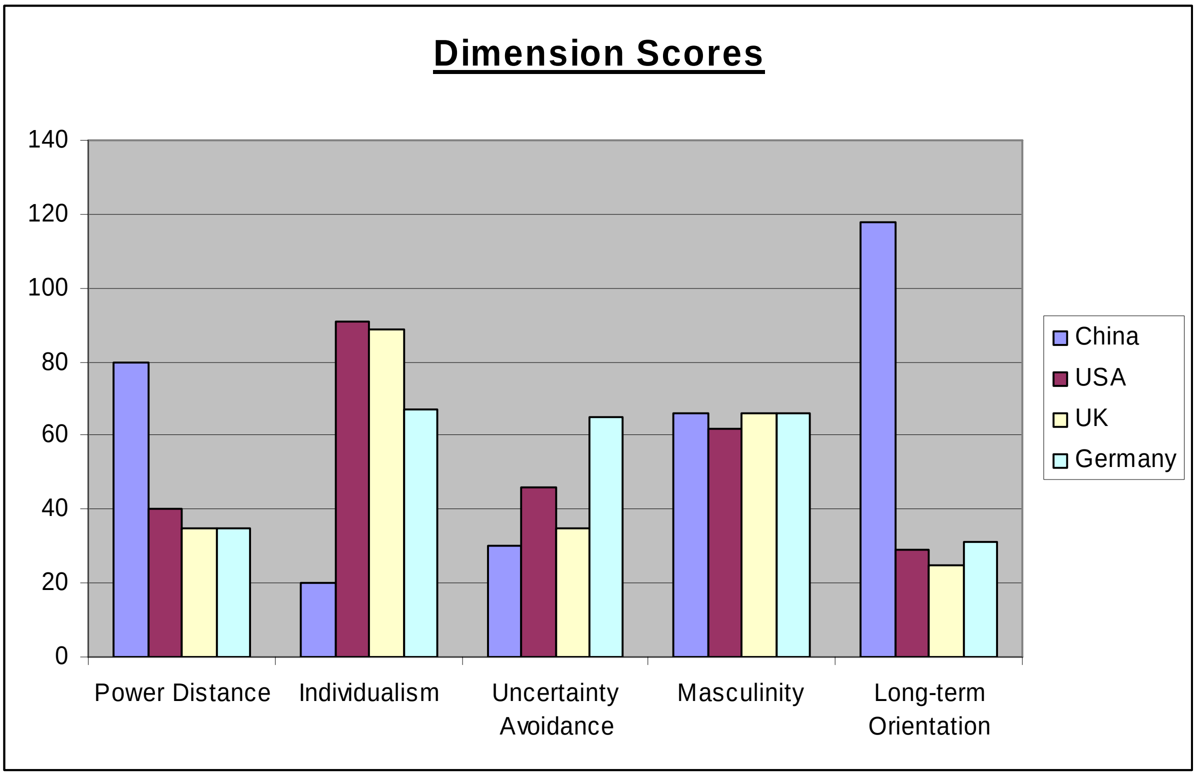
Uncertainty avoidance measures the degree to which cultures avoid ambiguous situations and desire formal rules and procedures. The Greek culture ranks highest on this dimensions and it represents a societal concern for the lack of stability and a risk averse attitude. Singapore is ranked as the culture with lowest uncertainty avoidance. People in this culture are less risk averse and are comfortable with a greater level of individual autonomy.

- Masculinity

This dimension relates to the degree to which society values assertiveness, ambition, achievement and material possessions, over the quality of life. Slovakia scores highest on the masculinity dimension meaning there is a great importance placed on material wealth within the society and that gender roles are distinct. The Swedish culture scored lowest on the masculinity dimension meaning they value the quality of life more and believe there is a overlap between gender roles.

- Long-Term Orientation

Long-term orientation refers to the degree of concern with which a culture addresses the future and the value of thrift versus the degree of value given the past and present. China scores highest on this dimension and it implies its citizens are focused on long-term results and tend to be sparing with resources. The Pakistani culture scores lowest on the long-term orientation ranking, making it a short-term oriented culture focused more on instant results and social obligations.



The above graph shows the scores that the different countries were given by Hofstede (2001) for each of his dimensions. It is clear to see that even though the western cultures are not all identical; the Chinese culture is the one which differentiates itself the most. In the dimensions of masculinity and uncertainty avoidance the cultures are quite similar, while in the remaining three dimensions China clearly stands out.

The most obvious difference can be witnessed in the long-term orientation dimension. Whilst the Chinese consumer may tend to be frugal and sparing with resources, the western consumer may appear more willing to spend. Furthermore, the western consumer will expect results at once, whereas the Chinese consumer will be more patient when reaching a conclusion. The low level of individualism in the Chinese culture may imply that consumers from that culture use brands to signal an alliance to a group, in contrast to western consumers who may use brands to differentiate themselves. As far as the power distance dimension is concerned it might mean that Chinese consumers are willing to trust in information supplied to them from a source with high status, whereas western consumers might be more critical.

The above paragraph outlines and tries to explain what the cultural differences might mean for branding. However, culture is complex and trying to use the simplistic dimension scores above to determine ones branding approach will surely result in failure. What the dimensions do tell us is that the Chinese culture, and therefore the typical Chinese consumer, is very different from that of the main western economies. Therefore, attempting to transfer branding practices from China to one of the western countries will be much more problematic than for example transferring branding practices within the western countries (e.g. from Germany to the USA).

## 3.6 Lack of intellectual property rights

Intellectual property (IP) can be defined as "*A product of the intellect that has commercial value, including copyrighted property such as literary or artistic works, and ideational property, such as patents, appellations of origin, business methods, and industrial processes.*" (www.dictionary.com) In most countries Intellectual Property Rights (IPR) are enforced, which punish manufacturers from counterfeiting brands. In China the notion of IP Rights is still a infant one. The government did show some willingness to try and combat Intellectual Property Rights violations when it in 2001 signed the "*Agreement on Trade Related Aspects of Intellectual Property Rights*". (Wang; 2003, pg 93) However, a lack of stringent enforcement of these laws has done little to prevent markets from openly selling fake brands and manufacturers from producing them.

According to a study by the World Customs Organization (http://www.atkearney.com), counterfeiting accounts for as much as 5 to 7 percent of global merchandise trade. This is equivalent to approximately US$512 billion. This is no small figure and estimates show that two-thirds of the world's fake and pirated goods stem from China. IPR violations are a great burden on Chinese firms, not only the US$24 billion loss in annual sales (http://www.atkearney.com), but also its detrimental affect on the ability and willingness of firms to develop brands.

When brands are counterfeited or copied, the original creator of the brand is basically stolen from because the investment in his brand is devalued. When consumers purchase fake products the original brand loses out on a potential sale, but more importantly the image of the brand is tarnished. Manufacturers of counterfeit goods will naturally use inferior raw materials when copying a product; therefore the customer will have a less favourable experience and associate this to the original brand, thereby devaluing the brand. This loss in brand value acts as a disincentive to invest in branding and acts as a real detriment to the development of strong national brands. It therefore comes as no surprise that "*most Chinese firms are using pricing strategies to compete.*" (Child and Tse; 2001, pg 12)

The lack of IPRs further limits the development of Chinese branding because foreign brands are reluctant to enter the market for fear of being counterfeited. Therefore, domestic companies are unable to learn from the branding strategies and ideas implemented by their foreign counterparts. It is clear that in order for Chinese branding to develop and fully flourish, Intellectual Property Rights must be upheld. Even though the past has been bleak there are signs that in the future China may discover the virtues of intellectual property. In February this year (2006), we witnessed for the first time a Chinese IT company ( Netac from Shenzhen) taking an American company (PNY Technologies from New Jersey) to court on grounds of patent infringement, usually it has been the other way around. (The Economist, 4/1/2006)

## 3.7 Country image

When consumers try to decide what product they should purchase, many attributes are taken into consideration. The ranking and importance of the various attributes changes depending on the purchase situation and product category, but mostly price and product quality have the majority of influence. However, when consumers can not easily differentiate the selection of offerings on the basis of these two attributes, they will use other factors to infer the quality of a product. One such factor that a consumer may use is the country of origin of the product. (Han; 1989, pg 223) Here a consumer evaluates a products attributes using her/his *country image*, which can be define as the "*consumers' general perceptions of quality for products made in a given country*". (Han 1989, pg 222)

Naturally, country image is very specific to product categories. For example, an Afghan rug would be perceived to be of much greater quality than an Afghan microwave. Similarly, the importance of country image in the purchase decision also differs according to product category. Jaffe and Nebenzahl (2001, pg 91) showed that Cars (54%), Clothing (51%), Electronics (31%), and Small Appliances (15%) are the product categories for which country of origin is of most importance. Apart from cars, the four biggest product groups exported from China in 2004 fall into the remaining three categorisations.(www.intracen.org) This goes to show that the country image of China can play a significance role in the success of its brands abroad.

Even though the influence of country image on purchase decisions may vary immensely according to product type and nationality of consumer in question, it will nonetheless be of a general importance. This is especially true for China. The lack of exports of high-quality Chinese products or brands in the past means that consumers around the world have little knowledge of Chinese brands and can not infer a product's quality from their brand name. As a result they will make use of other product attributes and most likely attach a greater value to country image. Unfortunately, the country image for China is rather negative and this is reflected in brand perceptions. In 2005 www.brandchannel.com (Swystun, Burt and

Ly; 2005) conducted a survey on what people associated with Chinese brands and the top five responses were:

1. Cheap
2. Poor Value
3. Poor Quality
4. Unreliable
5. Unsophisticated

Having accepted that the average consumer will place greater importance on country image for products from China, it is a further challenge for Chinese brands to overcome their country's unfavourable image.

Theory within this field has pointed to two types of sources that shape a consumers country image, *Halo* and *Summary Construct*. (Jaffe and Nebenzahl 2001, pg 42) The Halo construct is prominent when the consumer has little or no knowledge of brands from a country and thus uses alternative knowledge to form his his/her perception of the product. The alternative knowledge used by consumers might be the economic and political development in the country, and also ones opinions towards people from that country. The Summary construct is a factor when the consumer does have prior experience, either directly or indirectly (eg. through word of mouth), with brands from this country. The consumer then utilizes these past brand experiences and applies them to the evaluation of the new unknown brand. As the consumer gathers more and more experiences with brands from a country, the Summary construct will play the major role in forming his/her country image. On the other hand, when the political developments of a familiar country are seen as extreme by the consumer, the Halo construct may play a leading role in forming ones country image. A good example of this was the anti-French sentiment in the USA during the Iraq war, which resulted in "*freedom-fries*". (www.news.bbc.co.uk)

According to the theory above, improving ones country image should be done through maintaining positive political relations and exporting brands that leave consumers with favourable experiences. The Summary construct definitely has the strongest influence of the two and hence China should clearly focus more on exporting brands with quality products than trying to boost its political or economic image. The process of improving ones country image is a long and delicate one, but it has been done before as we have seen with brands from South Korea and Japan. (Papadopoulos and Heslop; 1993, pg 104)

## 3.8 Summary

In this chapter we have outlined the main factors responsible for the limited number of global Chinese brands. It started with historical factors that gave China a late start in the race to establish global brands. Then when reform eventually took place, the Chinese economy became more and more conducive to branding. However, certain barriers to competition still exist and thus Chinese entrepreneurs do not yet have the same possibilities or incentives to develop global brands as their western counterparts. The historical independence and substantial differences between the provinces in China makes it difficult for companies to establish large national brands, which may eventually become global brands. The lack of consumer research has meant that Chinese firms have little experience in gathering and interpreting such data when developing a brand. Naturally, the cultural differences documented in this chapter also pose a great obstacle to Chinese firms trying to build brands in western markets. Furthermore, the lack of IPRs has meant that firms have mainly competed on price and the unfavourable country image of China has given little opportunity or incentive for firms to focus on the global market.

Having established both the need for Chinese firms to establish global brands and the difficulties they face in doing so, the next chapter will outline the different strategies that a brand can adopt when attempting to enter foreign markets.

# 4. How to develop a global brand

## 4.1 Relevant foreign market entry methods

The theories we utilized here are foreign market entry-strategies because in essence that is what the firms are doing, trying to make a name for themselves in foreign markets. Effort has been made to focus on the consequences these strategies will have on branding and Chinese firms in particular. Lasserre (2003; chapter 7) lists six main forms of foreign market entry:

- Representative Office

This form of entry entails sending a manager to the foreign market in order to collect information, establish contacts, negotiate distribution, and organise direct sales. This is a strategy with minimal risk and can be seen as a stepping-stone into the foreign market.

- Local agent or Distributor

This is where the firm appoints a local sales agent or distributor in the foreign market. A local sale agent would be in charge of selling the firms product, while a distributor would be concerned with the logistics, stocking and billing. This is also a strategy with limited risk and a form of testing the market.

- Licensing or Franchising agreement.

Here a foreign firm is given the permission to sell products in their home-market on the behalf of another firm. The foreign firm then pays a fee up-front and some form of royalties in exchange for being able to utilize the other firm’s technology or brand name. This form of entry requires little capital involvement but does have some inherent risks.

- Joint Venture

This is when two firms create a partnership and invest capital in common infrastructure. In regards to brands this is a form of branding alliance and the advantages and disadvantages of this strategy will be discussed in detail in the next chapter.

- Acquisition

This is when a firm enters a foreign market by simply buying a local competitor, thereby making use of the already established distribution networks, suppliers, and customer relationships. This is a time efficient strategy but often does not come cheap.

- Wholly-owned subsidiary

Here a firm enters a foreign market with full force. It sets up a local office and hires some local staff, but is usually run by management from the home-country. This requires significant research and funding, but the firm has full responsibility and control over the division.

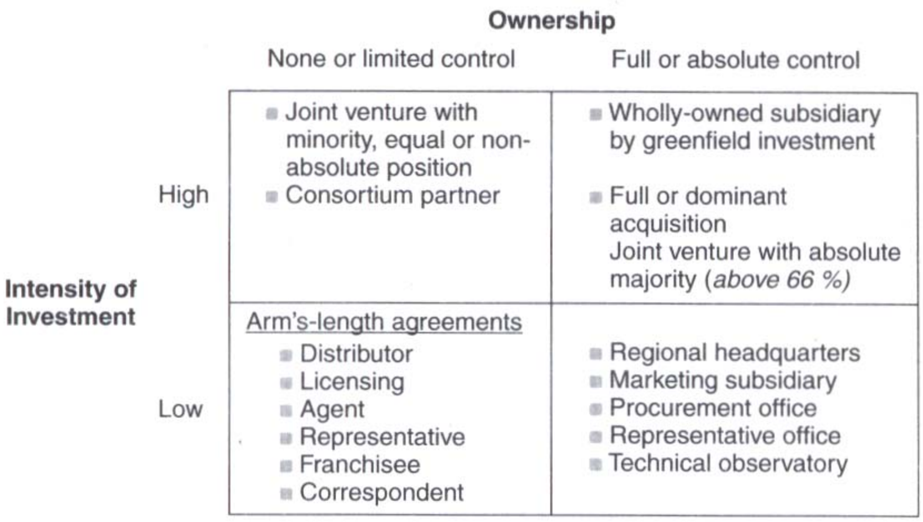
Each form of entry outlined above obviously has a long list of advantages and disadvantages, but in this chapter the focus will be on the latter two entry forms; Acquisition and Wholly-owned subsidiary. In an attempt to justify this focus reference to Lasserre (2003, pg 189) will be made, who mentions "*timing of entry*" as a key factor in influencing the entry mode. He distinguishes between four phases:

1. The Premature phase – where there is a lack of purchasing power or an absence of demand for the product/service.
2. The Window phase – where the market is in the take-off stage but competitors have not yet fully established themselves there.
3. The Competitive Growth phase – where some competitors are present in the market and the market is exhibiting high-growth rates.

4. The Mature phase – where competitors are well established in the market and high-growth rates are no longer evident.

In regards to Chinese firms entering western markets, the timing phase that seems most suitable is the Mature phase since western markets are well entrenched with competitors and growth rates in established consumer goods markets are not astoundingly high. Having determined that the Mature phase is the relevant phase, Lassere (2003, pg 191) states that in this phase "*acquisition or direct investment with an innovative product is generally the only way to enter.*", hence justifying our focus on these two entry modes.

Further justification of our focus on these two entry modes can be witnessed when looking at the below 2-by-2 diagram. This diagram is also taken from Lasserre (2003, pg 192):



| | | **Ownership** | |
|---|---|---|---|
| | | None or limited control | Full or absolute control |
| **Intensity of Investment** | High | ■ Joint venture with minority, equal or non-absolute position<br>■ Consortium partner | ■ Wholly-owned subsidiary by greenfield investment<br>■ Full or dominant acquisition<br>Joint venture with absolute majority (*above 66 %)* |
| | Low | Arm's-length agreements<br>■ Distributor<br>■ Licensing<br>■ Agent<br>■ Representative<br>■ Franchisee<br>■ Correspondent | ■ Regional headquarters<br>■ Marketing subsidiary<br>■ Procurement office<br>■ Representative office<br>■ Technical observatory |

The horizontal axis represents the extent of ownership control that a firm desires in the foreign market. In the case of branding, full control is necessary because developing consumer associations to a brand is a delicate process and consistency is extremely important. Therefore if a foreign subsidiary acts in a way that is not consistent with other aspects of the brand, consumers will become confused and eventually develop unfavourable associations towards that brand. As a result Chinese firms should seek full control of foreign operations.

The vertical axis represents the level to which the firm is investing in competencies that add value. Building a brand is an intricate process and can not be achieved through limiting foreign operations to administrative activities. Furthermore, a main reason for Chinese firms to build a global brand was to engage in the more value-adding activities of the value chain, therefore Chinese firms should not take this investment lightly.

Given the two arguments above, Chinese firms should engage in the entry modes found in the top-right segment of the 2-by-2 diagram. These are again either Wholly-owned subsidiary or dominant acquisition. The following sections of this chapter will investigate these two entry modes in more detail. Although discussed separately, it is important to note that these strategies are not mutually exclusive and a firm can utilize aspects of both strategies at the same time.

## 4.2 Organic expansion

Given that the foreign market does not impose any domestic ownership restrictions, such as in the United Arab Emirates where at least 51% of company shares must be owned by locals (http://www.government.ae), a firm can enter a market by setting up their own wholly-owned subsidiary (or organic expansion as it is also known). This form of market entry has numerous advantages and disadvantages.

### 4.2.1 Advantages

As we mentioned previously, when you start your foreign operations from scratch you have absolute control over your business activities. Within the legal framework of the host country, you get to decide what suppliers you deal with, what distributors you deal with, what type of marketing campaign you want to run, and who you want to employ. The ability to make these decisions without having to debate with a local partner can save time, ensure your subsidiary integrates well with the rest of your organisation, and help maintain a consistent image in the different markets you operate.

The majority of business activities the subsidiary undertakes will influence the associations consumers have to the brand, such as what channels you use to distribute your goods and what people you employ. By starting afresh you can build these associations from scratch, whereas if you take over already established operations you have to breakdown the existing consumers associations before you can establish new ones. Here a firm also runs the risk of confusing the consumer through inconsistent brand images. Furthermore, establishing a dominant presence in a foreign market from scratch signals significant resources and thus a certain level of product quality to consumers. (Child and Rodrigues; 2005, pg 398)

In chapter 3 we highlighted the difference in culture between China and other western countries. These differences naturally affect corporate culture and management styles within firms. Employees in western nations might not be fond of Chinese management styles and corporate culture. By hiring new local employees and training them from scratch there is a higher likelihood that they will accept these different practices, than if one attempted to alter already established procedures. In addition, it increases the probability that they, as ambassadors of the brand, project a positive and consistent image of the brand.

### 4.2.2 Disadvantages

One of the largest drawbacks of establishing a wholly-owned subsidiary is the amount of resources it demands. Firstly, the firm should conduct a feasibility study on the foreign market it plans to enter and decide where it should settle. Secondly, the firm needs to familiarize itself with local institutions and legal requirements. Thirdly, it must pay for the real estate, construction and interior set-up of the office. Fourthly, it has to cover training expenses for employees and conduct market research on how best to target customers. Lastly, the firm needs to try and establish business relationships with suppliers and distributors. In the case of Chinese firms, the funding of this type of expansion may not be as big of a concern as for other firms due to the support they receive from their government, but it is still an issue.

The above cost dimension also highlights the amount of time it takes to set-up such a wholly-owned subsidiary. In addition, once the above tasks are completed there is still the long process of establishing strong and positive associations towards the brand in the mind of the consumer. Given the arguments presented in chapter 2 for the urgency of Chinese firms to establish global brands, time is of the essence. "*Japanese and South Korean companies like Toyota, Sony and Samsung made the moves from national to global brands quite successfully, but it took years. Analysts say that Chinese companies do not have that luxury, because the rapid pace of globalization means that markets are now quickly won and lost.*" (Barboza; 2005)

Adapting to foreign regulations, as well as more subtle market characteristics, is a difficult process. Without any prior experience to draw on, a newly established subsidiary will face many challenges trying to understand local practices. Starting from scratch may aid in training local employees to grasp home-country customs, but is a significant disadvantage when it comes to understanding host-country consumers. The substantial cultural differences we mentioned previously will only exacerbate the challenge facing Chinese managers.

Another disadvantage of this type of entry mode that applies to Chinese firms is the increased need for managerial talent. When expanding operations abroad and making home-country managers responsible for activities in the host-country there will inevitably be demand for more qualified personnel. Managers in the home-country will also have to engage in a broader variety of tasks, such as including the foreign subsidiary in their accounts and ensuring they maintain an open channel of communication between headquarters and the foreign subsidiary. Due to the shortage of experienced and well-educated people in the Chinese labour market, the stretching of managerial capability and demand for additional personnel can become a problem. (Child and Rodrigues; 2005, pg. 398)

### 4.2.3 Examples

The Haier Group was incorporated in 1984 and produced only household refrigerators at the time, currently however it manufactures a wide range of household electrical appliances, 15,100 varieties of items in 96 product lines, and exports products to more than 100 countries. (http://www.haier.com.pk) Shifting from a collectively-owned enterprise (the Qingdao Refrigerator Factory) to a corporation with global presence, the Haier Group frequently adapted an organic expansion strategy.

Haier focused on the USA at an early stage and after exporting for 9 years it finally established its first overseas manufacturing facility in South Carolina on 30th April 1999. This enabled them not only to overcome quota restrictions and potential anti-dumping suits, but also to minimise (not eliminate due to their foreign brand) the country of origin effect by printing “Made in the USA” on the goods produced there. This move, in combination with the opening of a design centre in Los Angeles, clearly demonstrated Haier’s organic internationalization strategy and its attempt to establish a locally recognized brand. These two moves are “*examples of Haier America's commitment to the US market*”, trying to ensure consumers of their quality and long-term obligation (http://www.haieramerica.com).

The above steps taken by Haier are both attempts to increase the salience and quality perception of the brand value, however, the most obvious action taken by Haier to establish their brand abroad was the purchase of the former headquarters of the Greenwich Bank at 1356 Broadway. This central location in Manhattan is to become Haier’s headquarters in the USA. The building is far from cost effective but its aim is clear, to signify quality and prosperity to its visitors and by-passers. When engaging in an organic expansion strategy to establish your brand abroad, purchasing a plush landmark building in the centre of a leading city and posting your brand name on is a strong way to improve the quality associations towards your brand, which is what Chinese brands need.

## 4.3 Acquisition expansion

The alternative strategy to organic expansion is expansion through Acquisitions. Here the firm can simply buy up a foreign competitor and sell their products under the newly acquired brand. Naturally there are occasionally barriers to such actions, such as national legislation or the recent upsurge of “*economic patriotism*” in France, sparked by a bid from Italian Enel to acquire the French energy company Suez. (www.news.bbc.co.uk) The focus of this paper is mostly on entering western economies and consumer goods markets where the barriers to acquisition tend to be not as significant. As is the case with all strategies, establishing a global brand through acquisitions has its advantages and disadvantages.

### 4.3.1 Advantages

The greatest advantage with the Acquisition route is its speed. Once the target company has been purchased the new market entrant has access to its suppliers, distributors, technology and management. Most importantly it can utilize the target firm’s brand name. Given that the brand name evokes positive associations from customers, the new owners of the brand can sell their products to customers using this locally trusted brand. Using the already established brand the new firm can circumvent the long and delicate process of building a brand, and limit (not eliminate) the negative country of origin affects.

Another advantage of expanding abroad using acquisitions is that the company utilizes the existing market share. If for example there are 10 equal competitors in the market you are attempting to enter, when you buy one of the competitors there are still only 10 players in the market and you automatically get 10% market share. If you enter without an acquisition it means there are now 11 players in the market and you have to steal market share away from your well entrenched competitors. It is usually much harder to acquire a new customer than keep an existing one. In addition, when you purchase a firm it prevents other competitors from doing so, thereby limiting their ability to strengthen their business through acquisition of new technology and customers.

Most firms that are susceptible to being acquired are typically small or not performing so well, which means that when taken over by another company there is a chance that the new company has some competencies that the old firm was lacking. If for example a company with a strong brand name struggles because of high production costs, then being acquired by a Chinese firm with low production costs may solve this problem and result in a turnaround performance. Although in practice often things are not that simple.

When discussing the organic expansion method we mentioned that adapting to subtle market characteristics can be a challenge. When acquiring a foreign business, the staff is already trained and has a good understanding of the local market characteristics as well as the characteristics of your potential customers. Furthermore, the Chinese firm can exploit the knowledge of its home market by selling goods there under the foreign brand name, thereby eluding many of the negative associations Chinese consumers have of goods manufactured in China.

### 4.3.2 Disadvantages

We mentioned that brands that were performing poorly were those most susceptible to being taken over. However, when deciding on local brands to buy, Chinese firms should focus on strong brands that will favourable affect the image of their product offerings. If you acquire a failing brand you have to invest in it and build it up again, in which case you may just as well have built your brand up organically. Given that the acquisition focus should be on strong brands, the price that has to be paid for these brands is often shocking; we noted in the introduction that the Coca Cola brand alone is valued at more than $65 billion. This is one of the main disadvantages of expansion through acquisition. You are often over-paying for an asset that is hard to inspect, yet easily destroyed. If the brand's existing customers resented the foreign take over of the firm, or the company has undiscovered detrimental baggage, the brand you just paid so dearly for has already depreciated in value.

Research on cross-border acquisitions in Europe has shown that "*overall 25% were straight failures and 25% not worth doing, giving a success score of 50%*". (Lasserre; 2003, pg 138) A large contributing factor to this low success rate is the difficulty involved when trying to fuse together two distinct corporations from different countries. The survey here focused only on cross-border acquisitions within Europe, so we can imagine the success rate dropping considerably if it were to include Chinese firms. The before mentioned cultural difference, and not at least the linguistic difference, between Chinese firms and those of the west will no doubt magnify the conflicts encountered while integrating the two firms. A typical cultural example would be the Chinese firm promoting employees on the basis of seniority, whilst western firms would insist to promote employees on the basis of merit.

One could argue that since the Chinese firm is acquiring a majority stake in the western firm it has the ability to dictate procedures and actions. Technically, the Chinese firm may have that ability, but strategically it would be disastrous because gradually the employees would leave the organisation. When employees leave a corporation, especially management, they take with them their competencies and thereby many of the advantages you initially acquired the firm for. The brand image can very easily be tarnished, not only by media reports of employees leaving the newly acquired firm, but also because the people you hire to replace the former employees may not necessarily have the training and experience needed to fully understand and maintain the original brand image.

If the existing employees leave the firm you also have to pay for recruitment and training of new employees, on top of the possibly inflated purchase price. However, even if the employees in the newly acquired firm don't leave, there will still be an extra strain on the management in the home-country, which now has to establish good communications with their new foreign subsidiary. As we mentioned before, the availability of capable Chinese managers is not great and in combination with the significant cultural differences we can assume establishing effective communications will be a major challenge.

Lastly, finding suitable targets for acquisition may also be a difficult process. Albeit one pays a substantial price for a company, national institutions or shareholders may prevent the acquisition from going ahead. A domestic firm being taken over by a foreign company may bruise national pride and being a Chinese company, in for example the USA, will not reduce the extent of this bruising.

### 4.3.3 Examples

The most demonstrative example of a Chinese firm establishing a global brand through acquisition is that of the I.T. company Lenovo. Lenovo (know as Legend until 2003) was started in 1984 on a Beijing campus by eleven likeminded scientists. Their initial investment only amounted to $24,000 and they acted as a distributor of foreign brands such as IBM and Hewlett Packard (www.news.bbc.co.uk). The company has since grown at an astounding rate, for the year ended 31 March 2006 the company turnover was $13,276 million and employment equalled 21,400 people worldwide (www.pc.ibm.com).

In December 2004 Lenovo paid $1.75 billion for IBM's PC hardware division and the right to use the IBM brand for five years. After the acquisition Lenovo is now the world's third largest computer vendor after Dell and Hewlett Packard (www.news.bbc.co.uk). The move was clearly designed to overcome the weak brand image Lenovo had outside Asian markets. Now Lenovo can exploit IBM's brand image and sell products under their name.

Lenovo realised the danger of employees fleeing their newly acquired company and hence assigned IBM's senior vice president Stephen Ward, as the firm's chief executive. Another aspect of the deal that increases the likelihood of successful integration between the two firms is that IBM has 18.9% stake in Lenovo and thus have an incentive for the acquisition to go smoothly. In addition, the Lenovo headquarters have now moved from Beijing to New York, which further confirms Lenovo's intention to become a global brand (www.news.bbc.co.uk).

## 4.4 Example pitfalls

The examples we gave of Chinese firms attempting to develop global brands through engaging in either organic or acquisition expansion strategies both seemed rather positive, but they are one of the few successful examples and even they are not without troubles. For Haier, establishing a production plant in South Carolina and setting up their US headquarters in Manhattan will erode a substantial part of their low-cost advantage. If it were not for the encouragement and help it received from the Chinese government, who is a part owner, this move would have been of greater detriment to the firm. Building a global brand takes time, but for being the world's fourth-largest white-goods maker (after Whirlpool, Electrolux and Bosch-Siemens; before GE) with substantial market share, its brand still carries relatively little weight internationally. (www.economist.com)

Lenovo is also a partly state-owned company and also received crucial help to finance their acquisition of IBM's PC hardware division. We mentioned previously that when acquiring a foreign brand one should target strong brands. While IBM is by no means a weak brand, it has been moving its focus away from personal computers to the business-to-business market and has thus perhaps not brought Lenovo the profits it hoped. On the 1st August 2006 Reuters news agency reported that "*Lenovo Group Ltd. is expected to post its second straight quarterly loss as the world's third-largest PC maker struggles to turn around the loss-making business it bought from IBM.*" (Leung; 01/08/2006) In addition, the previously mentioned disadvantage of resistance from national institutions was also evident during this acquisition as the U.S. Justice Department, and Department of Homeland Security, both voiced concerns about the Lenovo purchase, fearing it could offer opportunities for industrial espionage (www.news.bbc.co.uk).

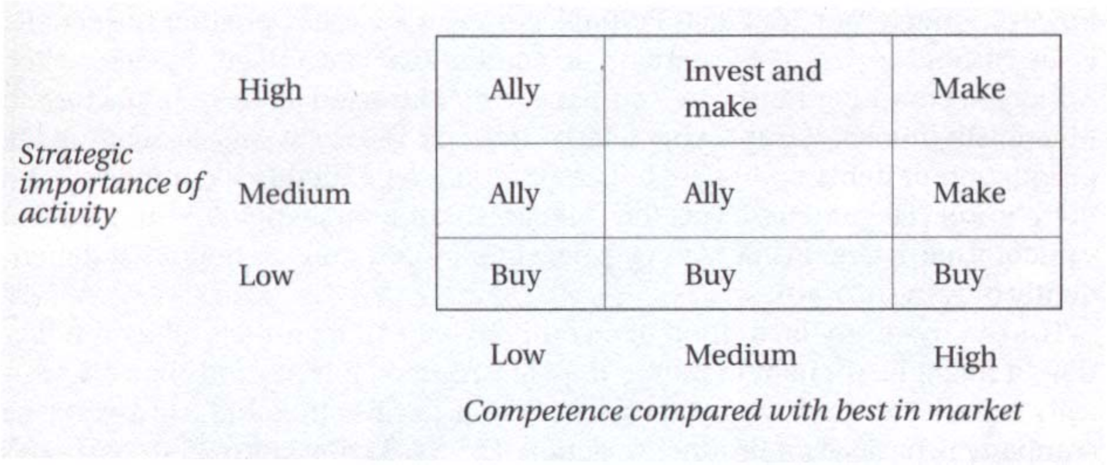
## 4.5 Summary

At the beginning of this chapter it was argued that the focus for Chinese firms attempting to establish global brands should either be on a wholly-owned subsidiary strategy or one of acquisition. We then went on to outline the broad advantages and disadvantages of such strategies. The examples presented showed that Chinese firms do engage in such strategies and that they are not without dangers. In the next chapter we will seek to explain how joint-ventures, in a branding context, can perhaps be an even more favourable strategic option for Chinese firms.

# 5. Alliance expansion strategy

## 5.1 Joint ventures

Using the below make-buy-ally (MBA) matrix (Child and Faulkner; 1998, pg 91) we can conclude that allying with another organisation can also be an appropriate course of action when attempting to establish a global brand:



| | | Competence compared with best in market | | |
|---|---|---|---|---|
| | | Low | Medium | High |
| *Strategic importance of activity* | High | Ally | Invest and make | Make |
| | Medium | Ally | Ally | Make |
| | Low | Buy | Buy | Buy |

The MBA matrix is meant as an aid to managers when deciding on how best to carry out business activities (versus entry modes in the previous chapter). Should the organisation either “Buy” the product from an external organisation (the acquisition alternative), “Make” the product in-house (the organic expansion alternative), or “Ally” with a partner to produce it together. Depending on the strategic importance of the activity and the competence a firm has regarding this activity, it should choose how to proceed.

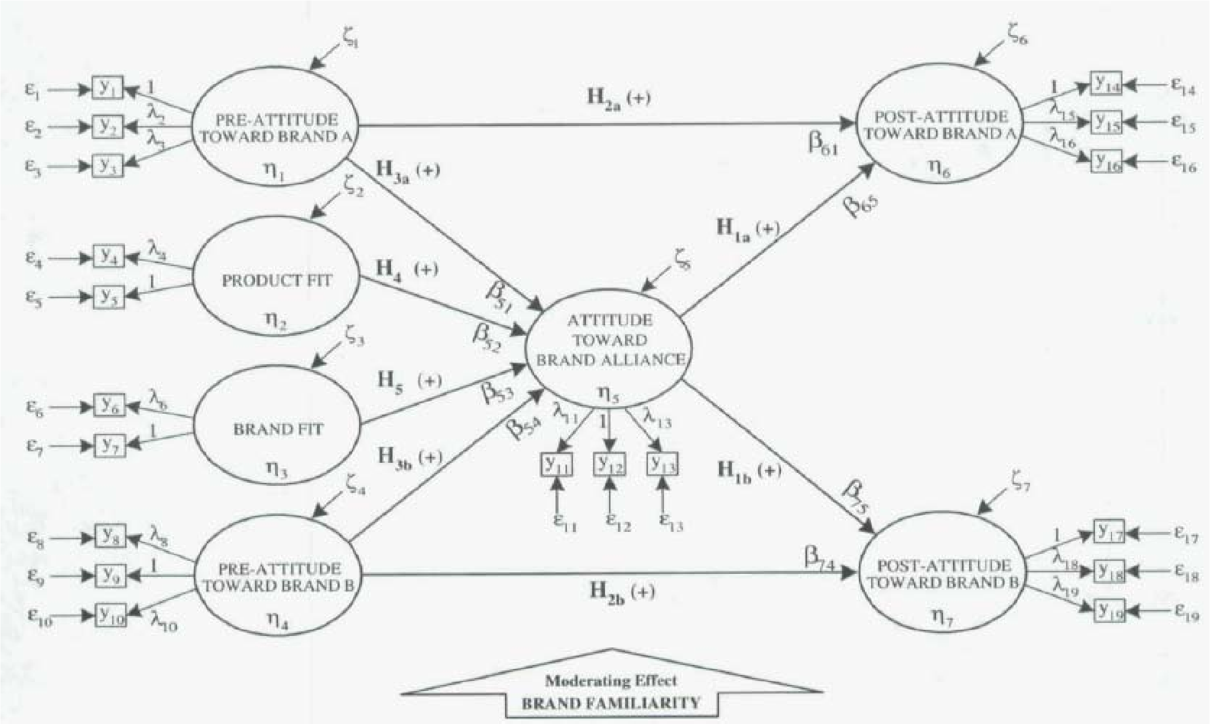
In the case of Chinese firms establishing global brands, we argued in the second chapter of this paper that this activity was of great strategic importance. In regards to the competence that Chinese firms have in this field, we argued in the third chapter of this paper that this was low. As a result we clearly see that it is the top right-hand box that applies to us, namely

"Ally". This means that Chinese firms should seek out organisations in western markets that have a competence in branding and form a type of Joint-Venture (J-V) with them so they can enhance their own brand equity. J-Vs come in many forms but in essence it is "*an agreement by two or more companies to produce a product or service together.*" (Gooderham and Nordhaug; 2003, pg 17) As stated previously, the focus of this paper is predominantly on the branding aspect of Chinese firms. In the field of branding a J-V is in essence a co-branding partnership.

## 5.2 Co-branding

When Chinese firms enter foreign markets by partnering their brand with a local brand they are engaging in a branding alliance, also know as co-branding. Co-branding is essentially when two or more organisations work together to promote their products using both their brands in the marketing context. For a more exact definition please see the introduction of this paper where we quoted Simonin (1998). Branding alliances are a relatively new phenomenon and have increased dramatically over the last decade. Some of the earliest and most known examples of co-branding can be found in credit card industry where Visa has teamed up with likes of General Motors and AT&T. Other examples of co-branding include McDonalds working with Disney (eg. The Lion King), Diet Coke and NutraSweet, Intel (inside) and IBM, Nestle and Nesquik (Cereal Bars).

By using two brands instead of one, the companies basically hope to reach a larger customer base and convey a stronger reassurance of quality. This might help them sell more units of the co-branded product but how does this affect the individual partner brands (referred to as parent brands) when they are selling their own products and thus how can it aid Chinese brands in overcoming their branding disadvantage? Simonin and Ruth (1998; pg 31) constructed a conceptual model of how this occurs and what factors play a role in determining the eventual effects on the parent brands:


PRE-ATTITUDE TOWARD BRAND A
$\eta_1$
PRODUCT FIT
$\eta_2$
BRAND FIT
$\eta_3$
PRE-ATTITUDE TOWARD BRAND B
$\eta_4$
ATTITUDE TOWARD BRAND ALLIANCE
$\eta_5$
POST-ATTITUDE TOWARD BRAND A
$\eta_6$
POST-ATTITUDE TOWARD BRAND B
$\eta_7$
$H_{2a}$ (+)
$H_{3a}$ (+)
$H_4$ (+)
$H_5$ (+)
$H_{3b}$ (+)
$H_{1a}$ (+)
$H_{1b}$ (+)
$H_{2b}$ (+)
$\beta_{51}$
$\beta_{52}$
$\beta_{53}$
$\beta_{54}$
$\beta_{61}$
$\beta_{65}$
$\beta_{74}$
$\beta_{75}$
$\zeta_1$
$\zeta_2$
$\zeta_3$
$\zeta_4$
$\zeta_5$
$\zeta_6$
$\zeta_7$
Moderating Effect
BRAND FAMILIARITY

We can see that they highlight four main factors that contribute positively towards the perception of the brand alliance. It comes as no surprise that attitudes towards the parent brands prior to the alliance will have an impact on the attitudes towards the eventual alliance. The more positive the pre-attitudes are the more favourable the attitudes toward the brand alliance will be ($H_{3a}$ & $H_{3b}$). Product fit implies the extent to which the product categories of the parent brands are related or match. If the level of fit is high, it will have a positive effect on the attitude towards the brand alliance ($H_4$). Brand fit relates to the level of cohesiveness between the parent brands and how well they suit each other. The better the fit, the more favourable the evaluation of the brand alliance will be ($H_5$).

Simonin and Ruth (1998) found that the spillover effect, which is what affects the consumers' attitude towards the parent brands, stem from the perception of the branding alliance. The more positive the perception of the branding alliance, the more favourable the affect upon the parent brands will be ($H_{1a}$ & $H_{1b}$). Simonin and Ruth (1998, pg 36) claim this affect ($H_{1a}$ & $H_{1b}$) is not negligible as they state "*brand alliances do measurably affect* *perceptions of partner brands, a relationship of significant theoretical and practical importance…*".

Another discovery made by Simonin and Ruth (1998) that is of relevance to Chinese firms wanting to establish global brands is that the spillover effects from a branding alliance do not necessarily affect the partners equally. What they found was that the less familiar brand in the alliance will experience stronger spillover effects. This appears logical as consumers have, prior to the alliance, not yet had a chance to developed strong associations towards the lesser known brand. This can be seen as a great opportunity for Chinese firms, as they are typically the lesser known brand and can therefore experience greater brand image improvement through the spillover effects, given that the consumer views the alliance as favourable. However, it can also be seen as a possible danger because if the alliance is viewed as unfavourable by the consumer, the detrimental effects of the spillover are also greater.

## 5.3 Alliance benefits

### 5.3.1 Joint venture advantages

Forming a J-V has certain general advantages. Similar to the acquisition route, forming a J-V gives a firm access to the competencies and expertise of a local company, which can help it adapt to some of the subtle differences of the local market. The foreign firm does not have to recruit and train a large number of new employees because it can to some extent utilize the staff of the local company. We also mentioned that sometimes in an acquisition, management leave the company that was acquired and thus take with them the firms competencies and expertise. In the case of J-Vs we could argue that the likelihood for employees to leave the collaboration is less because they have a guaranteed say in its activities and a share in its outcome. In addition, the action of forming a partnership indicates some level of willingness to make the alliance beneficial.

Compared to the organic and acquisition routes, the J-V option is a less costly and thus risky entry strategy. You do not have to build up a market presence from scratch and you do not have to buy a possibly over-priced local brand. This is important since the majority of Chinese firms have a low-cost strategy and should not erode this competitive advantage. Working in a J-V you can pay for the expertise and knowledge you receive by offering your partner knowledge and expertise concerning your core competence. In the case of Chinese firms, they can perhaps offer information and advice on doing business in the world's largest consumer market in exchange for branding expertise in western markets.

The speed, at which the foreign firm can establish a brand presence in the local market with a J-V, is potentially very fast. Given access to the partner's customer base, the foreign firm can easily get in direct contact with potential customers. Moreover, using the existing distribution networks of ones partner can significantly increase the rate at which the foreign firm gets it products in stores and its brand visible. The J-V route is faster than the organic route, but the fastest way to gain a brand presence in a foreign market is naturally through the acquisition route.

Another advantage of J-Vs that is worthy of mentioning is that it very often avoids troublesome protectionist legislation. Also, the acquisition of a domestic company may stir up scepticism and unleash a wave of "*economic patriotism*", followed by negative media coverage and thus poor consumer attitudes towards the foreign brand. However, engaging in a partnership with a local company will doubtfully incite such a response. Furthermore, the previously mentioned detrimental effects of the Chinese country image may be reduced since a partnership with a local firm weakens the link of a product to its foreign counterpart.

### 5.3.2 Co-branding advantages

Additional advantages of J-Vs that are specific to co-branding can be witnessed in research carried out by Washburn et al (2000). Washburn investigated the consequences of co-branding between brands of different equity. Brand equity is in a sense the strength of a brand, and since recognition and awareness (i.e. salience) are vital parts of becoming a strong brand, we can argue that Chinese brands are typically of low equity in the international setting. The research focused on four types of co-brands:

1. A high equity brand pairing with another high equity brand
2. A low equity brand pairing with a low equity brand
3. A high equity brand pairing with a low equity brand
4. A low equity (LE) brand pairing with a high equity (HE) brand

The first type of co-brand is of little interest to us as it is not applicable to Chinese (LE) brands, but the findings from the other three types of co-brands are of significance. They found that when a HE brand was paired with a LE brand and product trials were positive that brand equity of the LE brand increased significantly whilst the brand equity of the HE remained the same. Similarly, when a LE brand was paired with a HE brand and product trials were positive, the brand equity of the LE brand increased significantly whilst the brand equity of the HE brand remained stable. Even though the brand equity of the LE brands in the two types of co-brands (type 2 & 3) both increased, it was when the LE brand took the dominant position in the partnership that it benefited the most (type 2). The research also found that when a LE brand paired with a LE brand, the brand equity of the two constituent brands both increased after a positive product trial, albeit not very much.

The research thus suggests that for Chinese firms, pairing with a HE brand from a compatible product category will result in significant positive spillovers; given the product trials are positive. Being the dominant partner gives the Chinese brand a greater brand equity increase, but either way the Chinese brand gains. Furthermore, even if Chinese brands pair with other LE brands and the product trials are positive, there will be some favourable spillover effects for both parties. The main positive outcome for Chinese brands was that none of the HE brands were negatively affected when paired with LE brands. This means that when Chinese brands attempt to find HE partners to pair with they can point to research that assures their potential partners they will not suffer from the partnership, given positive product trials.

Perception of poor quality is one of the main challenges that Chinese brands have to endure in foreign markets, as well as the domestic market. The negative quality association means that potential customers are reluctant to try the Chinese products, but when co-branded with a firm that has favourable quality associations, consumers would be more willing to take the chance. Rao, Akshay R. et al (1999) state that consumers are more willing to take this chance because the Chinese brand is in essence buying "*vulnerability*" from the more established brand. The new (Chinese) brand may just be a short-term venture intending to trick consumers into buying their product before they close operations and shift to a new brand name, whereas if the established brand delivers lower than claimed quality it will result in intolerable economic losses.

A branding alliance gives Chinese brands the opportunity not only to convince potential customers to try their brand (albeit co-branded), but also to increase the equity of their brand through positive spillovers. This gives Chinese brands a foot in the door and the chance to eventually sell many of their own branded products in the foreign market. There are many additional advantages of engaging in a branding alliance, Blackett & Boad (1999, Ch.2) list 23 specific opportunities and benefits in their book. However, in the case of Chinese brands entering developed markets, the broad advantages of J-Vs mentioned in section 5.3.1 and the advantages discussed in this section, are most relevant ones.

## 5.4 Alliance drawbacks

### 5.4.1 Joint venture disadvantages

A J-V seems to overcome many of the drawbacks of the organic or acquisition route, but obviously they are not without potential pitfalls. Firstly there is a lack of total control in partnership. If one buys or builds a brand one has the authority to quickly take difficult decisions, but if one is in a partnership, one must try to solve issues of conflict through consensus. This can be a very long and strenuous process since the goals of the partnering brands are never identical. One of the first tasks that are often mentioned as a potential conflict source is nominating one single boss for the alliance.

Given that the pre-partnership negotiations and boss appointing go smoothly, there is no way to assure that the local firm shares the intangible knowledge nested inside their employees. Even if the local firm is flexible and willing to share this knowledge, that is still no guarantee. Knowledge transfer is a complicated process and its complexity is exacerbated by the differences in national and corporate culture that typical exists between Chinese and western firms.

We previously discussed the shortage of talented managers in China and the difficulty this posed for the other two types of brand establishing routes. Although perhaps not as significant, the need for culturally sensitive and competent managers is also an issue in branding alliances. Finding these types of capable managers may be a challenge for the Chinese firm and create a strain on their resources. In addition, the employees from the western firm might also not have a high level of cultural understanding.

### 5.4.2 Co-branding disadvantages

A potential disadvantage of J-Vs that is specific to co-branding is the concept of brand dilution. Nunes et al (2003, pg 22) describes brand dilution as when the brand loses its meaning to customers. If a brand forms alliances with a large number of other brands it risks confusing the customer and thus upsetting them and causing them to opt for another brand which they feel they understand better. (The exception here is VISA which has joined with countless other brands yet still has a strong brand) This negative effect is more applicable to well established brands with many branding alliances, thus may not be such a significant risk to Chinese brands.

Another risk of co-branding is the possibility of the devaluation of your partner's brand and thereby the devaluation of your own brand. If the company, which you are engaged in a branding alliance with, acts in a grossly unethical manner and it becomes known to the public, the negative press will result in unfavourable associations towards the partner brand. This will directly affect the co-branded product and thus result in detrimental spillover effects for both parent brands. As we have mentioned earlier in this chapter, the spillover effects are great for the Chinese brands. (i.e. low-equity brands)

Although it is a challenge that is generic for all J-Vs, finding a suitable and willing partner for a co-branding partnership is even more difficult and crucial for the success of an alliance. According to Simonin and Ruth (1999) a good partner brand should evoke positive associations (attitudes) from the consumer, fit well with your product group, and mesh well with your brand image. These requirements significantly limit the amount of potential partners that Chinese firms should choose from.

## 5.5 Summary

At the start of this chapter we used established theories to argue that forming a J-V was a suitable strategy for Chinese firms to adopt when developing a global brand. We then proceeded to distinguish co-branding as a certain form of J-V and explained how a branding alliance can affect the original partner brands through spillovers. In addition, we argued that Chinese brands would be more susceptible to spillover effects. Then the generic advantages of J-Vs and more specific advantages of co-branding were discussed, followed by their disadvantages.

In the next chapter an attempt will be made to summarise the main aspects of this project and formulate general recommendations applicable to Chinese firms wishing to establish global brands. Lastly, we will discuss some of the limitations of this research.

# 6. Conclusion

## 6.1 Summary and contributions

In regards to Chinese consumer markets, most of the existing research centres on how western firms can and should enter these rapidly growing markets. In comparison, there is rather limited coverage of how Chinese firms can and should enter western markets. This paper sheds some light on why and how Chinese firms should seek to enter foreign markets.

The second chapter presented some strong arguments for why Chinese firms should change their focus from being low-cost OEM's (Original Equipment Manufacturers) to concentrating on promoting their own brand. The OEM focus has been profitable in the past as China has capitalised on its low-cost labour, but as the market gets more crowded input prices will eventually rise and thus diminish this competitive advantage. Furthermore, if China eventually gives in to US pressure to raise the value of the Yuan (eg. the suggested 40%), it will mean a drastic reduction in China's low-cost advantage. We are already witnessing some businesses moving production to Vietnam and Bangladesh in order to cut costs, thereby proving this focus is not sustainable in the long-run.

In addition to the OEM focus not being sustainable in the long-run, five arguments for establishing a global presence were listed and applied to Chinese firms. The knowledge imperative and globalization of competitors were mentioned as the most pressing arguments. The rise in global competitors was further highlighted using research showing an increased presence of foreign brands in the mind of Chinese consumers. As a result, the main argument for Chinese firms to go global was not so much to gain a competitive advantage, but rather to eliminate a competitive disadvantage in relation to western brands already present in Chinese markets.

The associated prestige and perceived quality of being a "global" brand was also documented, adding to the incentive for Chinese firms to go global. Attention was also drawn to the high ratings Chinese consumers (especially the younger generation) gave foreign produced goods versus the low ratings they gave domestically produced products. This implies that if Chinese brands go global they should emphasize this when marketing goods in their home market, thereby attempting to distance themselves from the poor quality associated with domestic producers. Lastly, the second chapter concluded by outlining some of the initiatives put in place by the Chinese government in order to encourage the establishment of global Chinese brands. This serves an additional confirmation of the importance, and adds another incentive, for Chinese firms to develop strong global brands.

In chapter 3 attempts were made to explain why China had not yet developed globally known brands and what obstacles lay in the way for Chinese firms wanting to establish such brands in the future. Historical factors were mentioned as one of the main reasons why the notion of branding was discovered so late in China. Given this late start Chinese entrepreneurs have a lot to learn from their western counterparts and have to try and progress faster along the branding learning curve.

The Chinese economy has in the past couple decades demonstrated astounding growth and taken substantial steps towards opening up to the world's markets. However, obstacles to free-competition are still present and these indirectly reduce the incentive to build brands. In a free-market economy the majority of Chinese SOEs would have been closed down long ago and replaced by more entrepreneurial companies who would be much more inclined to utilise (albeit more risky) strategies that could lead to a sustainable competitive advantage, i.e. building a strong brand.

The rise in urbanisation and improvement in infrastructure over the past years has meant that Chinese consumers are now much more susceptive to branding campaigns. Therefore Chinese firms should regularly re-evaluate the potential reach (profitability) of domestic branding campaigns. Furthermore, in western markets infrastructure tends to be more developed and better suited for marketing campaigns, hence Chinese firms should keep this in mind when calculating possible payoffs.

The high level of provincial independence and embedded rivalry amongst these provinces is also used to explain why China has not until lately raised any strong national brands. Instead, China has produced many regional brands that are not as well equipped to develop into global brands as perhaps a strong national brand would have been. Every nation will have some element of regional rivalry, which Chinese firms will be well equipped to handle, but an over emphasis on these rivalries may be detrimental in well developed economies.

Lack of consumer research in the past has meant that Chinese firms are not very familiar with their customer groups. In the past Chinese consumers simply had to purchase what firms produced and there was no need for firms to listen to their customers. However, in the competitive markets of today, Chinese firms must not only listen to what their customers want but even try to predict what they may want in the future. For this to be possible, detailed descriptions of the firm's customer segments and how they have changed over time are vital. This puts Chinese firms at a disadvantage since their consumer research industry is still in its early stages. Furthermore, with the rapidly changing consumer markets and diversity of customers in China, developing a detailed national branding strategy with a narrow customer focus is near impossible. Given the particular infrastructure and culture in China, firms will need to develop their own method for collecting and interpreting consumer research.

Using theory regarding culture comparison, it was argued that China faced an additional challenge when attempting to establish brands in western markets. The bar charts that were presented showed that the average Chinese consumer was very different from his/her western counterpart in three out of the five dimensions. This implies that Chinese firms will have a hard time trying to interpret or predict the behaviour of their western customers, and should therefore take into account the culture dimension rankings when undergoing such interpretation. Furthermore, branding strategies that were successful in western markets may not bring the same benefits in Chinese markets. Although Chinese firms have to catch up to the advanced stages of branding in the west, they should not be too eager and accept everything because it may not be applicable in their culture.

The lack of IPRs in China is a further disincentive to establishing strong brands. It makes it possible for counterfeiters to benefit from the resources other companies have invested into building a brand, whilst damaging the reputation of the original brands. In western markets IPRs are enforced more strictly and hence Chinese firms need not be as reluctant to invest in their brand image there.

Lastly the chapter concludes by citing country image as a severe obstacle for developing global Chinese brands. Given the rather weak track record for global Chinese brands, consumers in western markets have little knowledge of Chinese products and therefore use the country's unfavourable country image as a main factor when assessing a new products quality. Chinese firms must be aware of this disadvantage and attempt to limit it. The best way to do that is to export a stream of quality products over time and thereby gradually alter the summary construct of the western consumers' Chinese country image.

In chapter 4 it was argued that the only viable strategy for entering foreign markets and establishing a brand presence was either the organic route or the acquisition route. The advantages of the organic route were mainly full control and starting with a clean slate, whilst the disadvantages were basically the financial resources demanded and time required. As an example, the Haier Group and its activities were elaborated upon. The advantages of the acquisition route were amongst others, the speed at which a brand presence could be established and the direct link to existing customers. Its disadvantages included paying inflated prices for vulnerable brands and the possibility of conflict between the two firms. Lenevo was the Chinese firm used to demonstrate the acquisition route.

Chapter 5 suggested a middle alternative to the two strategies discussed in chapter 4, namely co-branding. It was explained that by marketing a co-branded product it would not only be easier to get consumers to try a unknown Chinese brand, but that positive experiences could result in spillover effects that would be favourable to the Chinese parent brand. Furthermore, research was discussed that showed Chinese brands would be more susceptible to these spillover effects since they were typically the least known of the partnering brands. The more generic advantages of forming a J-V, compared to organic or acquisition growth, were also discussed.

The main disadvantages of forming a J-V were said to be the lack of full control, thus the need for consensus, and the fact that there is no guarantee that firms will be able to transfer knowledge to each other. The more specific co-branding disadvantages that were mentioned were brand dilution and brand devaluation. However, the main challenge of forming a successful branding alliance is finding the right partner. Not only does the company in question have to have a strong brand name that fits with the brand and product group of the partner, but also the firms has to be willing to partner with a lesser known Chinese brand.

## 6.2 Recommendation

Chinese firms who currently enjoy the benefits of a low-cost base and focus on producing un-branded goods for foreign firms to sell under their own brand, should realise that their competitive advantage will not last much longer. They should capitalise on their current low-cost advantage and use it to help transform themselves to globally recognized brands. The manufacturing process and production techniques that the Chinese firms have learnt whilst producing for foreign brands can be of some use when the foreign brands eventually pull-out, but without a competitively low cost base or a strong brand, theses skills are little use.

Regardless of the difficulty that finding a suitable partner poses, engaging in a branding alliance generally seems to be the most attractive strategy for Chinese firms establishing a brand presence in a foreign market. The co-branding method falls in between the two extremes of the alternative strategies, thereby seemingly reaping most of their benefits yet avoiding their drawbacks.

Firstly, the potential costs of this strategy are much lower than both the organic or acquisition route. Naturally the Chinese firms still has to set up core functions in the foreign country, but costs for such things as marketing and distribution can be significantly reduced. Secondly, the Chinese firm is not forced to invest large amounts of money like with the other two strategies, yet it still establishes a quick presence in the foreign market. Keeping costs down is a vital competitive advantage for a majority of Chinese firms and engaging in an expensive entry strategy, like we saw with the Lenovo and Haier examples in chapter 4, can seriously damage a firms profitability.

Thirdly, co-branding is a form of partnership, which none of the other two strategies are. This signals a will to work together and this is dearly needed if the Chinese firm is to learn about a complex and intangible concept like branding. Fourthly, when a well established western brand is willing to partner up with a Chinese brand it signals an instant guarantee (vulnerability) to the western consumer. This guarantee reduces one of the largest barriers Chinese firms face when attempting to establish their brands in the west, the negative quality associations that consumers have of products with Chinese origin. When undertaking the organic strategy there is no such guarantee, and when undertaking the acquisition strategy there is a risk of economic patriotism.

In addition, the main disadvantage of the co-branding strategy is not only finding a suitable partner, but finding a suitable partner that is willing to partner with an unknown Chinese brand. However, the lack of will by western brands to pair with Chinese brands is a disadvantage that may slowly become less of a problem. As the Chinese economy grows and consumer markets become more lucrative, foreign brands will become more determined to be major players in these markets.  This implies that the local knowledge and networks, which domestic firms have developed, will make them a more attractive partner to western firms.

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