

China goes Europe

Chinese companies have been gearing up for their long march to the West for quite some time. Their joint ventures with established brand-name manufacturers and acquisitions of smaller companies make up for their weaknesses in service and marketing.

- China is coming. Just ask any of the
- happy few with membership at Berlin's China Club how close it has really got. The club has a bar, library and seven private dining rooms done up in a 1930s Shanghai Art Deco style with salmon-pink satin walls, luxuriously intricate 19th century Chinese art and oil paintings of post-Mao Red Guards. In the restaurant, head chef Tam Kok Kong prepares his signature dish—wasabi prawns.

When she founded this exclusive club in the Adlon Hotel at Berlin's Brandenburg Gate, Anne Maria Jagdfeld drew inspiration from the China Club in Hong Kong, of which she has been a member for many years. "I wanted to create a glamorous, cosmopolitan social club where members can network at the highest level," says Jagdfeld, who also owns Quartier 206, a posh Berlin department

**THE FLOW OF FUNDS IS STILL
HIGHLY IRREGULAR, BUT CHINA'S
INVESTMENTS ARE RAPIDLY GROWING**

store. Much of that networking is conducted with businesspeople from China itself. The Chinese are coming as students, tourists, immigrants and investors. According to Professor Rolf D. Cremer, vice president of the International Business School in Shanghai, who has twenty years of professional experience in Asia, Chinese companies' global expansion is not just about their looking for new sales markets. It also has to do with China's image of itself as a world leader. China does not see itself in the

long term as the world's mass production center, as merely contributing cheap labor to the manufacturing sector. Bessie Lee, CEO of the market research company Mindshare & Maxus China, confirms this: "By globalizing, Chinese companies improve their image." (See sidebar.) In 2003, according to the OECD, only around \$600 million in Chinese capital went abroad, while China itself drew direct investment to the tune of \$53 billion. However, it can be assumed that in the future, "Chinese investments abroad will quickly increase past current levels." That is the conclusion of a recent report prepared by the German embassy in Beijing. Where is the money going? "North America remains the developed market of choice, followed by Western Europe," says Wei Zhou, a Roland Berger consultant in Shanghai and author of a study entitled "From Middle Kingdom to global market." This study describes the expansion strategies of China's top 50 corporate groups. Fifty-six percent of these companies are seeking new sales markets overseas because their internal dynamics are driving them to expand internationally. Companies that manufacture PCs, TVs or air conditioners are finding it necessary to increase their exports since domestic production capacities are exceeding local demand. Market entry seldom takes the form of a head-on assault. China's groups "are on the lookout for segments that market leaders have already given up or that they are no



Bessie Lee, CEO, Mindshare & Maxus China

Self-image counts



Why are Chinese companies expanding? That has a great deal to do with China's perception of itself as a great nation. China compares its economic importance to that of countries like the US, Japan, Germany and Great Britain. By globalizing, Chinese companies are enhancing their prestige. The government is backing these companies and encouraging them to become active worldwide. China has a very different attitude toward competition than other Asian countries.

Right now, it seems like the high-tech industries are most aggressive in expanding abroad. Examples include IT companies such as Lenovo and home-electronics manufacturers such as Haier and TCL. These groups have highly developed products and abilities. I suspect that such high-end markets guarantee them a better return from a financial perspective as well as in terms of image and national prestige. Chinese companies are most interested in Europe and the United States simply because of the size of these markets.

Looking into the future, consider this: Less than 20 years after its markets opened up, already 6 percent of all Asia's top 50 companies are Chinese, which is absolutely impressive. I expect this figure will double by 2020, and possibly even triple.





Victor Yuan, Chairman, Horizon Research

Using cost advantages



Currently, Chinese companies are primarily manufacturing low-priced products for local markets. Their global partners are encouraging them to use their cost and price advantages to penetrate into international markets. This would also boost their domestic performance. Many Chinese consumers believe that an international company can make better products.

In established markets, Chinese companies are presently pursuing a low-price, low-end strategy. However, they absolutely have the ability to undertake a medium-price strategy in developing markets. For example, it is much more profitable to develop a bicycle business in Afghanistan than in the US market.

To date, Chinese companies have concentrated on the United States and Europe, but I believe they should focus more on developing markets. Many Chinese companies are concerned about social conditions in these types of countries, but some of them are starting to get interested in big, developing nations such as India and Brazil. Yet, from an overall perspective, the growth of Chinese companies will still be determined by China's domestic market. The scale of their multinational operations is still smaller than the overseas operations of Taiwanese or Korean companies.



longer interested in because of insufficient profit margins and sales volumes," write Ming Zeng and Peter Williamson, professors at the INSEAD Business School in Singapore, in the *Harvard Business Review*. Harro von Senger, a professor of Sinology at the University of Freiburg, Germany, agrees: "For Chinese companies, global expansion may initially only mean a partial expansion—into a foreign market in a specific region that is particularly well-suited for a Chinese product."

A good example of this is Haier. As the company, which today is the fourth-biggest manufacturer of refrigerators and washing machines in the world, expanded into the American market in 1994, it concentrated initially on the overlooked niche of small refrigerators for minibars and student lodgings. Soon Haier had reached a 50 percent share of the market.

There are no challenges that Haier balks at. "We always follow the principle of cracking the toughest nut first," says CEO Zhang Ruimin. And that is not always an easy task. For instance, Zhang characterizes German consumers as adamantly stuck on their national brands. To get around this, the company has since the mid-1980s been producing its refrigerators under license from the German manufacturer Liebherr—even winning a seal of approval by the German consumer association Stiftung Warentest. This award means so much to Ruimin that he has it on display in Haier's headquarters in Qingdao, hanging between a dedication penned by Premier Wen Jiabao and the document produced by the American finance magazine *Fortune* describing the company leader as one of the 25 most powerful managers outside the United States.

With its strategy, Haier is protected from the Achilles heel that Chinese companies traditionally possess: the lack of a strong brand name. "Chinese companies that want to expand globally need to build up a brand

name," says Thomas Eichelmann, a member of Roland Berger Strategy Consultants' executive committee. This is why they are increasingly seeking manufacturing opportunities in locations that stand for both high quality and premium products.

"Over the next few years, we will see takeovers of very established brand names for which Chinese companies will be paying accordingly," says Eichelmann. One particular reason for this trend has to do with the needs of the domestic market, since China's emerging middle class favors internationally recognized brand-name products.

CHINESE COMPANIES SUCCEED IN SEGMENTS THAT EMPHASIZE BOTH QUALITY AND LOW COST

IT and consumer electronics are the principal focus for expanding Chinese companies. The strategy is simple: The expansion begins with partnerships or with the acquisition of brands that are already established in the target market. Production takes place either partially or completely in China, with marketing and sales conducted in the Western location.

This is the path trodden by Lenovo, China's biggest personal computer manufacturer. The *Beijing Morning Post* recently reported that Lenovo will take over US giant IBM's production facility for notebooks and servers in Shenzhen. It's a perfect springboard: Lenovo is teaming up with the chip manufacturer Intel and will supply the servers and computers for the 2006 Winter Olympics in Turin, Italy.

Another expanding Chinese company is TCL. In 2002 the company, originally a huge cell phone manufacturer, took over Schneider, the insolvent TV and hi-fi manufacturer based in Bavaria, Germany, best known for its "Dual" record player. For two years TCL kept production in Germany alive; now it is divesting all but sales, marketing, and elements of research and development.

“For Chinese companies, global expansion may initially only mean a partial expansion into a specific foreign market.”

Professor Harro von Senger

TCL is engaged in a partnership strategy of global importance with the French group Thomson. Overnight the joint venture, of which TCL owns a 67 percent share, became the biggest manufacturer of consumer electronics in the world. It is aiming at producing—in Hong Kong—18 million color televisions and up to 4 million DVD players, with the technology originating in France. It is not only Western brands and Western technologies that China can build upon. The Old World’s big cities are vying to serve as bridgeheads for the future economic superpower. Hamburg (referred to in Chinese as Hanbao, “castle of the Chinese”) feels it stands a good chance of fulfilling this role, as it has already provided a branch location for 320 Chinese companies. “It is our stated objective to become Europe’s number one city in doing business with China,” says Reinhard Stuth, a counselor with the State Senate’s chancellery. The Senate has set up a Chinese-language wing at a city high school for the children of Hamburg’s 3,000 Chinese residents. And The Hochschule für Angewandte Wissenschaft, a university for applied science, has established an engineering college jointly with the University of Shanghai. The university clinic in Eppendorf plans to open an internationally significant institute for traditional Chinese medicine.

CHINESE IMMIGRANTS MOVE AROUND EUROPE AS IF IT WERE A LARGE CHESSBOARD

Hardly noticed by the public, some European cities such as Milan in Italy have even sprouted small Chinatowns. Chinese leatherworkers and silk-tie salesmen had already set up shop in the Via Paolo Sarpi district back in the 1930s. In fact, northern Italy has had an official Chinese trade and industry association since 1968. However, most of Italy’s 16,000-member Chinese community lives in Prato, a city near Florence built

around the textile industry. Leather-processing plants in particular have drawn immigrants, many of them illegal, from Fujian and Zhejiang provinces. Yet as quickly as the Chinese community grows, it could also just as rapidly shrink if economic conditions were to become unfavorable, as they did in Prato, where more and more leather companies are closing.

“Chinese immigrants consider Europe a kind of chessboard across which they can move about freely. As a result of their strong family ties and networks, they have start-up possibilities all over the continent,” says Professor Antonaella Ceccagno, head of Prato’s immigration center.

While Chinese from the lower class try to make a go of it in leather manufacturing or in Asian restaurants, the middle class comes to Europe to study, especially since the drastic post-9/11 security measures have scared off enrollees in the United States. According to the national statistics office in Beijing, 89.5 percent of all young Chinese want to study abroad. In 2003, more than 20,000 Chinese students were enrolled in German universities. And, looking at the issue optimistically, it is possible that anyone who has studied at a European university may return as a vacationer. The numbers may back that projection. In 2003, 20.2 million people from China’s fast-growing middle and upper classes traveled abroad. Of them 300,000 went to France, Europe’s traditional travel destination.

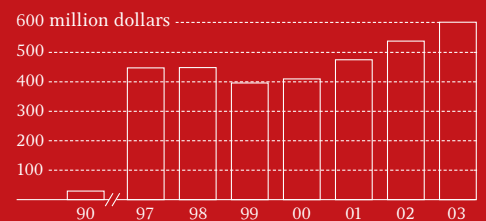
Chen Wang, head of the management board at Caissa Touristic AG, believes that the Chinese will constitute the fourth largest tourist group in the world by 2020. Many perceive the ever-growing stream of Chinese tourists, students and investors as a sign that the sleeping giant is awakening. “China’s broad impact on key indicators in all international spheres will be comparable to the global Americanization in the second half of the 20th century,” says Cremer.

Chinese companies are pushing into Western markets because...

- Chinese production of goods is greater than the purchasing power of Chinese consumers and their still comparatively low average income. China cannot absorb all its domestically produced goods.
- The principle “a bigger market is better for business” also applies to Chinese companies.
- Chinese companies can gain commercially useful business and other types of expertise by being internationally competitive.
- Global competition can help Chinese companies avoid both the hazard of becoming “inbred” and the associated inhibitors of development.
- Chinese companies earn foreign currency on the world market with which they can purchase expertise and technologies.

[Source: Professor Harro von Senger]

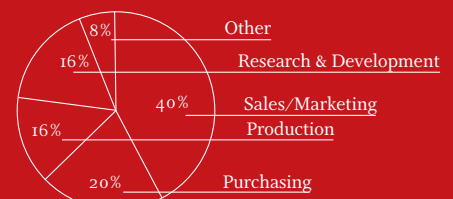
CHINA’S DIRECT INVESTMENT ABROAD



Since 1999, government-sponsored direct investment abroad has increased steadily.

Source: OECD

CHINA’S GLOBALIZED SECTORS



As they expand, Chinese companies are using international partnerships to compensate for their weaknesses, primarily in sales and marketing.

Source: Roland Berger Strategy Consultants