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Growth market China

How European companies manage the delegation of power

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Executive Summary

This research deals with the characteristics required of the leader of an international European company's outpost in China. It provides a synthesis of current theories, builds context based on supporting literature, and is complemented by a survey of the different experiences of local managers to identify contemporary issues.

In the past, companies expanded operations to China first and foremost to profit from the cost advantage that China offered. Meanwhile, increasing consumer purchasing power and a developing preference for brand name and luxury goods make the Chinese market a dynamic one that offers international companies substantial potential. This market sales potential has become the main driver.

Different forms of market entry are available for specific company strategies. The most common are the representative office, a joint venture, and the wholly foreign owned entity. In spite of the positive developments in the Chinese market, numerous challenges await companies planning to establish a local business unit. The labour market exhibits weaknesses in the Chinese education system. Job applicants often lack creativity and general communication skills, as well as competent English skills. Although its importance is on a decline, the issue of intellectual property remains a concern whereas the problem of corruption persists. The standards and concepts used to recognize and label corruption are still deeply linked with the local cultures making their reconciliation a challenge that companies need to overcome.

The human resource management strategy has to take cultural differences into consideration. There are two main point of focus. The first originates with Confucian values. Status, money and career perspective are aspirations that any attractive employment opportunity has to address. Western leaders also have to be aware that Chinese social hierarchy dictates that interaction between managers and subordinates can cross the traditional western line between private and professional matters. The second point of focus, the posting of expatriates including preparation, onsite support during the stay abroad as well as reintegration upon repatriation, is integral to the project. Careful and detailed planning and execution are of utmost importance to ensure the successful completion of the Chinese office setup.

Integration of a foreign unit depends on the industry, market entry form, as well as the maturity level of the company. In this context the manger plays an important role. This research disclosed that it is common to use an expatriate's experience and skills to build the foundation of the new foreign unit. The final objective is to find a local successor who is well connected and accepted in the local network to continue the operation. The selection is based on the company's profile (industry and company size, etc.) and circumstances (maturity level, phase of internationalisation). Finally, the quality of the leader does not depend on nationality. Knowledge and skill, but above all else respect for and understanding of both cultures are key characteristics a leader needs to manage the delegation of power.

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Dominik Hedrich Sebastian Hindelang

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List of Abbreviations

BCG	Boston Consulting Group
CFO	Chief Financial Officer
CQ	Cultural Intelligence
CSR	Corporate Social Responsibility
EPRG	Ethnocentric, Polycentric, Regiocentric and Global
EQ	Emotional Quotient
GDP	Gross Domestic Product
GLOBE	Global Leadership and Organisational Behaviour Effectiveness Research Program
HR	Human Resources
HRM	Human Resource Management
IBM	International Business Machines
IDV	Individualism versus Collectivism
IQ	Intelligence Quotient
IVR	Indulgence versus Restraint
JV	Joint Venture
LTO	Long-term versus Short-term Orientation
MAS	Masculinity versus Femininity
PDI	Power Distance
PRC	People’s Republic of China
SHRM	Strategic Human Resource Management
SWOT	Strengths, Weaknesses, Opportunities and Threats
UAI	Uncertainty Avoidance Index
UK	United Kingdom
US	United States
WFOE	Wholly Foreign Owned Enterprise
WTO	World Trade Organisation

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1. Introduction

1.1. Background

For European companies the importance of the Chinese market has increased in recent years. Due to market size and continuous growth, many European companies are expanding their business to China or are increasing their existing operations.

In a recently published survey of the European Chamber of Commerce in China (2012, p. 6) 97 per cent of the participants named China as the most important market in their globalisation strategy. More than half of the companies disclosed that more than ten per cent of their profit originates from that market. Furthermore, 60 per cent of the responses foresee further investment in China.

Nevertheless, the expansion into the Middle Kingdom can be seen as a challenge for the management of European international companies. Dealing with cultural misunderstandings, plagiarism issues, and different market characteristics require higher competencies of the leader in international business. Additionally, uncertainty of customer demands, a different supplier network and other market circumstances result in an increasing complexity

Examples of western companies discontinuing their business in China[1] as well as failed joint ventures in the past show that the environment is challenging. The disregard for cultural aspects forces companies to stop their endeavour in the land of the dragon. Therefore, qualified personnel who know the environment are essential. The question if a leader from the home country can better deal with these issues or if a local person is more appropriate will be further analysed below.

1.2. Problem

On the one hand, the Chinese market offers considerable potential to western companies. This is due to its size, its large numbers of consumers, as well as cost advantages for production and personnel.

On the other hand, the big differences to the home country have to be overcome by international western companies. Setting up and opening a foreign branch and its opera-

[1] Berndes, a pan producer, relocated production back to Germany to be more flexible (Gärtner, 2012) and Ravensburger, a toy producer, relocated the production because of quality issues (Giese *et al.,* 2012).

tion entail several challenges. The head office is far away from the location of sales and production. The subsidiary has to be integrated into the existing organisations and at the same time appropriate personnel has to be found, cultural differences need to be considered and communication and language barriers need to be overcome.

Against this backdrop the question arises how a western company can deal the characteristics of the country in order to be able to utilise them to accomplish the company objectives best. Here in particular, the decision maker plays a deciding role in the company's ability to manage the increased complexity. The staffing of these key positions influences significantly the success on the foreign market.

1.3. Objective

The objective of this research is to identify the contemporary issues facing mangers of European companies in China via a primary research. Consequently, the different motives why a company goes abroad and enters into different markets are highlighted. In addition, the different ways to enter the market shall be presented.

This research analyses the relevant circumstances of the Chinese market for the leader. In particular, the opportunities and risks in regard to the delegation of responsibility shall be further assessed and the ways in which a manager has to adjust his or her leadership style and behaviour. In addition, the research shall assess how the responsibility between the head office and the local unit is usually split, as well as how to incorporate the local unit into the overall company organisation.

Besides this, the paper shows what a decision maker has to consider for a company's market entry in China. This shall answer the questions about what cultural differences and which further aspects are important in respect to the company. As the company has to be operative in China, the decision maker also has to determine how to find sufficiently qualified employees for the local unit. In this respect the different factors which determine the attractiveness of the employer shall be identified.

As there are different cultures in these markets, the research shall also examine whether the leadership style has to be adjusted to incorporate the concepts of motivation and communication. It shall also answer the question whether culture has an impact on the delegation of decision making power. As the role of the local decision maker has an impact on the foreign unit, the details of the role will also be further assessed and the key differences will be determined.

Since western companies are concerned about how to deal with intellectual property rights as well as the perception of corruption, this research shall also assess these topics. Beside the above mentioned characteristics, the scope of this research is limited to the economical, competitive, societal and technological aspects. It excludes aspects of politics as well as a deeper assessment of the governmental structures and legislative processes.

1.4. Methodology

To answer the objectives of this research this paper follows this approach: the introduction provides the background information on why this research is relevant, including the problem definition and the objectives this research shall answer.

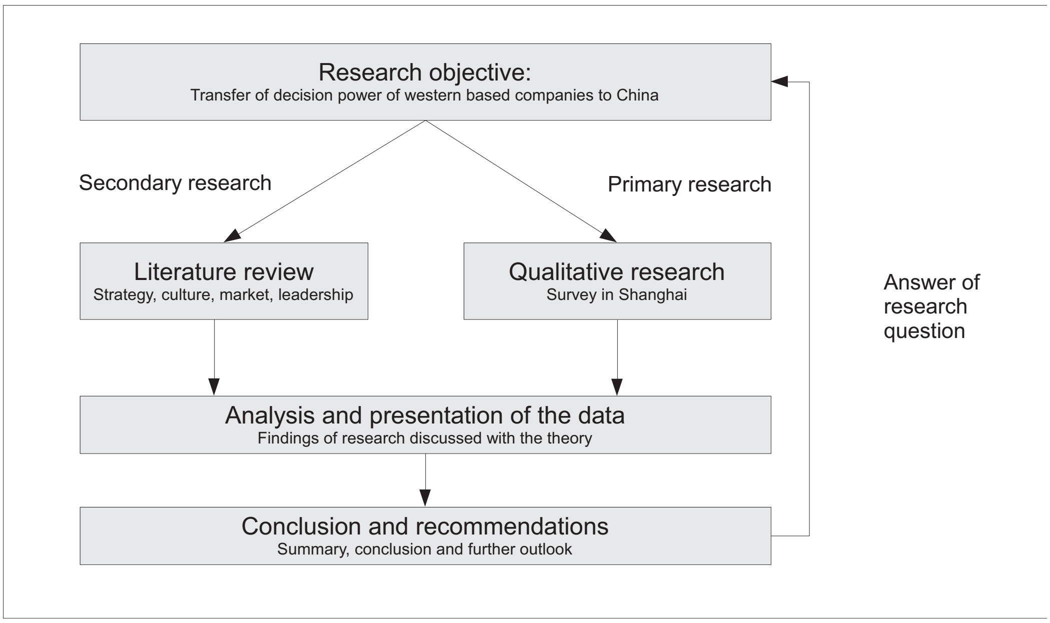

Figure 1: Structure of the research
Source: Compiled by the authors

In the second chapter, a secondary research is conducted on what the current literature provides on this topic. It focuses on the areas of strategy, cultural aspects, and market characteristics and concludes with the assessment of management and leadership.

In the third chapter, the research design is presented in which the details of the conducted primary research in Shanghai are described.

The fourth chapter analyses and presents the conducted information of the primary research and compares it with the existing theory out of the secondary research in the focus areas of the market findings, cultural and company aspects. Finally, the role of decision making is further described.

At the end of this work, a summary, conclusion and outlook highlight the main findings. Figure 1 summarises the approach.

2. Literature review

This chapter presents the relevant literature. It starts with the strategy process and is followed by a presentation of the cultural aspects. The characteristics of the Chinese market are shown as well as the details of the management and leadership role.

2.1. Strategy

The term strategy is explained in this chapter. Consequently, the reasons for a company to expand into international markets are described. Organisational forms are also detailed to later determine an appropriate form to fit the demands of a company expanding its business to China.

2.1.1. Strategy definition

The term strategy in economics has its origin in military[2] and describes the way to achieve an end. Strategy also includes thoughts, ideas and perceptions on how to reach this goal. Chandler (1962, p. 9) describes, "*Strategy can be defined as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals*".[3] Many more opinions exist about how to define strategy and what facets it includes.[4]

Determining the strategy process is the task of the top management. Within the strategy process, a strategy and its corresponding objectives are agreed upon. At the top of each strategy there is a vision, meaning superordinate long-term objectives (Venzin *et al.*, 2003, p. 50). On the next level is the mission, which contains the area of activity, e.g., why the company was founded, what products and services it offers, and company values such as corporate culture and code of conduct (Venzin *et al.*, 2003, p. 47). Figure 2 illustrates the hierarchy of the different part of the strategy.

The strategy process consists of three major parts[5] (Mintzberg *et al.*, 2008, p. 7):

1) Strategy analysis: the goal of this step is to identify market characteristics of the target market. Strengths and weaknesses of the company are assessed. Tools commonly

[2] In the military, strategy described the fundamental nature of warfare and was formed by General Clausewitz in the 19th century.
[3] Alfred Chandler can be seen as a pioneer of strategy in terms of economics.
[4] Mintzberg *et al.* (2008, p. 5) summarises the most important schools of thought concerning strategy
[5] Other authors call them differently and provide a different set of tools supporting each step.

used in this step are Porter's five forces (1980), SWOT-Analysis, BCG matrix or portfolio techniques.

2) Strategy development: different strategic alternatives and options and their impact on business are analysed in this step. Commonly this is done using tools to analyse the stakeholders, the corporate culture or the break-even point. In addition, scoring models are used for the strategy development.

3) Strategy implementation: it describes the concrete implementation of the strategy. Usually this is accomplished through an organisational change. Therefore, well-performing change management is important in this step. Objectives have to be specific, measurable, attainable, realistic and tangible (Griffin, 2007, p. 65). Those objectives can be integrated into a balance score card as a tool for the execution of the strategy (Kaplan and Norton, 1996, p. 291).

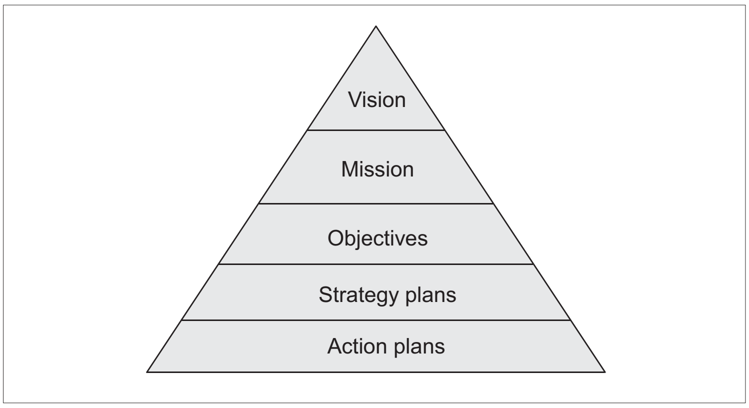

Figure 2: Strategy hierarchy
Source: Adapted from Bamford and West, 2010, p. 64

One way to achieve the strategic goals might be to expand business to foreign markets as described in the next chapter.

2.1.2. Internationalisation strategies

Internationalisation of a company often begins with a first relationship with a distributor or customer abroad. It should be noted that internationalisation is separate from globalisation in that the term globalisation describes advantages in economies of scale. These are gained when different national markets are grouped in almost homogenous regional markets with only slightly country-specific product adaptations (Wiesner, 2004, p. 11). An effect of increasing globalisation in the last decades has been an increase in the internationalisation of companies. Trade barriers have been reduced leading to a global interconnection of markets for services and products and a higher level of competition. Companies no longer depend on a single economy and can further use scale effects.

Reasons for a company to internationalise can be divided into pull and push-factors (Gutmann and Kabst, 2000, p. 184), depending on whether the market conditions abroad attract (pull) a company to a market or whether the domestic market conditions force (push) a company to start international activity.

	Internal	External
Pull	• Managerial urge • Unique production / competence • Marketing advantages • Economies of scale	• Foreign market opportunities
Push	• Risk diversification • Extended sales of seasonal products	• Small home market

Figure 3: Classification for internationalisation motives
Source: Adapted from Albaum and Duerr, 2008, p. 40

The main drivers can be grouped in three main categories: market expansion, securing resources and cost reduction (Geyer and Uriep, 2012, pp. 11–12):

Market expansion: can be driven by an individual manager's personal interests. Holidays and business trips abroad, study abroad and family ties all provide opportunity to make contacts abroad that may later develop into business partnerships (Schmidt-Buchholz, 2001, p. 211). Foreign customers with a demand for a company's reputable know-how can also incite expansion. On the supply side, the expansion can add a market to serve (Holtbrügge and Enßlinger, 2005, p. 370). Similarly a large customer's order for goods and services not only for local units, but also for units abroad, creates opportunity. In this context it is also necessary to consider that the population in Europe is shrinking while the population in Asia is increasing (United Nations, p. 22).This is also complemented by advantages of economics of scale as a higher number of produced products shrink the unit costs (Burgel and Murray, 1998, p. 36).

From the risk perspective, market diversification does lower the concentrated risk of operating in one market only. Furthermore, market saturation in the home market may make increased sales unattainable. Subsequently, market expansion is required to achieve company growth.

Securing resources: the availability of resources is a further motivating factor for a company in that existing cost advantages in international markets can be harnessed. Raw materials can be bought from the most cost effective supplier independent of the country. Furthermore, technology and other resources, such as specialised workers or field experts, can be scarce in the home market (Geyer and Uriep, 2012, p. 12).

Cost reduction: cost can be seen as a push factor and as a pull factor. Lower production costs abroad, including salaries and wages, can incite a company to internationalise. Nevertheless, according to current surveys cost reduction is not the leading motive for a company to expand internationally but rather the market opportunities (Geyer and Uriep, 2012, p. 12).

To describe the steps of internationalisation of a company, the Uppsala model developed by Johanson and Vahlne (1977, p. 26) can be used. The model assumes that companies prefer to internationalise in incremental steps rather than in one big step. Johanson and Vahlne describe common *patterns of internationalisation* which include the *establishment chain* and *psychic distance.* The establishment chain depicts how intensively the international activities are developed. The psychic distance chain explains the need to gain experience in and knowledge of foreign markets. After empirical underpinning of these patterns, Johanson and Vahlne built the *model of internationalisation.* The model consists of *static aspects* and *dynamic aspects.*

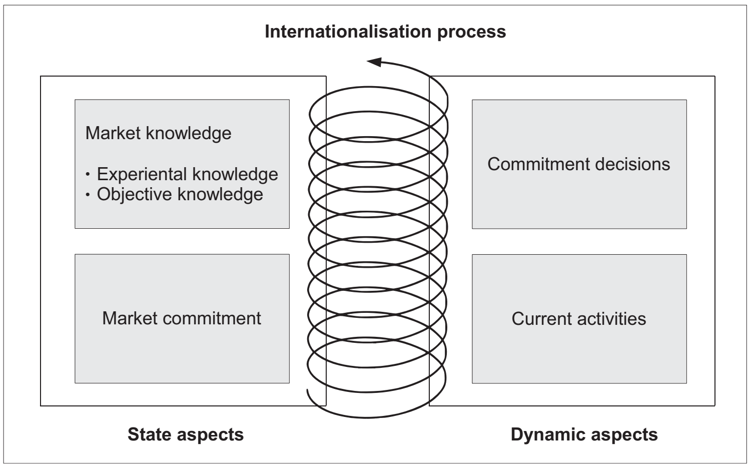

Figure 4: Internationalisation model of Uppsala
Source: Adapted from Johanson and Vahlne, 1977, p. 26

Market commitment and market knowledge are static aspects. Market commitment describes that according to its position on the establishment chain, a company has certain dependencies in foreign markets due to the activities abroad at a particular time.

Market knowledge depends on two aspects: the psychic distance and the information about a particular market the company has acquired.

Dynamic aspects are commitment decisions, meaning management decisions for further internationalisation and ongoing activities abroad, described as current activities.

Dynamic and static elements influence each other. The lack of knowledge about foreign markets leads to slow, stepwise progression. Each new decision is based on increased international experience. Knowledge is seen as the key variable; it increases the basis for decisions. The level of internationalisation advances and likewise the development of the company increases.

The Uppsala model has been often cited and has been double checked by various authors such as Cagusvil (1984), Bilkey and Tesar (1977), Malnight (1995). The criticism is that the model has an insufficient proof of stability over time. Furthermore, specific company aspects are not considered: company resources or branch specific influences. Also the phenomenon of "born globals" is hard to describe with this model. This type of company sells on international markets almost from its inception. Due to the criticism, the model has been modified with a network approach. With contacts to partners abroad, the company becomes involved in the network. This can further improve and enhance the relationship to a country. Nevertheless, the power of explanation decreases when branch and company are already in an advanced stage of internationalisation (Meckl, 2006, p. 41).

A company's culture is formed by its flow of communication, how information is controlled or shared within the organisation. The company derives its philosophy from this basis. Philosophy, in turn, impacts the company's strategy, the type of organisation used as well as the leadership style. The strategic profile of a company can be defined as ethnocentric, polycentric, regiocentric or global (EPRG model) (Perlmutter, 1969, pp. 9–18). These profiles are explained in the following section.

Within the *ethnocentric model*, the company headquarter has complete control and makes all strategic decisions. In this form the culture of the home market is simply applied to all subsidiaries abroad. It can be compared to colonialism. In contrast within a *polycentric model, s*ubsidiaries can also decide on operational tasks and specific strategic decisions. The strategy, structure and the company principles are adapted to the local habits. When different countries are grouped into regions, they are said to be *regio-*

centric. In this strategic profile, each region has its own headquarter. To ensure that not every regional branch develops their own work approach, their subcultures are kept under the umbrella of a common corporate culture. Within the *geocentric* model, the decision making power is distributed between the head office and its subsidiaries abroad. In this form, values and principles from all branch offices are combined. The goal is to create a new "symbiotic" company culture.

Based on its regional profiles, a company can derive its strategic options concerning procurement, sales and efficiency. The strategic profile shows the direction of trust and can be used as the basis for selecting the market entry form.

Although there are good reasons for internationalisation, there are also certain risks connected to it. Therefore, good risk management is necessary. Kühlmann and Haas (2009, p. 31) describe risks related to international activities.[6] Cultural risks such as conflicts in multicultural teams or *an expatriate's overemphasis of his or her own culture can occur* (Kühlmann, 2009, p. 61).

In some cases quitting operations in a country can be the better choice for a company (Schmid, 2007, p. 27).

2.1.3. Organisational management

In business, organisations are seen as management functions to ensure the fulfilment of the company objectives (Laske *et al.*, 2006, p. 13). The structural organisation is a system of units, where each unit has different responsibilities to fulfil the company's objectives. The structure is supported by rules. These define the hierarchy and the different units (Weißenborn, 2012, p. 3). The organisation also has to support the internationalisation strategy of the company.

Meckl (2006, pp. 116–123) presented several approaches to incorporate the foreign market into the company's organisation:

One line reporting structure: the international market is integrated into the functional (e.g., sales or purchasing) or object (e.g., product) reporting line. Advantages are either the increased efficiencies as similar functions are grouped together or object efficiencies as only coordination has to take place within the object. A disadvantage is the increased

6 Other risks are political, such as the risk of expropriation, or economic risks, such as counter party risk. These will not be further assessed in this research.

coordination effort for the function across different objects or the lack of synergy in the object oriented organisation.

Segregated international division: the foreign market's own international division is established in addition to the existing organisation. The advantage is high resource efficiency as it realises synergies across all objects and collects expert know-how from the foreign market. The disadvantage is limited process efficiencies between the international division and the product divisions due to the coordination effort.

Regional structure: as more and more markets come into perspective, the organisation can be structured based on those. Several markets can be grouped into regions. Advantages are higher market and process efficiencies as only the coordination within the market has to take place. Further, the responsibility for the profit can be delegated to the different market divisions. The head office has the disadvantage of being responsible for coordinating the different markets, with the risk of duplicating work and failing to share knowledge and experience with different markets.

Matrix organisation: it has become the most popular organisational structure for German companies doing international business. The structure is modified so that the object and the markets represent two dimensions. The head of the object is responsible for the product globally but has to coordinate with market head for respective regional adjustments. The market head is responsible for the entire business in that market. Figure 5 shows the different organisational forms.

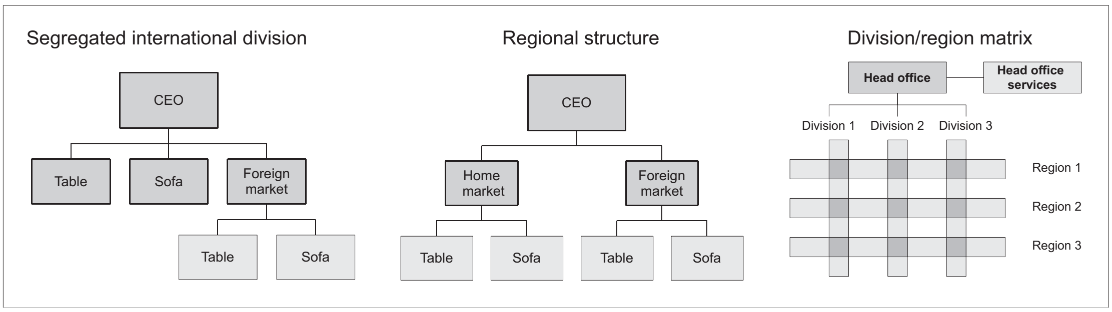

Figure 5: Organisational forms
Source: Adapted from Meckl, 2006, pp. 116–123

The advantage is that both dimensions are considered whereas in other forms one dimension is regularly neglected. Accordingly, people with the know-how of the market and the object, e.g., the product, are available to harness all potentials of the market. The disadvantage is the risk of conflicting interest between the different dimensions and the need of more managers.

Whether the company follows a centralised or decentralised approach determines which organisational structure selected. In the centralised approach the head office determines the strategy execution. In the decentralised approach the foreign business units have more freedom to make decisions locally for their respective business. The underlying question is, if all markets should be treated equally to gain higher efficiency or if the markets should be treated separately so the products can be more localised. Finally, it is a question of standardisation vs. differentiation. This determines the allocation of decision making power within the company. This area of conflict needs to be considered in the organisation for international companies (Meckl, 2006, p. 95).

Depending on the level of international activity and the importance of the different markets, an adequate organisational structure should be selected by the company to support the internationalisation strategy.

2.2. Cultural aspects

International decision makers have to deal with humans cross culturally. This chapter gives a definition of what culture is and shows how it can be described in a model. The behavioural principles particular to a Western or German person are highlighted and further explained. It concludes with the communication aspects that play an important role.

2.2.1. Definition of culture

There is no unique definition of culture. One quite popular is provided by Geert Hofstede[7] (2010, p. 6) who describes culture as *"the collective programming of the mind that distinguishes the members of one group or category of people from others"*.

Hofstede describes that every person has their own "unique mental programming" which contains universal, group specific and individual aspects that are either inherited or learned. Figure 6 shows that culture is situated between human nature, things all human have in common like the ability to feel anger, love, or to be frightened and the individual personality, consisting of learned and inherited behaviour and personal experiences. Hofstede explains that the border between culture and personality is hard to draw. The culture level contains specific values, rituals, heroes and symbols. Like some other authors, Hofstede *et al.* (2010, pp. 6–7) shares the opinion that culture contains

[7] Geert Hofsteede is a Dutch scientist who researches in national cultures and cultural differences.