Chinese brands: the build or buy considerations

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Abstract: This paper discusses the strategic motives, the markets entered, the methods used and the challenges faced by Chinese companies building their own brand or buying one to expand globally. We present a regression model enabling the analysis of recent Mergers and Acquisitions (M&A) activities and the successes and failures between the Chinese and foreign target companies. The developed model considers the strategic motives to globalise, the type of country and acquisition. By using the Monte Carlo resampling methods, we can draw conclusions about the probability of success of the outbound M&A success.

Our results show that brand-motivated acquisitions are more likely to be completed than resource-based acquisitions both in developed and developing markets. Our research found that all branding related acquisitions are in developed countries. However, the numbers of resource based acquisitions were evenly split between developing and developed countries, where in the developed countries, they were more likely to fail than in the developing ones. Nationalistic sentiments seem to be heightened by these resource-based acquisitions and were much more common in developed countries than in developing ones. It also seems that Chinese companies build brand recognition in developed countries by buying readily established brand names and are more likely to build their own brand in developing countries.

Keywords: international business; globalisation; automotive industry; China; exporting M&A; branding; international marketing; Outward Direct Investment; ODI.


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1 Introduction

Current literature focuses on China as a recipient of Foreign Direct Investment (FDI), as an Original Equipment Manufacturer (OEM) or contract manufacturer, or as a low-cost producer. There are numerous papers, articles, books and media reports about the size and attractiveness of the Chinese market for foreign brands. However, little has been written about the potential direction of Chinese brands outside China (Interbrand, 2005). A recent phenomenon is that Chinese firms are no longer focusing on their domestic market; they are now going ‘global’. The current outbound foreign investment of China in 2005 amounted to USD 11.4 bn (IMF database, 2006). This paper considers the globalisation of Chinese brands with a specific focus on the following questions:

- Why are Chinese companies going global?
- In what markets and segments are they going to compete globally?
- How do they enter target markets?
- What are the strategies that Chinese firms have used to go global? Have those strategies been a success or failure?

The second section of this paper will discuss the motives of Chinese companies that are going global. The following section discusses the various markets the Chinese firms have entered and the corresponding market segments. Section 4 discusses the different modes of entry into the target market of the Chinese firms. It will also provide an overview of the most recent Mergers and Acquisitions (M&A) the Chinese firms used in going global and their corresponding success or failure. In Section 5, we discuss the challenges for Chinese firms in building global brands and the possible actions Chinese firms may take in order to overcome those challenges. Finally, we provide a model which Chinese companies might follow in their global metamorphosis and then we present our conclusions.

2 The Dragon awakens

2.1 Reasons for going global

China has overtaken Japan within the last decade to become the largest manufacturer and exporter of consumer goods. It is believed that China is now the world’s number one producer in 172 categories of different consumer and industrial goods. Despite being the world’s factory, China has not yet created a single brand that is recognised worldwide (Fan, 2006). Recent research has shown there are many motives for Chinese
firms to go global. Various studies (Wu, 2005c; Beebe et al., 2006) have identified two main groups of strategic motives for Chinese companies to globalise, selling motives and sourcing motives.

2.1.1 Selling/Brand motives

Seeking new markets for growth is mainly driven by deregulation of the manufacturing sector, which suffers from a huge overcapacity left by companies that had previously contracted with Chinese firms. The departure, collapse or weakening of these contract manufacturers left a production capacity void that needed to be filled by access to new markets and an increase in demand for those products (Beebe et al., 2006). According to analysis by McKinsey & Co. estimated overcapacity runs at 30%-40% for washing machines, refrigerators and microwave ovens and at nearly 90% for televisions (Lunding, 2006). Overcapacity has been driven by a decline in orders from OEM’s and increasing competition within China.

There has been an increase in domestic home-grown companies consistent with traditional industry life cycle but the overcapacity has been compounded by the entry of foreign competitors. Ironically, as mature ‘developed’ markets are saturated with global brands, firms from Developed Countries (DC) explore opportunities in developing markets. Thus, China’s growing wealth and rising middle class have attracted tremendous foreign direct investment from developed countries. In 2005 foreign direct investment into China was approximately USD 79.1 bn (Lunding, 2006). This has led to duel surpluses in both capital and current accounts for China and a rapid growth in reserves available for domestic and outbound investments. As a result, Chinese firms have begun to expand outside of China. Recently Chinese firms have acquired developed country brands and established Joint Venture (JV) with others. While selling own branded products provides higher margins which translate into higher profits for firms, Chinese firms have had little success with own brand products outside of China (Gao et al., 2003).

Thus, by going global, Chinese firms can reduce their exposure to changes in demand and competition within their home markets while diversifying their risk and increasing their brand recognition and profitability.

2.1.2 Sourcing motive

China has an increasing need for energy, raw materials and other inputs due to booming industrial production and overall growth. Chinese firms are not only acquiring advanced technology and management skills, but they also need to procure much of their energy and material resources to keep up with the demand. Their needs far outstrip their domestic capacity. According to Deutsche Bank Research, M&A investments by sector in 2005, 46% of Chinese M&A’s were for natural resources (Lunding, 2006). Chinese M&A activity is driven (and financed) through broader governmental initiatives for the development of national industry champions and the procurement of overseas natural resources. This centralised strategy underpins a broader politically driven agenda of economic nationalism focused on issues of energy security, geopolitical positioning and national competitiveness (Lunding, 2006). Yet, these strategies have put China at odds with its international obligations as a member of the WTO and has stimulated nationalist obstructionism in Western markets.
The following figure summarises the main motives for Chinese companies to go global.

Thus, we consider Chinese companies have two strategic motives to go abroad, either for sourcing or selling. The selling success that Chinese companies have had as contract manufacturers has been a consistent driver of industry, but has left Chinese firms uncertain about the relative merits of branding and global marketing versus maintaining the status quo as a contract manufacturers for established global brands. In foreign markets where Chinese firms have chosen to compete there is still uncertainty about whether to build their own channel and sell their own brands, or to buy a foreign brand to bridge those markets (Fan, 2006).

Figure 1  Strategic motives of Chinese companies

<table>
<thead>
<tr>
<th>Selling Motives</th>
<th>Sourcing Motives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Deregulation</td>
<td>• Access to raw material</td>
</tr>
<tr>
<td>• Overcapacity</td>
<td>• Access to other production resources</td>
</tr>
<tr>
<td>• Increasing domestic competition</td>
<td>• Government initiatives</td>
</tr>
<tr>
<td>• Higher margin with branded products</td>
<td>• Management skills</td>
</tr>
<tr>
<td>• Diversify risk</td>
<td>• Technology skills</td>
</tr>
</tbody>
</table>

2.2 Markets Chinese companies are targeting

Low-cost Chinese exports have led Chinese firms to great success in entering more price-sensitive or emerging markets. This has given them a dominant position in many of those markets both textile and furniture industries are now largely dominated by Chinese manufacturers. Williams (2005) and The Economist (2006) discussed China’s dominant position in textiles as a direct result of the elimination of global quotas. Gumbel and Jakes (2005) describe China’s domination of furniture manufacturing in Italy. Chinese firms have dominant positions in much of Asia within certain industries Valentin et al. (2006) discussed the pharmaceuticals industry in Asia where Chinese family firms are the dominant producers and Abbas (2006) discusses their dominance in many other industries in Africa and parts of Latin America.

Herein lays the paradox, the low-cost, bare-bones products that have led to great success in these developing markets have left Chinese firms largely unnoticed in the developed markets. The developed markets have more sophisticated competition and better educated/differentiated consumers according to Paul (1979) and Hill (1984). Both authors identified already many years ago that the competition in developed markets is fierce and many of the players are very well entrenched. Paul (1979) and Hill (1984) describe marketing problems that plague foreign entrants emerging markets; these problems result from the lack of market research infrastructure and cultural sensitivity among others. This may explain why Chinese firms often approach emerging markets first.
While export is the low-cost, low-risk mode of entry into foreign markets by Chinese firms, overseas production is a mode of entry more common among developed countries firms, but not widely considered among Chinese firms. Chinese firms may dismiss overseas production as too costly and unnecessary. Instead, they may focus on low-cost local production and related cost savings generated through their low-cost labour, and may perceive this as the main source of their competitive position. This strategy may work well for competition within China but it may leave Chinese firms open to a number of obstacles in foreign markets; tariffs, barriers and anti-dumping charges and higher transportation costs. Jiang and Ellinger (2003) showed that many of these criticisms have already been levelled against Chinese manufacturers. Overseas production may offer a way around these obstacles by making their products both a foreign and domestic brand.

2.2.1 Developing markets

When we look closer at the destination of Chinese outbound FDI, Chinese companies primarily focus on firms residing in nearby Asian countries. This strategy may be a result of their need to shore up elements of the supply chain outside of China. In 2003, about 53.3% of the FDI of Chinese companies had been in those countries where out of the total FDI spending in 2003, 39.9% was alone in Hong-Kong and Macau (Wu, 2005c). Many of these investments are in firms that provide technical expertise, distribution and products unavailable in China. Chinese companies are also establishing dominant brand presence in many other developing markets (Gao et al., 2003). For example, the main export destinations of Chinese cars include Africa, Middle East, Central Asia, Southeast Asia and Latin America.

2.2.2 Developed markets

As discussed earlier, much of the developed markets are more competitive, complex, and expensive to enter; the success of new Chinese brands in these markets is uncertain (Gao et al., 2003, p.5). The financial resources and time required to develop their own channel in these markets would be significant and potentially cost prohibitive.

2.2.3 Niche market

Chinese firms have capitalised on niche markets, these markets are often overlooked by large global competitors, yet they may represent significant opportunities to Chinese firms that work well on very focused business models. For example the company St. Allen’s produces tens of millions of nail clippers each year. This Chinese company set up in 1989 now has about 10% of the global market. Other niche players include China international marine Containers, which has an estimated 50% of the shopping container market, and Guangdong Galanz Enterprise, which has about 40% of the microwave oven market (Interbrand, 2006).

We categorise the market opportunities for Chinese firms into three basic categories developing or Emerging-Markets (EM), Developed Markets (DM) and Niche Markets (NM). The following figure compares the three possible market options Chinese firms can enter, challenges they may face and their relative rating of that market based on a ranking scale from interviews.
The figure shows that developed countries represent the most challenging markets for new entrants. The sophistication of customers and marketers, in addition to the level of competition would make entry into developed markets costly and challenging. However, the reward for market participants within developed countries can be significantly higher margins. This is particularly the case for niche market players as the degree of specialisation and potential barriers to entry yields a market premium consistent with monopolistic competition. Emerging markets are at the opposite end of the spectrum as participants are more price-sensitive, marketers have less access to consumer information and distribution channels are often poorly developed. Entry into emerging markets may prove less difficult as price-sensitivity and little brand recognition may discourage foreign competitors. In addition, local manufacturers may lack the scale to compete on price with foreign firms; these attributes make emerging markets ideal markets for Chinese firms. Paradoxically, while political risk may make foreign companies more wary of emerging markets, where foreign investment is growing rapidly, the investment stimulates economic growth and stability. Thus, early entrants may reap the benefit of strong brand recognition and a loyal customer base within the market that later entrants may find difficult or costly to challenge.

Figure 2  Comparison of market options

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Emerging Markets</th>
<th>Developed Markets</th>
<th>Niche Markets</th>
</tr>
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<tbody>
<tr>
<td>Competition</td>
<td></td>
<td></td>
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<tr>
<td>Customer Sophistication</td>
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<tr>
<td>Barriers to Entry/Investments</td>
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<tr>
<td>Potential Margins</td>
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<tr>
<td>Building Brand Reputation</td>
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<td>Political Risk</td>
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3 The Dragon takes off

Regardless of the market, once a Chinese company has decided to go global, there are two primary entry options, either building their own brand and distribution channel or buying one. Each has its own advantages and disadvantage and each method has led to successes and failures for Chinese firms. There is no single ‘right’ path for Chinese companies pursuing global expansion. However, Chinese manufacturers with significant
exports, might strategically leverage their supply-chain expertise to build their globalisation capabilities and go directly to developed countries. Chinese companies with limited global experience may first consider developing countries before attempting entry into developed markets like the USA or Europe. For example, Chinese automakers such as Geely and Chery are exporting and assembling low-end models in Latin America and the Middle East before entering the USA (US entry may begin as early as 2008/2009). By doing so, they can gain experience (Beebe et al., 2006). The following sections discuss the various challenges Chinese companies will have to overcome when entering foreign markets.

3.1 Manufacturing ‘own brand’

Manufacturing and selling ‘own brand’ products are often the most lucrative method as organisations that produce and sell ‘own brand’ products capture much of the profits within the value chain. Industry profits reside at many different points within the value chain. Engardio and Amdt (2006) describe methods of Chinese firm, Haier, “first, build a huge base at home that gives you economies of scale and a market where you can test products and perfect your manufacturing. Then go on the offensive overseas and race up the value chain”. This has been a proven method of entering foreign markets for Chinese firms. However, Chinese firms take this a step further by segmenting global markets into emerging and developed countries and in many cases entering developed ones only after successfully entering emerging markets or countries. In emerging markets, brand recognition is less of an issue, exports, are often limited to low-priced options. In some rare cases, once Chinese firms have established themselves in the emerging market, the firms have chosen to invest in those markets and develop the domestic capability of producing their products. Strategically, this helps alleviate the foreign brand image, blurring the line between foreign and domestic produced goods. The Chinese government may support overseas production as it helps keep exchange rates stable and Chinese goods more affordable. However, entry into developed highly competitive markets has proven much more difficult for Chinese companies so far. Inexpensive Chinese products have not easily found their way on to the shelves of the leading retail outlets and are more often relegated to second and third tier retailers.

Chinese firms also need to adapt the branding practices they use in China to appeal to consumers in sophisticated markets. One size does not fit all, for example, Europeans are more conscious than US consumers of brands and quality (Gao et al., 2003). Chinese companies are less aware of branding, as a brand is much more than just a logo or a symbol on a product (Beebe et al., 2006). Therefore, depending on the type of market, it may take a long time for a firm to establish their brand, for the brand to be accepted and ultimately to become a strong brand.

3.1.1 Country of origin effect

Country of Origin (CO) effect has been a mixed blessing for Chinese firms. Their reputation for low-cost, high-volume, limited selection has put them at odds with competitors reputation for innovation and high product quality. The country of origin effect is a powerful image variable that can be used to gain competitive advantage in international marketing but it can also hurt companies from countries which have a poor product reputation which seems to be the case for China so far. China is largely
viewed as a land of Contract Manufacturers (CM) where Chinese firms are viewed as ones that remain in the background by supplying products for global branded OEMs rather than selling their own global brands (Interbrand, 2005). A brand survey conducted by Interbrand with 243 respondents shows that 79% believe that a ‘made in China’ label hurts Chinese brands. This may explain why some Chinese companies prefer to acquire a foreign brands instead of selling their own brand abroad. The survey also included a question which highlighted the words that best characterised the respondents perception of Chinese brands today. The top five words were ‘cheap’, ‘poor value’, ‘poor quality’, ‘unreliable’ and ‘unsophisticated’. All these words suggest poor product quality and lack of innovation. As a direct result of these perceptions, many Chinese firms are pursuing a second tier brand in most foreign markets. Factors of trust, reliability, credibility, brand awareness, overall value are critical to improving the perception of Chinese brands. Another study undertaken in France, UK, and the USA reveals that despite the Interbrand findings of negative Chinese brand perception, the respondents of this survey have positive brand perception for Chinese electronic goods, computers, clothing and mobile phones (Beebe et al., 2006). This might suggest, that in some industries Chinese firms may be well on their way to establishing a global recognition for their brands. Larger, more global Chinese brands are extending their reach, not only through sales, but also through operations. Haier is building manufacturing facilities in the west, including a second plant in South Carolina, while also making local acquisitions (Interbrand, 2006).

A comparison can be drawn to Japanese and South Korean companies which also specialised in specific industries like automotives and electronics. Japanese firms, much like Chinese, had poor brand perception in the postwar era. It was not until efforts by Demming, Crosby, Juran and other quality gurus directed through initiatives by Gen. D. Macarthur that manufacturing problems were addressed in Japan and Japanese firms began the long steady climb to higher-quality products and positive brand recognition. South Korean firms also faced similar problems, but their low-cost, skilled labour force attracted investment from high-tech manufacturing firms in the USA and Japan. The expertise gained in developing high-tech products transferred across to several industries. As is often the case, the domestic contract manufacturers developed into global players.

### 3.1.2 Developing experience

Managers and decision-makers at Chinese companies recognise branding is important and they want to better understand the ‘brand’ concept, but they lack the expertise. As of 2006, there is not yet a single Chinese brand that is recognised worldwide (Fan, 2006). Thanks to a recent acquisition, the most well-known Chinese brand is currently IBM/Lenovo and is well regarded for the brand image created by IBM over its tenure; even this branding will be short-lived as the deal only gives Lenovo rights to use the IBM brand for only five years. Many Chinese companies do not understand multiple branding, and use the same corporate name for various diversified products. For example Yuetu extended its branding from cigarettes to female sanitary protection (Fan, 2006). The confusion of customers is inevitable if the same practice is used in markets outside of China.
3.1.3 Developing of R&D and innovation

A key problem for many Chinese firms is weak intellectual property legislation and poor investment in Research and Development (R&D). The two issues are related as intellectual property in China is not seen as property that can be owned by an individual or organisation. So, R&D that gives a firm a competitive advantage in intellectual property in the developed world is an anathema to the Chinese. As contract manufacturers, Chinese firms have depended on their international partners for the research and development expertise and investment. While this enabled rapid growth in industry, it hurts branding of Chinese products. This has led to many Chinese products falling short on innovation and quality when compared with their international competitors. However, there has recently been a precipitous rise in the number of patents filed by Chinese firms. Investment in higher education and research facilities have also begun to attract many of the departed scientists and engineers back to China. While this suggests a brighter future for China it still leaves many gaps in the innovation necessary to sustain competitive businesses. One such example of the effects of limited R&D is the Chinese automotive industry. This industry is in its infancy, insufficient funding for research and development has led to a poor quality reputation. The research and development expenditure of Chinese automotive companies usually accounts for less than 1% of their sales volume, while this proportion is between 3%–5% for their corresponding competitors. For example, not long after Land Wind, produced by the Jiangxi-based Jiangling Holding Co., entered the European market, it has been plagued by questions over its safety standards. The ambitious Chery Company has also met with setbacks in its expansion in Malaysia, where not only the sales of Chery’s complete cars are banned, but also the sales of locally assembled Chery cars with imported parts. Strong product innovation, by having excellent product development and design, is an important aspect. Chinese firms have begun to focus more on R&D and product design, this may result in a radically changed business and brand image (Interbrand, 2006).

3.1.4 Set-up distribution channels

Another major hurdle for Chinese brands are unexisting or weak distribution channels. The lack of development of these channels result from contract manufacturing and the dependence of Chinese firms on the sales and distribution network of foreign partners. As a direct result of contract manufacturing, very few Chinese firms have developed their marketing, distribution, sales and aftersales capabilities. Therefore, most Chinese companies have no overseas distribution channels or service network in place and little promotional or advertising savvy (Gao et al., 2003). Chinese firms have approached these markets largely through joint ventures with foreign, well-known brands. For example Geely, the Chinese automotive manufacturer, has entered into a number of joint ventures to build a full service network for their sales, repair, maintenance and leasing.1 Gree, one of China’s largest appliance manufacturers, has several joint ventures with Siemens, Sony and Sharp.

3.2 Brand acquisition

As we travel along the value chain, few Chinese companies are experienced in logistics, marketing, sales, and after sales service; these shortcomings hamper brand development. Acquisition of foreign firms seems to have gained legitimacy for Chinese firms as a quick
way to overcome many of the related challenges of educating consumers and selling their own brands. Over the last five years many government agencies, such as the National Development and Reform Commission (NRDC), the Ministry of Finance, the Ministry of Commerce and the State Administration of Foreign Exchange (SAFE) have all developed policies encouraging Chinese companies to expand overseas (Beebe et al., 2006). State support for the overseas expansion of Chinese enterprises may come in a number of different forms such as investment friendly policy of foreign currency control, direct and indirect subsidies and favourable financing terms (Lunding, 2006). For example, Huawei got a USD 10 bn credit from the China Development Bank to help funds its global expansion efforts (Beebe et al., 2006). By acquiring a foreign brand, they have quick access to a well known brand, technology and management skills, R&D, and a distribution, sales and after-sales network.

However, some M&A’s between foreigner and Chinese companies are not successful. While M&A’s are an effective way of achieving global expansion, many studies have shown that between 60%–70% of M&A deals fail to deliver shareholder value (Lunding, 2006). While shareholder value in the West is driven by bottom-line demands and not national strategic considerations, these may not apply to state financed, government-owned Chinese firms where the major shareholder is more focused on strategic decisions.

3.2.1 National protectionism

State ownership of Chinese companies has proven troublesome with regard to foreign acquisition; for many foreign governments it is not clear if the firm or the Chinese government is behind the acquisition. The structure of Chinese firms with large government ownership and financing leave the impression it is both. China National Offshore Oil Corporation’s (CNOOC) failed takeover attempt of Unocal came largely as a result of nationalistic concerns in the US Congress perceived China’s indirect acquisition as a threat and takeover of a strategic national asset. China Minmetals’ ran into regulatory difficulties in Canada during its attempt to take over Noranda. SINOPEC’s bid for Slavnet in Russia was also derailed by nationalistic concerns. Many of the large high-profile acquisitions that would be high on China’s top 120 firms list of targets, would probably remain out of reach due to the high perceived involvement of the Chinese government. While most M&A’s may be considered with respect to monopolistic concentration or on the merits of the acquirer and target, M&A’s where a government entity is a silent majority partner will attract national regulatory interests on the side of the target firm. It can be noted that most oppositions have happen when Chinese companies wanted to acquired natural resources rather than companies in any other industry.

3.2.2 Government control

Nationalistic concerns aside, Chinese companies have an advantage over their foreign competitors when it comes to access to financing. As a direct result of their strong state ownership, the government has greater than 30% ownership of many large and medium sized national firms, these Chinese firms can turn to government sources for M&A backing. The partnership gives them access to the government’s pool of investment capital. The Chinese government’s financial and political support of Outward Direct
Investment (ODI), under the slogan of ‘going global’, has intensified especially since 2001 (Lunding, 2006). They have set aside USD 711 bn to enable top Chinese firms to acquire strategic assets or strengthen domestic ones. These future ‘global champions’ will eventually be large multinational firms with globally recognised brands and should be able to compete in the international marketplace. The funds available for acquisition and investment will continue to increase; China’s dual surpluses (trade and capital account) have increased available investment funds by USD 17 billion per month. Thus, Chinese firms have deeper pockets than their competitive rivals and the role of the state remains silently dominant in Chinese ODI. In 2004, the public and state-owned parts of ODI were 45% and 34% respectively. While 34% represents a considerable, stake held by state ownership it should be noted that this is a decline from the previous year. The share of ODI held by state-owned enterprises fell from 43% in 2003 to 34% in 2004. The involvement of the state in ODI has been most evident in investments to procure natural resources (Lunding, 2006).

3.2.3 Poor post-merger integration

Government financial support enables Chinese firms to bid and acquire companies. However, issues about the hazards of private firms with large state ownership have been raised by Wu (2005a), Yin and Bao (2006). For example, they suggest that state ownership increases the probability of moral hazard; the chance that firm management will make very risky decisions that may not make sound financial sense. Several of the recent acquisitions of global firms have left the newly merged firms straddled with costly integration issues. TCL, a Chinese telecommunications company, has suffered financial losses as a result of poor integration with Thompson. Lenovo has also had significant operating losses as a result of poor integration and a lack of understanding of IBM’s culture, global management and operations. However, it is too early to say whether the integration of IBM’s PC division and brand into Lenovo’s product portfolio is a success or failure.

The following figure summarises the key challenges of building their own brands versus buying one.

**Figure 3** Challenges to overcome by Chinese brands

![Figure 3: Challenges to overcome by Chinese brands](image)
The figure shows that there are pro and cons for each strategy and that Chinese companies must carefully consider their market, motives and resources for expanding abroad, as well as their capabilities. If carefully considered, they can match their internal strengths with the external opportunities and overcome their weaknesses.

4 The Dragon is hungry

To establish their own global brands Chinese firms have to take into consideration more dimensions than just the price. Low-cost and subsequent low price without attention to quality will only take Chinese firms so far. In more developed markets, customers actively seek products that have a brand perception of high quality and innovation. In order to build their brands, Chinese firms will need to educate consumers, differentiate their products, improve quality, develop global infrastructure for sales and distribution, and cultivate ‘global managers’ with the requisite market knowledge to enable the firms to compete in the global marketplace. More importantly, they have to overcome the poor brand perception that consumers currently associate with Chinese products on the national and company level. Chinese firms are more than capable of making the grade in product features and quality, but it is not yet clear whether they can develop global marketing strategies for branded products (Gao et al., 2003).

As mentioned in the previous section, in some cases Chinese companies have short-circuited the typically lengthy, growth process in developed countries through M&A. They are a fast way to gain brand recognition and develop market access and infrastructure. While this might significantly reduce the time-to-market it will not solve all the challenges of short-term integration of operations to longer-term differences in corporate cultures and brand/marketing expertise. Brand acquisition is a quick way for firms to enter a market and claim the brand, the customers and the channels of the acquisition target. Customers may give the new owners an opportunity to demonstrate their commitment. However, the window of tolerance may be more dependent on the way the new owner treat customers.

Chinese ODI flow have undergone a remarkable expansion over the past 25 years, with particularly strong growth posted since entering into the WTO in 2001. China has overtaken South Korea and Taiwan in terms of outbound M&A investment already in 2002 (Lunding, 2006). For 2004 and 2005, growth in ODI registered at 93% and 25% respectively with a total value of more than USD 11.3 billion in 2005. The China Ministry of Commerce predicts outbound investment will maintain an average annual growth rate of over 22% during the next five years and exceed USD 60 billion per year by 2010 (Beebe et al., 2006). However, it should be noted that some of those figures might be lower due to the fact of ‘round-tripping’ investments, which involves taking domestic capital out of the country only then to bring it back in as foreign capital (Lunding, 2006).

The questions arise whether sourcing or selling motives are driving Chinese companies to acquire foreign firms. One might also ask, which markets and which industries are most likely to have such M&A deals? Finally, also why some M&A deals on behalf of Chinese companies have been aborted? In order to answer these and more question, we analyse the most recent and widely known M&A deals between Chinese companies and any foreigner company.2
4.1 Most recent Chinese M&A

Table 1 shows the most recent M&A activity between Chinese buyers and a foreign target companies. The table summarises the year of the acquisition, the buyer company, the target company, followed by the country of the target company, the value of the deal, if provided, as well as the industry. Finally, we have also provided information about the outcome, whether the deal has been completed, is pending or has been aborted as of December 2006.

![Table 1 Sample Chinese and foreign M&A deals (estimates)](image-url)
Table 1  Sample Chinese and foreign M&A deals (estimates) (continued)

<table>
<thead>
<tr>
<th>Year</th>
<th>Buyer (Chinese)</th>
<th>Target</th>
<th>Country of target</th>
<th>Value in USD</th>
<th>Industry</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>China Network Communications/Netcom</td>
<td>PCCW LTD HK</td>
<td>HK</td>
<td>1 bn</td>
<td>Communications</td>
<td>Completed</td>
</tr>
<tr>
<td>2005</td>
<td>TCL International</td>
<td>GoVideo USA</td>
<td>USA</td>
<td>N/A</td>
<td>Electronics (DVD)</td>
<td>Completed</td>
</tr>
<tr>
<td>2005</td>
<td>Sinochem</td>
<td>Inchon South Korea</td>
<td>South Korea</td>
<td>N/A</td>
<td>Chemicals</td>
<td>Aborted</td>
</tr>
<tr>
<td>2006</td>
<td>CNOOC</td>
<td>Akpo oil field assets</td>
<td>Nigeria</td>
<td>1.7 bn</td>
<td>Energy</td>
<td>Pending</td>
</tr>
<tr>
<td>2006</td>
<td>SINOPEC</td>
<td>Northern Lights Project</td>
<td>Canada</td>
<td>124 mm</td>
<td>Chemicals</td>
<td>Completed</td>
</tr>
</tbody>
</table>

The two key strategic motives of Chinese companies for going global is to expand the markets for sales of their products or to secure their increasing domestic need for raw materials. We have also shown that Chinese companies may use tiered strategies for different markets depending on whether they are entering developed countries or emerging markets. The table above provides a sample of the most recent M&A deals between Chinese and foreign target companies. To further consider relationships between selling/brand effects and sourcing we examined the two-by-two contingency table with the first variable, type of market (developed versus emerging) and the second variable, the strategic motive to conduct an M&A (selling/brand versus sourcing). With our sample of recent M&A activity between Chinese companies and foreign targets we get the following results.

Table 2  Total deals

<table>
<thead>
<tr>
<th>Market type</th>
<th>Selling</th>
<th>Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed</td>
<td>11</td>
<td>7</td>
<td>18</td>
</tr>
<tr>
<td>Emerging</td>
<td>0</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>11</td>
<td>13</td>
<td>24</td>
</tr>
</tbody>
</table>

Out of our sample, the motive to acquire a foreign company is split between selling/brand and sourcing reasons, 46% and 54% respectively. Considering the type of markets Chinese firms use M&A to enter, 71% of the activity is in developed countries and 29% in emerging markets. It seems that Chinese firms that choose developed countries are more likely to do so for selling/brand reasons while Chinese firms that enter emerging markets are more likely to do so for sourcing reasons.

We then looked at the M&A deals that were pending or aborted. Sourcing acquisitions were more likely to be pending or aborted in developed countries than selling/brand acquisitions. In emerging markets there were no selling or brand acquisitions, this was consistent with our assertion that Chinese firms will enter emerging markets directly with their own brand. All of the aborted deals in developing countries were sourcing acquisitions by Chinese firms. We can see the overall results for aborted or pending deals in the following table.
Chinese brands: the build or buy considerations

Table 3  Aborted or pending deals

<table>
<thead>
<tr>
<th>Market type</th>
<th>Selling</th>
<th>Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed</td>
<td>1</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Emerging</td>
<td>0</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>1</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

The eight aborted/pending deals were evenly split between developed and emerging markets, also it should be noted that half of all deals in emerging markets are pending. The type of acquisition most likely to be pending or aborted (88% of the time) are sourcing acquisitions. Most of those deals, the government stepped in and either delayed or prevented the acquisition for ‘national security’ reasons. A good example is the case of Unocal, the US oil producer. When CNOOC bid well beyond other domestic industry players the US government intervened. The ensuing debates in Congress led to a rejection of the CNOOC on the grounds that Unocal is a strategic resource (Lunding, 2006). Another example of government intervention was in Canada, when China Minimetals attempted to acquire the Canadian firm Noranda, they ran into regulatory difficulties that halted the acquisition. It seems that in developed countries governments are more likely to interfere for resource-based acquisitions. We excluded the aborted/pending deals in our analysis in Table 4 for the remaining M&A deals as shown.

Table 4  Completed deals

<table>
<thead>
<tr>
<th>Market type</th>
<th>Selling</th>
<th>Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed</td>
<td>10</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>Emerging</td>
<td>0</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>6</td>
<td>16</td>
</tr>
</tbody>
</table>

Table 4 shows an even clearer picture of the market and motivational tradeoff. According to our results, Chinese companies enter developed markets to acquire brands. However, Morck and Yeung (1991), discussed the failure rates of firms that were acquiring intangible assets. They suggest that firms with high intangible assets that acquired firms with low intangible assets but high tangible assets were the most successful. It seems that Chinese companies are going global and enter developed markets by acquiring a brand (intangible assets) or build their ‘own brand’ in emerging countries. However, they prefer to acquire resources in emerging markets. Resource acquisition in emerging markets may be due in part to government intervention in developed countries.

4.2 A model of Chinese M&A

Can the data explain why some M&As were successful and why others have been aborted or delayed? We propose a model that assess the success of an acquisition is dependent on the type of acquisition and its purpose (sourcing versus selling) and that the type of market (developed versus developing) also plays an important role. In that respect we develop a logistic model outlining the probability of a successful M&A (outcome) given the type of market (developed versus emerging) and the type of strategic motive (selling/brand versus sourcing). The model takes the following form:
\[ LN(\Omega) = y + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_1 x_2. \]  
where \( \Omega \) represents the dependent binary outcome of the merger or acquisition and \( y \) represents any constant or intercept term. Where the probability of a successful acquisition could be found by Equation 2:

\[ P(\Omega) = \frac{e^{(y + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_1 x_2)}}{1 + e^{(y + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_1 x_2)}}. \]

The variable \( x_1 \) represents the type of strategic motive to acquire a company (build versus buy). For example, a target that is a petroleum manufacturer would be a resource play (sourcing) and a manufacturer of consumer products might be a selling/brand play. Variable \( x_2 \) represents the dimension of the type of market to enter (developed versus developing); this is captured by the country of the target company. For example, a target in the UK would be categorised as developed market and one in Vietnam would be classified as an developing market. The interaction term \( x_1 x_2 \) represents the interaction between market and motive. The coefficient terms are \( \beta_1, \beta_2, \beta_3 \) respectively. The results of logistic regression confirmed that the type of motive was significant to the success of the M&A but the market was not. The interaction between market and motive not significant and was dropped from the model. As can be seen in table below.

### Table 5  Logistic regression coefficients

<table>
<thead>
<tr>
<th>Reason type</th>
<th>B</th>
<th>Sig.</th>
<th>Exp(B)</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>0.132</td>
<td>0.895</td>
<td>1.141</td>
<td>0.161</td>
<td>8.058</td>
</tr>
<tr>
<td>Motive</td>
<td>-2.482</td>
<td>0.039</td>
<td>0.084</td>
<td>0.008</td>
<td>0.886</td>
</tr>
<tr>
<td>Constant</td>
<td>0.094</td>
<td>0.897</td>
<td>1.098</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Therefore the outcome of Chinese M&A with regard to market and motive effects can be expressed as:

\[ LN(\Omega) = 0.094 - 2.482 \times \text{Motive} + .132 \times \text{Market}. \]

With the probability of a positive outcome (success) shown as follows:

\[ P(\Omega) = \frac{e^{(0.094 - 2.482 \times \text{Motive} + .132 \times \text{Market})}}{1 + e^{(0.094 - 2.482 \times \text{Motive} + .132 \times \text{Market})}}. \]

and the probability of a negative outcome (failure) can be expressed as:

\[ 1 - P(\Omega) = \frac{1}{1 + e^{(0.094 - 2.482 \times \text{Motive} + .132 \times \text{Market})}}. \]

For the purposes of estimation we leave out the market term as it is not significant. The table of probabilities is displayed below.
Our analysis shows that there is a motive effect, as selling/brand acquisitions are coded (1) and sourcing acquisitions are coded (0) where selling/brand has a much higher probability of a positive outcome of the M&A. In fact, we can say that the odds of a successful selling/brand acquisition are around 13 times more likely to be successful than a sourcing acquisition. Given the small number of observations from the original dataset and the lack of brand related acquisitions in developed countries the effect of market development is not significant and does not really add much to the equation. The intercept and interaction terms were not significant either. However, for confirmation due to the relatively small sample size a Monte Carlo resampling or bootstrapping was performed with 10 000 replications with replacement the results are shown in Table 8.

Table 6  Logistic regression model of probabilities and the odds ratio

<table>
<thead>
<tr>
<th>Motive</th>
<th>Resource (0)</th>
<th>Selling (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delayed/Aborted (1)</td>
<td>( P(O = 1</td>
<td>I = 0) = \frac{e^{0.094}}{1 + e^{0.094}} )</td>
</tr>
<tr>
<td>Success (0)</td>
<td>( P(O = 0</td>
<td>I = 0) = \frac{1}{1 + e^{0.094}} )</td>
</tr>
<tr>
<td>Odds ratio</td>
<td>( \psi = \frac{(P(O = 1</td>
<td>I = 1) \cdot P(O = 0</td>
</tr>
</tbody>
</table>

Table 7  Logistic regression probabilities and odds ratio results

<table>
<thead>
<tr>
<th>Type of Market</th>
<th>Developed</th>
<th>Emerging</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Resource (0)</td>
<td>Selling (1)</td>
</tr>
<tr>
<td>Delayed /Aborted (1)</td>
<td>0.523</td>
<td>0.084</td>
</tr>
<tr>
<td>Success (0)</td>
<td>0.477</td>
<td>0.916</td>
</tr>
<tr>
<td>Odds ratio</td>
<td>11.97</td>
<td>11.97</td>
</tr>
</tbody>
</table>

Table 8  Bootstrapped logistic regression probabilities and odds ratio results

<table>
<thead>
<tr>
<th>Bootstrapped simulation (10 000 replications)</th>
<th>Type of market</th>
<th>Developed</th>
<th>Emerging</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Resource (0)</td>
<td>Selling (1)</td>
</tr>
<tr>
<td>Merger (Outcome)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delayed/Aborted (1)</td>
<td></td>
<td>0.525</td>
<td>0.076</td>
</tr>
<tr>
<td>Success (0)</td>
<td></td>
<td>0.475</td>
<td>0.924</td>
</tr>
<tr>
<td>Odds ratio</td>
<td></td>
<td>13.45</td>
<td>13.45</td>
</tr>
</tbody>
</table>
Although there was only a small sample the results are significant and a classification test on results showed that 71% were correctly classified by our model. Furthermore, bootstrapped results of the data confirmed our initial findings. We bootstrapped the results to give narrower confidence intervals to better estimate the population beta's for both independent variables, Motive [selling (1) versus resource (0)] and Market type [developed (0) versus emerging (1)].

The bootstrapped results confirm the effects we observed in the original sparse data. Further simulations were done with twenty thousand replications and yielded similar results. The stationarity of the findings suggested that a larger sample would have yielded similar parameter estimates. We deduced that the results we had were significant enough from which to draw conclusions.

Table 9 Bootstrapped logistic regression coefficients

<table>
<thead>
<tr>
<th>Reason type</th>
<th>B</th>
<th>Sig.</th>
<th>Exp(B)</th>
<th>95.0% C.I. for EXP(B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>0.164</td>
<td>0.001</td>
<td>1.179</td>
<td>1.070 - 1.298</td>
</tr>
<tr>
<td>Motive</td>
<td>-2.599</td>
<td>0.000</td>
<td>0.074</td>
<td>0.066 - 0.084</td>
</tr>
<tr>
<td>Constant</td>
<td>0.100</td>
<td>0.005</td>
<td>1.105</td>
<td></td>
</tr>
</tbody>
</table>

Our results suggest that Chinese firms are more likely to have a successful M&A outcome for selling/brand acquisitions in developed markets. M&As of sourcing acquisitions are more difficult to be completed no matter in which market also the likelihood of failure for sourcing M&A’s is higher in developed markets. Resource acquisitions are split between success 47.7% and failed or aborted at 53.3%, thus they are less likely to succeed then selling/brand acquisitions which succeed in the developed world of 91.6% of the time and failed 8.4% of the time. This is partially due to the type of acquisition as almost all of the acquisitions in the emerging markets by Chinese firms were resource related. These resource related acquisitions are more likely impeded by a number of unexpected obstacles. This is consistent with the nationalistic market behaviour observed in developed markets. Thus, Chinese firms considering resource acquisitions must be mindful of the nationalism of the target market; failure to consider these sentiments can disrupt the progress of an acquisition. Chinese firms signing a resource-based acquisition should plan to counter the nationalistic sentiments prior to proceeding with the acquisition. Another strategy that might prove effective would be joint ventures with resource providers and gradual accumulation of control. While much of the evidence suggests that Chinese firms have higher success with selling/brand acquisitions, it should be noted that the theoretical evidence suggests that the sourcing acquisitions should be more successful in the long run. Morck and Yeung (1991) highlighted the transient success that comes from selling/brand acquisitions, unless they are fulfilling a resource or asset based need of the acquirer, the added costs, overhead and complexity become a drag on the productivity of the newly merged firm. They also went on to discuss the relative success of the firms that acquired resources and assets that were critical to the firm’s operation. These firms will more likely to benefit from the synergies of the merger or acquisition.
4.3 Which companies may be next to globalise?

Our model predicts that M&A’s in the developed world will focus on brand acquisition and that many of those will be successful. There is also a reasonable chance of resource acquisition in developed countries, but they are more likely to meet with regulatory challenges and be aborted. In emerging markets, there is little chance of selling/brand acquisition but a high probability of resource acquisition. Suitable targets would be companies with valuable assets, brands, huge customer base, technology or overpriced products due to high production or labour intensive costs (hence potential to get products produced in China) or big brand firms with negative earning as a result of competitive pressure. The most likely next Chinese companies would be those with sufficient size and funds (annual sales over USD 1 bn) and those identified by the Chinese Government.

5 Conclusion

In summary, we have shown that Chinese brands have begun their journey beyond the borders of China. That many larger and middle-sized Chinese firms have become strong domestic producers with the partnership and backing of the government. The Chinese marketplace and contract manufacturing is no longer the only focus of domestic Chinese firms and that they have several ways to expand globally. There are still obstacles that must be overcome by these firms for success beyond the great wall. Current negative perception of Chinese brand and product quality are clearly hurt by the negative country of origin effect but these issues could be overcome over time. Garment and furniture are great examples of quality successes. Other industries need to follow the lead of these industries. Trust and quality perception for Chinese goods will not come over night; it took Japanese and South Korean companies several years to overcome their poor quality reputation, but they did overcome it.

Success will not come easy and in the short run, Chinese companies operate in a new era with intense global competition, open markets, instant communication and sophisticated consumers. The competitiveness of Chinese brands in the global market is unclear but likely to be very strong in the near future. What is clear, the number of leading global brands owned by Chinese entities will climb in the next few years; it will be due to a combination of acquisitions and accelerated brand building. Lenovo, Haier and Bird represent aggressive acquirers and impressive entities in their domestic markets; and are more globally competitive year after year.

Chinese companies have to choose between building their own brands versus buying one. The more conservative, incremental brand building approach starts form local markets, expands to regional, and finally goes global, a slow but effective internal growth process. A good example of this strategy is the company Changhong. In contrast, TCL and Lenovo have adopted the more aggressive external growth approach to accelerate the internationalisation by acquiring foreign brands, like IBM PC’s or Thompson. Chinese companies more often acquire firms in developed countries if they want to sell products, whereas they acquire companies in emerging countries only when they want to secure their sourcing. If they want to build their own brand, they seem to enter developing markets first. Many of these developing markets are neighbouring countries in Southeast Asia, which are relatively easy for Chinese firms to enter as a result of their smaller
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geographic and cultural distance. Only after success in the developing markets, Chinese firms enter developed countries. It is too early to say whether this strategy will prove effective or whether the ‘own brand’ strategy used in the emerging markets will be more appropriate for all markets.

References
Bibliography

Notes
1 Just recently, Geely has lined-up spare parts suppliers outside of China - from Germany, Italy and South Korea.
2 In this analysis we omit all types of Joint-Ventures, Co-branding efforts, as such deals are interesting to look from a branding perspective but are more difficult to measure.
3 For this analysis, we omit the niche market as it can be either in a developed or emerging market.