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Why are South Korean Companies Strong in the Chinese Market?

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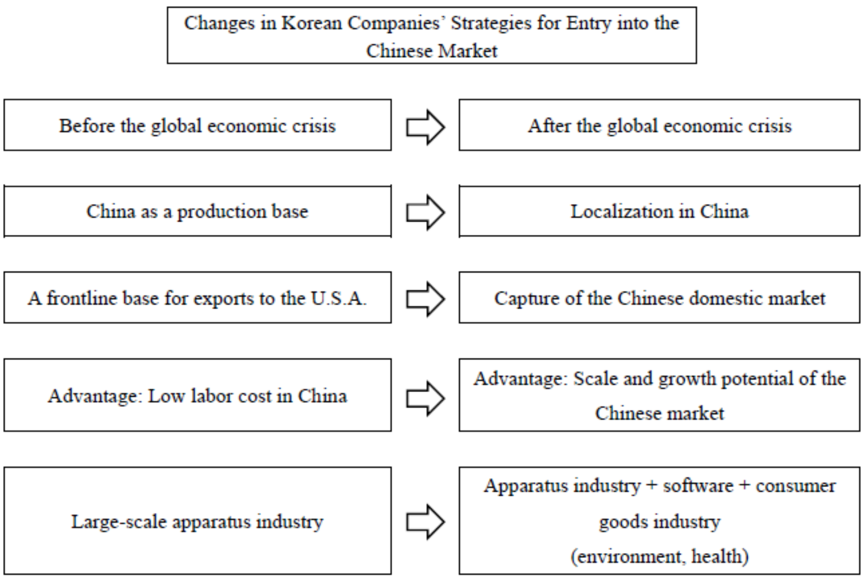
Abstract

The purpose of this report is to clarify the management strategy of the South Korean companies which advanced to the Chinese market, and to compare it with the management strategy of Japanese companies. By analyzing it, the new possibility of the Chinese market capture of Japanese companies is explored in the future

Introduction

Since the global economic crisis in 2008, the number of Korean companies entering the Chinese market has been increasing again. This is because these companies shifted their strategies from “producing in China to earn dollars” to “selling in China to earn Chinese yuan” as they renewed their awareness of the high potential of the Chinese domestic market, which had maintained an annual economic growth rate of 8% even in the midst of the global economic crisis.



Source: International Labour Cooperation Project, *Success Factors and Implications of Global Companies Entry into the Chinese Market*, page 39. http://www.koilaf.org/index.do

Figure 1

Global companies enjoyed the fruit of high economic growth resulting from China's reforms and open door policy after the end of the 1980s. However, the rapid change in business environment after the 2000s is impacting the future prospects of many of these companies. This is because an adverse business environment for global companies has emerged due to the following: the Chinese government's cutbacks in preferential measures for foreign investment, the rise of local companies, the fact that Chinese consumers have developed a discerning eye, and improved workers' awareness of their rights.

In the 1980s, Korean companies expanded exports to China via Hong Kong. While exports to China by Korean companies stopped temporarily due to the Tiananmen Square incident in 1989, Korean companies' entry into the Chinese market gained momentum in the wake of the normalization of diplomatic relations between Korea and China in August 1992.

Thus, it can be said that Korean companies' entry into the Chinese market advanced in tandem with China's policy to open up the country to foreign businesses and accelerated during each economic crisis, such the Asian currency crisis and global economic crisis, demonstrating that the Korean economy is heavily dependent on overseas market and that Korean companies have a strong interest in the global market, particularly the Chinese market.

This report aims to elucidate theoreticaly the characteristics, issues, and future prospects of Korean companies' entry into the Chinese market in the first place, and the second is to discuss whether Japanese companies can leverage the experience of Korean companies as a lesson for their entry into the Chinese market.

1. Characteristics of Korean companies' entry into the Chinese market

When the recent development of Korean companies in the Chinese market is examined, the following three characteristics become evident: the creation of a locally self-contained management system, the acceptance of the specific nature/uniqueness of China, and risk management. These three characteristics are examined in more detail below.

(1) Locally self-contained management system

The locally self-contained management system fully leverages the abilities and skills of local human resources by increasing the percentage of local employees from the early stages of the entry into the Chinese market and by providing them opportunities to assume positions of greater responsibility and that aims to develop a core global R&D center by transferring the major R&D functions of the headquarters to China while flexibly responding to changes in demand through community-based R&D.

To that end, Korean companies form partnerships with local companies, which have the adequate production capability to serve as part of the companies' local production systems, and fully leverage their capabilities. The companies then build local procurement systems, which cover everything from raw materials and semi-finished products to the consignment production of finished products, during the early stages of their entry into the Chinese market. Through partnerships with and mergers and acquisitions of local companies, they secure distribution and sales networks in a short time, which cover not only large cities along the coast, but also small and medium-sized inland cities and farming villages. This is how the locally self-contained management system, a system to conduct production, distribution, and sales in a consistent manner in China, is created.

(2) Management strategies based on the acceptance of the specific nature of China

The management strategies based on the acceptance of the specific nature of China mean to closely investigate the specific or unique mindset and behavioral patterns of Chinese people through the history, culture, and customs of China and reflect the results in corporate management. The specific or unique nature of Chinese refers to Chinese pride in their long history and culture, which is called Sinocentrism, face-saving behavior unique to China, and traditional business practices. Sinocentrism, which has submerged due to rapid economic growth, is now re-emerging, and it is a common understanding around the world that the understanding of and respect for Sinocentrism is key to success in the Chinese market.

The management strategies based on the acceptance of the specific nature of China, therefore, aim to accept values unique to the Chinese (color, food, and houses), which reflect their pride in the traditional belief in the uniqueness of China and its culture, and reflect them in products. It is expected that Chinese people would regard such an approach as an expression of esteem for China and form a good impression of Korean products and companies. This is a strategy to fulfill the desire of China that China, which has established its position as an economic power, should be treated as a special market that has greater potential than the markets in other developed countries. Such a strategy serves to save “face” for the Chinese, who value appearance and scale.

It is also important to reflect the conventional Chinese business practice, which aims to purchase products not at list prices, but at discount prices, in business activities as much as possible.

(3) Risk management system

In China, foreign companies must take into consideration system reform risks arising from its socialist market economy system and risks associated with consumer behavior. Due to frequent policy changes and the fact that the enforcement of newly established laws depends totally on the government, the business situation in China is highly unpredictable, and it is not possible for foreign companies to fully respond to it.

For foreign companies, there are various regulations not only for their entry into the Chinese market, but also for their withdrawal from the market, which enable

China to minimize the risks associated with their withdrawal. Moreover, risks associated with consumer behavior are also emerging along with consumers' enhanced awareness of products and companies, such as safety and environmental issues that used to be of no serious concern for Chinese consumers.

In order for foreign companies to succeed in China, they may need to build friendly relations with the Chinese government by actively promoting social contribution activities that help solve the issues the Chinese government faces, such as inland development, regional disparity between urban and rural areas, and the elimination of other social disparities.

Moreover, foreign companies may encounter a serious management crisis if they fail to manage safety and environmental standards more strictly than in other developed countries since Chinese people are very sensitive to the view that regards China as a developing country. With regard to quality, environmental pollution, and safety in particular, China tends to incur stricter criteria for foreign companies than other developed countries. According to a foreign company questionnaire survey, Chinese people complain about production activities by foreign companies that pollute the environment (73.1%) and have ill feelings against those foreign companies that do not comply with Chinese labor and industrial standards (54.4%) and whose products do not meet the product safety standards of China (31.2%).[i]

2. Success Factors for the Entry into the Chinese Market

It follows from the above discussion that foreign companies entering the Chinese market must give due consideration to the culture and social system of China and build a risk management system to minimize potential risks. To conduct business activities in China in the same manner as in other countries without a deep understanding of the special business environment of China may lead to irreparable results. It seems that foreign companies planning to enter China should first enter the coastal region as many foreign companies have done and then, after learning enough about the Chinese market and enhancing brand awareness there, make their way into inland areas.

For inland areas, while these areas are rapidly growing now, income levels and consumption power still remain low, and adequate infrastructure for consumption has not been built. Therefore, the entry into these areas by companies, which have not established solid price or brand competitiveness in the Chinese market, is likely to end in failure. The probability of success by foreign companies, therefore, will increase if they first advance into the coastal region, where many Korean companies and a relatively large market already exist, and after learning the Chinese market and enhancing brand awareness there, make inroads into the mid-western inland region. In the coastal region, demand for durable goods, such as mobile phones, computers, and automobiles, and industrial products that improve people's quality of life and facilitate women's participation in society, such as dishwashers, kitchenware, and furniture, is high.[ii] Such information based on market research will provide a springboard for the successful entry of foreign companies into the Chinese market.

In addition, it is also necessary to boldly promote localization. Localization here does not mean the local procurement of components, which was a much-discussed topic in the 1990s. It means to employ local human resources and produce products tailored to local needs. For the employment of local human resources, Korean companies first expanded their local economic research divisions, enhanced their understanding of and judgment about the Chinese market, and expanded their networks with experts on the Chinese economy. A typical example of such an approach is the Samsung Economic Research Institute in China, which employed about 20 Chinese researchers with master's or doctoral degrees, who were from the mainland China or Hong Kong. Moreover, the advisory group of the Institute is said to include many leading experts on economics and business administration in China.

For the development of products that meet local needs, Hyundai Motor Company sold more than 250,000 Yue Dong models, the Avante compact sedan face-lifted for the Chinese market by widening the car interior and increasing the rear volume, in 2009. The model became the second most popular car in China, significantly contributing to an increase in Hyndai's sales in China by 94%. Thus, Hyndai does not export uniform products to other countries, but produces products tailored to the nationality and customs of each country.

There are also examples where a corporate group's top executives are injected into the Chinese market. LG Electronics Incorporated sent an overseas marketing expert, who boosted LG to the top IT company in the Brazilian market in 2008, into the Chinese market. The SK Group assigned the CEO of SK Holdings Co., Ltd., as a corporate president in China at the end of 2009. The Group sent a top executive of the Group into the Chinese market.[iii]

This approach, where a top executive of each group is assigned to China, is naturally welcomed by China, enhancing the value of Korean products and companies. It is evident that such localization strategies have driven the success of Korean companies in the Chinese market.

3. Reality of Korean companies' entry into the Chinese market: Samsung Electronics Case

Samsung Electronics Co., Ltd., established Samsung Electronics Huizhou Company in Guangdong, China, in 1992 and shifted its strategies for China from export via Hong Kong to local production. At the same time, Samsung Electronics established production bases in the areas geographically close to Korea, such as Tianjin. While the company's China business declined after the Asian Financial Crisis in 1997, it went into full swing again after 2000.

Samsung Electronics launched its integrated management system in China around 2004 when the following were established: a joint venture for WCDMA (a 3G mobile telecommunications method); sales branches in Chengdu and Shenyang; a semiconductor R&D center in Nanjing; sales branches in Shanghai, Beijing, and Guangzhou; and a global design center in Shanghai.

In 2005, Samsung China changed the name to China Samsung to emphasize its localization strategy. Since then, the China business has grown as a key project that determines the fate of Samsung Electronics. China Samsung comprises 23 group companies, and the total sales of Samsung Electronics' China business reached 23.1 trillion won, which accounted for 14% of the total sales of Samsung Electronics.

Major production bases of Samsung Electronics center in the northeastern part of China, such as Tianjin and Weihai; the east coast, including Suzhou and Ningbo; and the south coast, including Dongguan, Shenzhen, and Huzhou. While Tianjin is Samsung Electronics' production base for TVs, mobile phones, monitors, and cameras, Suzhou is a production base for LCDs, laptops, white goods, and semiconductor post-process lines, and Shenzhen and Huzhou are production bases for mobile phones. Samsung Electronics built its first 10-nano NAND flash memory plant in the western part of China (Xian, Shaanxi) and plans to invest a total of 7 billion dollars in it in the next few years. At the end of 2013, the company began the production of 10-nano NAND flash memory in full scale. Xian City in Shaanxi Province has adequate industrial infrastructure in place, including electricity and water. Moreover, since production and research bases of global IT companies concentrate in the surrounding areas of Xian, the location is ideal for Samsung Electronics to provide services to customers in a prompt and efficient manner and to acquire high-quality local human resources.[iv]

In 2011, Samsung Electronics introduced cutting-edge semiconductor production lines. With the new semiconductor lines, the company mass-produces less than 20-nano NAND flash memory, whose demand has been increasing due to the rapid penetration of smartphones and tablet PCs. The company also mass-produces 20-nano NAND flash memory in Hwaseong Plant, South Korea.

Consequently, the percentage of smartphones produced in China is expected to increase from 37% in 2012 to 48% in 2015. The percentage of tablet PCs produced in China reached 96% in 2012.

In 2011, the Samsung Group's sales in China were 58 trillion won (51 billion dollars), about five times the amount of accumulated investment (10.5 billion dollars), and the number of employees reached 107,000. Samsung Electronics accounts for approximately half of the total sales and number of employees of the Samsung Group in China, demonstrating that it is the flagship company among 23 group companies of China Samsung.

Moreover, China Samsung has made inroads into China in various fields, including semiconductor, mobile phone, home electric appliance, heavy industry, construction, and securities and is promoting a new strategy called "construction of a second Samsung." While Samsung Electronics leverages China as a production base and sales market, the company is advancing into the ultimate localization stage, where it plans to take root in China as a Chinese company by completing its integrated management system including production, sales, R&D, and design.

Specifically, the company has shifted the positioning of China from a large consumer market for home electric appliances, mobile phones, and semiconductors to a global supply base. The role of China as a base for R&D and the development of design and software, which can cater to the needs of developed and semi-developed countries, has increased. Samsung aims not to overtake the Chinese and world markets with low to medium quality products “made in China,” but to establish a group of products, including high-quality products and cutting-edge technology, which are “created in China” and can be exported to the global market.

The reasons behind the development of global products targeting the world market are rising labor cost and increasing costs due to reduced tax incentives. Consequently, Samsung Electronics moved its value-added production bases to Vietnam and shifted its strategies in China to the development and production of localized products and medium and high-quality products to export to the world market.

Samsung also aims to establish a global design center, which can meet the needs of global customers, in China. One of the purposes of such a design center is the management of a design bank system. The design bank system is a database that designers can use to search for designs and related information with ease. In the system, unused design is also stored and accumulated for future use. Upon the establishment of a design network, the role of Samsung China Design Institute (Shanghai) has become twofold: the development of design fit for the culture and lifestyle of Chinese people via analysis of their consumption patterns and the development of world-class design.

Samsung Electronics reviews its basic design every two years. The company analyzes local trends and develops product strategies in the first year and then creates new designs in the second year while giving due consideration to industrial and technology trends. In the future, while producing local products for the Chinese market, Samsung Electronics plans to build an integrated management system comprising production bases for various advanced products to cater to the needs of the global market, such as the production of semiconductors in the western region, distribution and sales networks, research and development, and the development of design and software.

The purpose of the “construction of a second Samsung” that Samsung Electronics aims to achieve in China is to build a locally self-contained management system.[v]

The sales promotion strategies that Samsung Electronics implements in the Chinese market are two-track marketing that differentiates strategies for cutting-edge products from those for low-end products. The mainstays of Samsung Electronics’ strategies are its *premium strategy* that aims to provide the world’s best quality products and its *local customization strategy* that aims to create new demand by producing products tailored to the needs of Chinese consumers. One of the reasons for the introduction of *premium products* is that the wealthy in China prefer foreign brands when purchasing mobile phones and expensive home electric appliances.

The typical targets of the premium strategy are smartphones and 3D TVs. In July 2011, only three months after the launch of the model in the United States, Samsung Electronics released Galaxy S2 in China and then Galaxy S3 through three companies of China Mobile, China Unicom, and China Telecom at the same time.

As a result, the market share distribution of smartphones for the second quarter of 2012 in China became as follows: Samsung Electronics 22.2%, Lenovo 11.9%, Huawei 11.2%, and Apple 7.1%. Samsung Electronics left Apple far behind.

One of the specific examples of the local customization strategy is the Galaxy Pocket, a smartphone in the 100-dollar range launched by Samsung Electronics in 2012. This is a low-end model developed to tap new markets in emerging countries, such as China.

A cooperative system with leading local distributors also supports the sales strategies of Samsung Electronics. Samsung Electronics and GOME Electronics, a leading Chinese distributor of electronic products, formed a strategic partnership, which aims to achieve sales of more than 5 trillion won in China in two years after September 2010. Samsung Electronics also formed a partnership with SUNING, a rival of GOME Electronics, which aims to achieve sales of about 1.7 trillion won in one year.

The main contributing factor that enables Samsung Electronics to provide a variety of products in the Chinese market is the company’s delegation of authority to local subsidiaries for almost everything, including marketing strategies, factory operation, and production/distribution/investment planning. It is this management system that allows the company’s speedy management in the entire process from need identification and product planning to commercialization of products.[vi]

Samsung Electronics sets the development of low-end products that can compete with Chinese products. It has thoroughly analyzed the costs of low-end products produced by Chinese companies, examined the feasibility of cost reduction by the use of components made in developing countries and China while maintaining quality, and made a detailed comparison of component and material prices by breaking down Chinese products (reverse engineering).

The greatest challenge of the effort is how to achieve a balance between domestic production in Korea and production in China. If Samsung Electronics transfers everything from production to R&D and design to China, it will give rise to a serious issue of the hollowing out of the domestic industry.

The further development of Samsung Electronics in the Chinese market, therefore, depends largely on the emergence of new industries within Korea. Specifically, new industries, such as organic EL (AMOLED), fuel cells (electric vehicles), and biomedicine, which can take the place of semiconductors and mobile phones, must be developed as new income sources in the next few years.

Unless next generation industries, which can serve as the mainstay of growth and income in Korea, are created early, Korean companies' entry into the Chinese market will lead to the hollowing out of the domestic industry.[vii]

As shown clearly by the above discussion, localization based on thorough market research is the China strategy of Samsung Electronics. It means to continue localization on an ongoing manner while flexibly responding to the rapidly changing needs of the Chinese market. In short, it is a strategy not to suit the market to the products of the company, but to suit the products to the market. This is what greatly differs from the approach of Japanese companies, which focuses solely on how to sell their products.

Conclusion

As discussed above, Korean companies adopt exceptional strategies when entering the Chinese market. The reasons for it are as follows: first, Korean companies do not regard their subsidiaries, which have entered the Chinese market, simply as subsidiaries, but completely localize them, including local discretion and human resources. On the other hand, since Japanese companies focus on the scheme of Japan = parent company and companies in China = subsidiaries, they are viewed by China as temporary visitors, who are less committed to business in China compared to Korean companies.

Second, while Korean companies adopt a top-down approach for decision-making, allowing fast and bold decision making, Japanese companies have a bottom-up decision-making system, which requires much time to arrive at a final decision and allows views of individuals and divisions that are not familiar with local business in China to enter the final decision, resulting in a mere desk plan.

Third, while Korean companies are required to implement thorough market research and sales activities due to their strategy of developing products tailored to local needs, Japanese companies sell the same products worldwide. Such an inflexible approach leads to not thorough, but more general market research and sales strategies.

Consequently, while each Korean company can make inroads into the Chinese market on its own without much trouble, Japanese companies may face difficulties due to cultural and value differences after entering the Chinese market.

In light of the aforementioned differences, if Japanese companies are to avoid trouble associated with the entry into the Chinese market or explore new methods for it, a Japan-Taiwan business alliance can be an important business strategy for the entry of Japanese companies into the Chinese market in the future. It is because since Taiwanese companies are more familiar with the Chinese market and companies, business alliances with them will make Japanese companies' entry into the Chinese market much easier. Second, business alliances with Taiwanese companies will hedge against risks associated with the market entry. Third, such alliances will enable Japanese companies to leverage the Economic Cooperation

Framework Agreement (ECFA) signed by China and Taiwan in June 2010 (effective in September 2010). Since the ECFA is equivalent to an economic partnership agreement between China and Taiwan, Japanese companies can enjoy preferential treatment for investment in China by entering China via Taiwan.

In light of these reasons, collaboration with Taiwanese companies will become an important option for Japanese companies that plan to enter the Chinese market in the future.

However, the Japan-Taiwan business alliance strategy poses some challenges. First of all, Japanese companies must speed up the decision-making process to move in tandem with Taiwanese companies. Since many Taiwanese companies are owned by sole proprietors who have substantial authority, decisions are made promptly. On the other hand, on top of the fact that it takes time for Japanese companies to make decisions, they often submit a matter not for local approval, but for headquarters' approval in Japan. Therefore, it is necessary for Japanese companies to delegate authority to subsidiaries in China and create a prompt decision-making system.

The second challenge is managers' awareness of responsibility. Among Taiwanese companies, many of which are owned by sole proprietors, remuneration for sole proprietors matches their responsibility and authority and therefore, they have a strong sense of responsibility. On the other hand, since remuneration does not necessarily match responsibility and authority among Japanese companies, executives assigned to China often lack aggressiveness and a strong sense of responsibility. While this issue cannot be solved easily since it is linked to the organizational systems of Japanese companies, Japanese companies should consider the development of a system applicable only to the business in China in addition to the business alliance strategy with Taiwanese companies.

Moreover, Japanese companies should gain a deeper understanding of Taiwanese companies' management approaches and ways to capture the Chinese market. The Chinese market features unique business practices and promotion methods that many Japanese companies often find it difficult to understand. On the other hand, Taiwanese companies are thoroughly familiar with them, which is the key factor for their success in the Chinese market. Japanese companies must at least understand Taiwanese companies' methods, if not imitate them.

These issues discussed above are more or less the problems faced by most large companies in Japan. It seems easier for small and medium-sized Japanese companies to understand the methods of Taiwanese companies, since most of them are owned by sole proprietors and their organizational and management systems are similar to those of Taiwanese companies. Therefore, small and medium-sized companies could play a major role in promoting Japan-Taiwan business alliances.

Thus, there are many issues that should be addressed and overcome in order for a Japan-Taiwan business alliance to work out nicely. However, if Japanese companies are to succeed in overseas operations, particularly in China, business alliances with Taiwanese companies will become an important option to which they should give serious thought.

Aiming to achieve localization as Korean companies have done is another option. In any case, in order for Japanese companies to make a significant leap forward, it is essential for them to overcome the aforementioned issues and develop new management strategies in addition to their conventional ones.

Notes

[i] International Labour Cooperation Project, *Success Factors and Implications of Global Companies' Entry into the Chinese Market*, page 39 to 45. www.koilaf.org/download.do?fileNo=844
[ii] ditto, pages 45 to 46
[iii] *Joseon Ibo* issued on January 25, 2010
[iv] *Toyo Keizai Nippo* issued on November 16, 2012
[v] *Toyo Keizai Nippo* issued on November 23, 2012
[vi] *Toyo Keizai Nippo* issued on November 30, 2012
[vii] *Toyo Keizai Nippo* issued on December 7, 2012

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