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**MARKET ENTRY PATTERNS OF FINNISH SMES ENTERING CHINA**

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## **ABSTRACT**

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In 2011 China became the world's second largest economy overtaking Japan. With its rapidly growing middle class buying diverse goods from consumption products to sophisticated technology and luxury products, it is also the fastest growing export market in the world. The purpose of this study is to examine what types of market entry modes Finnish SMEs use in China, which factors affect on their decisions and whether they have switched or combined the strategies after entering China. The goal is to understand the relevance of the entry mode choice related to the internationalization process and to evaluate how well it suits the Chinese business environment.

The empirical part of the study is a semi structured qualitative analysis of six case companies that represent different industry fields. The cases were selected based on the recent literature about the Finnish industry fields China is interested in to gain knowledge and expertise from. Companies included in the study are an architect office, two pharmaceutical development companies, an ICT company, a plastic mechanics company and a clean tech company.

The results of this study indicated that the market entry patterns of Finnish SMEs in China differ from each other based on the factors related to company's background, mode concerns and Chinese market influences.

## **TIIVISTELMÄ**

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Kiina kasvoi vuonna 2011 maailman toiseksi suurimmaksi talousalueeksi ohittaen Japanin. Kiinan nopeasti kasvava keskiluokka ostaa erilaisia hyödykkeitä aina kulutustavaroista korkeatasoiseen teknologiaan ja laadukkaisiin tuotteisiin ja näin ollen Kiina on myös maailman nopeimmin kasvava vientimaa. Tutkimuksen tavoitteena on tarkastella mitä etabloitumisstrategioita suomalaiset pk-yritykset käyttävät Kiinassa, mitkä tekijät vaikuttavat heidän päätöksiinsä ja ovatko yritykset yhdistäneet tai vaihtaneet strategioita etabloitumisen jälkeen. Tavoitteena on ymmärtää etabloitumisstrategian tärkeys kansainvälistymisprosessissa ja arvioida miten hyvin se sopii kiinalaiseen liiketoimintaympäristöön.

Tutkimuksen empiirinen osio on puolistrukturoitu kvalitatiivinen tutkimus kuudesta case-yrityksestä eri toimialoilta. Valitut yritykset edustavat Kiinalle osaamiseltaan ja tietotaidoltaan tärkeitä suomalaisyrityksiä viimeisimpään tutkimuskirjallisuuteen pohjaten. Tutkimuksessa tarkasteltavat yritykset ovat arkkitehtitoimisto, kaksi lääketieteellisen kehityksen yritystä, ICT-alan yritys, muovimekaniikkayritys ja clean tech-alan yritys.

Tutkimuksen tulokset osoittavat, että suomalaisten pk-yritysten etabloitumisstrategiat Kiinassa eroavat toisistaan riippuen yrityksen taustasta, ulkoisista tekijöistä sekä kiinalaiseen markkinaympäristöön liittyvistä tekijöistä.

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## **Abbreviations**

ASEAN	Association of Southeast Asian Nations
BENCH	Beneficial Business Contacts between the Central Baltic Region and China
CEO	Chief Executive Officer
EU	European Union
EVP	Executive Vice President
FECC	Finnish Environment Cluster for China
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IPR	Intellectual Property Rights
JV	Joint Venture
MNC	Multinational Company, sometimes also referred to as MNE (Multinational Enterprise)
NAFTA	North American Free Trade Agreement
PRC	People's Republic of China
RBV	Resource-based View
TEKES	The Finnish Funding Agency for Technology and Innovation
TEKEL	The Finnish Science Park Association
TCA	Transaction Cost Analysis
WFOE	Wholly Foreign Owned Enterprise, sometimes also referred to as WOFE (Wholly Owned Foreign Enterprise)

WOS Wholly Owned Subsidiary

WTO World Trade Organization



## **1. INTRODUCTION**

This chapter is an introduction to the study. It consists of the description of background of the study and represents research questions and objectives. Then, the main definitions are explained and abbreviations listed. Next, the chapter defines the limitations of the study and introduces the methodology used in the empirical part of the research. Finally the theoretical framework of the study is illustrated and the structure of the study is presented.

### **1.1. Background of the study**

The fast economic growth of China has continued for three decades even though recent problems in the world economy are challenging its economic development. The background for the long-term and rapid growth has been the “Open Door Policy” from the end of 1970s and the fast growth of foreign trade and international investments following that especially in the coastal areas. According to Kettunen et al. (2008, 1), China has become the world factory which even Asia’s financial crisis in 1997 did not prevent. During the worldwide financial crisis in 2008 China remained its fast economic growth due to recovery package. (Suomen Pankki 2011, 2) In 2003 China became the biggest target country for foreign investments leaving the United States behind. The major investors in addition to expatriate Chinese were Japanese, US, Korean and German enterprises. Most of the investments have been targeted to manufacturing industry. (Kettunen et al. 2008, 1; Fei 2011)

Currently China is continuing to strengthen intellectual property protection and improve the business environment for foreign firms which are entitled

to the same treatment as their Chinese counterparts. China Vice Premier Li Keqiang stated in China daily on January 2011 that China will continue to improve foreign business related laws, regulations and policies and give protection to IPR in order to provide a level playing field and a stable, orderly, transparent and predictable market environment for all players. (Fung 2011, 8) He also noted that to develop its service sector China will further open financial and logistics services and steadily open up education, health services and sports to foreign investment. China is aiming to strengthen its ties with EU which is its biggest trade partner.

The importance of Finnish enterprises in China's business activities remained modest for a long time regardless of the tripartite agreement and clearing trade which was practiced since 1950s. Larger Finnish enterprises began their market entry to China after 1980s and they expanded similar activities to the other parts of Asia at the same time. In the end of 1990s Finnish companies rushed to China and the investments were mainly targeted to coastal areas where both the number of companies and the value of investments have been growing steadily. In 2008 approximately 260 Finnish companies were functioning in China especially in the fields of workshop, electronics and ICT. Finnish investments had grown to 7 billion € and the companies were employing over 40 000 employees in China. (Kettunen et al. 2008, 1)

Currently the biggest Finnish employees in China are Nokia, Elqotec and Salcomp and the amount of new companies entering China is growing approximately 10 per year. The vast amount of Finnish companies is functioning in Beijing, Shanghai, Hong Kong and the area of Pearl River Delta. (Finpro 2010, 19)

## 1.2. Research questions and objectives

In this study, the focus is on Finnish companies since the study is made in Finland, but most likely information yielding from these companies may partially be applied to other foreign companies, too. The purpose of the study is to compare different entry mode strategies Finnish SMEs have used in internationalization of their businesses to China. The goal is to understand the relevance of the entry mode choice related to the internationalization process and to evaluate how well it suits to the Chinese business environment.

Research question:

- *What types of market entry patterns Finnish SMEs use in China?*

Sub questions:

- *Which factors affect Finnish SMEs in their market entry mode decision concerning their internationalization to China?*
- *Have Finnish SMEs switched or combined their market entry strategies after entering China?*

### 1.3. Definitions

#### *Market entry patterns*

The concept of market entry relates to the ease or difficulty with which a firm can become a member of a group of competing firms by producing a close substitute for the products they are offering. Successful entry depends on a number of factors. These include how the firm uses information about opportunities for profitable market entry, accesses productive resources, accesses markets and overcomes market entry barriers. (Bradley 1995, 323-324) Luostarinen & Welch (1990, 256) define term pattern as following: "An internationalization pattern for a particular firm might be measured in terms of a particular target country or by summing the patterns for all countries in which it is involved so that an overall company pattern might be obtained. The summation of this could then be carried through to a country or global level. "

#### *SMEs*

The definition by European Commission is applied in this study. Small and medium-sized enterprises, hereinafter referred to SMEs, have fewer than 250 employees and have either an annual turnover not exceeding ECU 50 million or an annual balance-sheet total not exceeding ECU 43 million and conform to the criterion of independence. (European Commission 2005)

#### *Internationalization*

Internationalization of the firm is a process in which the firm gradually increases their international involvement. Within the frame of economic and business factors, the characteristics of this process influence the pattern and pace of internationalization of firms. Internationalization theory (Johanson & Vahlne 1977, 23) builds upon the incremental process of a

firm's experiential learning in foreign markets to explain incremental accumulation of commitment to foreign markets.

#### **1.4. Delimitations**

The focus in this study is on Finnish SMEs and their market entry choice when entering the Chinese business environment. The main delimitation of the study is that it does not cover all the industries Finnish SMEs are functioning in Chinese market. The main idea is to concentrate on few companies which represent the most interesting and wanted industry fields of Finnish SMEs for the Chinese market. The purpose is to give a description of entry modes and analyze the market entry patterns Finnish SMEs have used in China; whether they have changed the entry mode or combined different modes in order to meet the needs of the Chinese market and implement the best possible strategy related to their industry field.

The purpose of the study is not to describe all the aspects of different entry mode choices but to give an idea of each one of them as an option and compare the functionality of them with the Chinese business environment. In addition, the study does not cover all the potential business areas in China.

#### **1.5. Methodology**

Qualitative research is a methodology which consist data of detailed descriptions of the situations, events, people, interactions and observed behaviors. It includes direct quotations from people about their experiences, attitudes, beliefs and thoughts and excerpts or entire

passages from documents, correspondence, records and case histories. The detailed descriptions, direct quotations and case documentation of qualitative measurement are raw data from the empirical world and it is collected as open-ended narrative without attempting to fit peoples' experiences into predetermined or standardized categories such as ready response choices. To sum it up, qualitative data provides depth and details which emerge through direct quotation and careful description. (Patton 1980, 22)

This study is a semi structured qualitative research of five Finnish SMEs from different industry fields operating in China. Additionally, one company from the pharmaceutical industry field was interviewed to compare the patterns of the other company in the same industry field. The study is conducted both via e-mail questionnaire and by recorded telephone interview. The respondents are representatives (three CEOs, one owner, one manager of Chinese business operations and one CVP responsible of China project origination and management) of Finnish SMEs which are already operating in China. Companies are selected based on the recent literature about the Finnish industry fields China is interested in to gain knowledge and expertise from. Companies included in the study are an architect office, two pharmaceutical development companies, an ICT company, a plastic mechanics company and a clean tech company. The respondents received a questionnaire via e-mail beforehand in order to familiarize with the questions and prepare for the answers. The timing for recorded Skype interview was agreed via e-mail and implemented later on.

The questionnaire (see Appendix 1) consists of the preliminary questions which include the industry field the company is operating in, the amount of personnel in the company, turnover in 2010, position of the respondent in the company, the year company entered China, the area of China the

company is operating in and international experience before entering China. The purpose is not to mention the name of these companies in the study and therefore to be able to receive more reliable information about their operations in China without revealing specific competitive information and focusing on the market entry choice and how it was carried out. The main questions are consisted in a way that the respondent can freely answer to them according to the experiences and their pre-requisite knowledge about the subjects. In case the answers were too short, unreliable or unclear, the respondents were asked to explain the answers more specifically.

### **1.6. Theoretical framework**

Theoretical framework of this study is presented in this chapter. The figure 1 introduces the main aspects of the study and how they are related to each other. The framework is adapted from the mode decision making model and method choice model presented by Welch et al. (2007, 438, 442) It is build by three different areas of subjects which ultimately have an effect on the entry mode strategy.

The factors which have most effect on mode strategy in company's background are the size and industry field the company is operating in, both its international and market experience and its existing resources. Company mode concerns include risk and uncertainty (see pages 12-16), profitability and partners and intermediates. The issues influenced by Chinese market consist of market conditions, government (see pages 17-18 & 23-24) and the way of doing business. Market conditions are the size of the market, competition and growth. Government-related issues include legislation, taxation, bureaucracy and corruption (see pages 23-25) whereas the way of doing business refers to the culture and networking (see pages 21-23). These different aspects have an impact on the entry

mode strategy chosen by a foreign company in their internationalization process to China. However, the entry mode actions in the framework include implementing the same chosen strategy, combining different modes or changing the mode strategy completely (see pages 37-42).

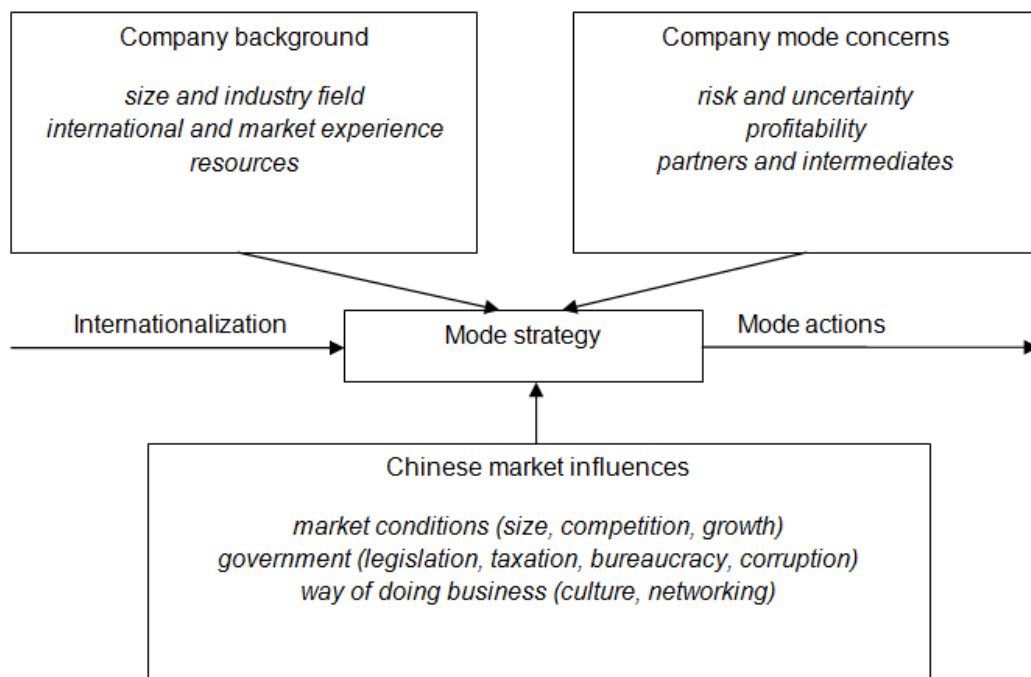


Figure 1 Theoretical framework of the study

### 1.7. Structure of the study

The study begins with a literature review in chapter 2. It consists of the theoretical background of the study introducing the most commonly used perspectives to market entry patterns by different scholars and description of the internationalization process of SMEs in China. The next part of the



chapter 2 describes the characteristics of Chinese business environment including China as an opportunity and challenge, guanxi and trust, the role of government and bureaucracy, corruption and overcoming the barriers and dealing with the challenges in China. The final part of the literature review introduces the market entry patterns of SMEs in China. It describes different entry mode choices, estimates the choice of market entry strategy and strategies of switching and combining methods.

The chapter 3 depicts the internationalization process of Finnish companies to China throughout different eras. It also evaluates the current status and future of Finnish SMEs in China.

Research method and case selection process are introduced in the first part of chapter 4. The second part of the chapter includes descriptions of the cases featured with within-case analysis in which the cases are evaluated and discussed separately. Cross-case analysis between the cases is implemented in the third part of the chapter.

The fifth and final chapter includes discussion and conclusion. It is consisted of the summary of major findings, managerial implications and finally limitations and suggestions for further research.

## **2. LITERATURE REVIEW**

A large number of theories have been used to explain the entry mode decision. According to Brouters & Hennart (2007, 400) the most commonly applied theories are transaction cost analysis (TCA), the resource-based view (RBV), institutional theory and Dunning's eclectic framework.

The first part of this chapter gives an insight of these theories as a theoretical background for descriptions of different entry mode options. The internationalization process of SMEs in China is examined in the second part of the chapter. The third part of the chapter describes the characteristics of Chinese business environment in relation to the opportunities and challenges, networking (guanxi) and trust, the role of government and bureaucracy, corruption and provides ways of overcoming these challenges. Finally, the market entry modes are introduced including the mode choice, switching and combining strategies.

### **2.1. Perspectives to market entry patterns**

Welch et al. (2007, 3) argue that foreign operation methods and their choice, use, management and change represent a critical component of international business activities. The issue is now recognized by researchers, lecturers and practitioners as basic to any discussion about companies' international business strategies and performance.

Over the period from the late 1950s there has been a growing interest in the internationalization process of firms. Gradual development in the area can be seen related to the research material found of the subject. Over the

time e.g. Dunning (1958), Johanson & Wiedersheim-Paul (1975), Johanson & Vahlne (1977), Luostarinen (1979), Luostarinen & Welch (1990), Erramilli (1991), Welch et al. (2007) and Benito et al. (2009) have presented theories shifting from the decision to export to more longitudinal approach, namely internationalization process.

### **2.1.1. Transaction cost analysis (TCA)**

TCA is the most widely used theoretical perspective in international entry mode research. It argues that managers suffer from bounded rationality whereas potential partners may opportunistically act if given the chance. Bounded rationality is the assumption that decision makers have constraints on their cognitive capabilities and limits on their rationality. (Brouthers & Hennart 2007, 400; Rindfleisch & Heide 1997, 31) In TCA framework, three factors are hypothesized to influence decision: asset specificity, uncertainty and frequency.

Brouthers & Hennart (2007, 400) claim that asset specificity is a central explanatory variable in most of the studies related to TCA. Asset specificity occurs when suppliers or customers have to make investments which are specific to the buyer. These investments expose them to have other party to alter the price of the product – a situation called holdup. In order to avoid holdup, the parties will draft a contract that specifies the price of the product for the useful life of transaction-specific investments.

Although the concept focuses on vertical investments, other entry mode scholars have used the concept to explain horizontal investments. Horizontal investments refer to investments which are made to exploit in one market knowledge or reputation developed in another. In the case of knowledge, the choice is between licensing and integration and that

licensing is chosen when asset specificity is low and integration is chosen when it is high. (Brouthers & Hennart 2007, 401-402) Williamson (1985) distinguishes that there are at least four different types of asset specificity; site, physical, human and dedicated asset specificity. Site specificity refers to the natural resource available at a certain location movable only at great cost whereas physical specificity is related to a specialized machine or complex computer system designed for a single purpose. According to Williamson, human specificity refers to highly specialized human skills whereas dedicated specificity is a discrete investment in a plant that cannot readily to be put to work for other purposes. Ultimately asset specificity only takes on importance in conjunction with bounded rationality or opportunism and in the presence of uncertainty. (Williamson 1985, 52-56)

The second main TCA variable, uncertainty, is divided into external and internal. External uncertainty makes it difficult to specify in advance all possible contingencies in a contract whereas internal uncertainty makes it difficult to verify performance later. Based on TCA framework, uncertainty makes contracts inefficient and exposes parties to holdup. On the other hand, if there are many potential buyers and sellers, switching costs are low and both types of uncertainty favor the market. External uncertainty is constructed by market-specific factors such as country risk and cultural distance and is measured using i.e. country risk index and the dimensions of culture initially identified by Hofstede. Internal uncertainty is thought to be lower if the MNE has more international experience and is often measured using i.e. number of years of worldwide experience, number of foreign investments and number of years presence in a host country. (Williamson 1985, 56-60)

Frequency, the third variable in TCA, is seen as affecting the boundary decisions of a firm. It refers to the choice between using market

contracting and integrating transactions within the firm. Although contracts use pre-existing reinforcement mechanisms, such as the courts, integration requires firms to craft their own enforcement mechanism. The review presented by Brouthers & Hennart (2007, 404), indicates that regardless of the wide amount of transaction cost-based studies, there is still room to improve the knowledge and application of TCA to the entry mode choice decision.

### **2.1.2. Resource-based view (RBV)**

The resource-based view suggests that firms develop unique resources which they can exploit in foreign markets or use foreign markets as a source for acquiring or developing new resource-based advantages. Originally, entry mode choice based on experience initialized from the internationalization theory by Johanson & Vahlne (1977) and scholars have suggested that over time firms gain experience in foreign markets and therefore move from simple exporting operations to more complex organizational structures such as JVs and WOSs. Erramilli (1991, 479) examined the length and scope of a firm's pre-entry international experience and how this experience influenced on the entry mode choice. In his study, Erramilli (1991, 496) found out that low levels of experience and greater experience lead to the use of full control modes whereas intermediate levels of experience were related to the market-based modes.

### **2.1.3. Institutional Theory**

According to Brouthers & Hennart (2007, 405-406), institutional theory suggests that a country's institutional environment affects firm boundary choices. They examined five types of risks of uncertainty: product,

government policy, macroeconomic, materials and competition. Findings of the study indicate that each of these risk or uncertainty types were important determinants of entry mode choice. The study has helped to understand the differences in institutional environments between home and host countries and how these differences might influence to the entry mode decision.

#### **2.1.4. Eclectic Framework**

Eclectic or OLI (ownership, location, internalization) framework by Dunning (1993, 76) is among the most frequently applied perspectives in international entry mode choice studies. The three components in the framework are ownership or firm-specific advantages, location advantages and internalization advantages. The framework can be conceptualized as a tool that combines insights from resource-based (firm-specific), institutional (location) and transaction cost (internalization) theories. Dunning's (1993, 79-81) eclectic framework of foreign direct investment as applied to entry mode choice suggests that firms will select their entry mode strategy by considering three different types of advantages. First of all, ownership advantages are concerned with the control issue, the costs and benefits of inter-firm relationships and transactions. Secondly, location advantages are concerned with the resource commitment issue, the availability and cost of resources. Thirdly, the internalization advantages are primarily concerned with reducing transaction and coordination costs.

#### **2.1.5. Uppsala model**

In their early study of internationalization, Johanson & Wiedersheim-Paul (1975, 307) examined the internationalization process of four Swedish

case firms. The Uppsala model suggested that there are four different stages of development of a firm in individual country. These are

- 1) No regular export activities
- 2) Export via independent representatives (agent)
- 3) Sales subsidiary
- 4) Production/manufacturing

Johanson & Wiedersheim-Paul (1975) consider these stages to be important because they are different with regard to the degree of involvement of the firm in a market and they are often referred to by people in business. They call the sequence of these stages as the establishment chain. However, the development is not expected to always follow the whole chain. There can be jumps in the establishment chain if a firm has extensive international experience from other foreign markets and several markets are not large enough for the resource demanding stages.

Ojala (2008, 136-137) argues that the Uppsala model suggests that indirect entry modes increase firm's knowledge about the target country and allow it to learn about how to deal with the customers in that country. Once the country has become more familiar for the firm, direct operations can be established. The firm might establish a sales subsidiary which requires more knowledge and commitment to the target country compared to indirect entry modes. During the fourth stage, a firm may start production or manufacturing activities in the market. However, the model does not include joint venture operations or partnering which also require intermediate level of knowledge and commitment.

Psychic distance may be useful concept in considering the extension of activities to new markets. The concept is defined as factors which are

preventing or disturbing the flows of information between a firm and market. Such factors are differences in language, culture, political system, level of education, level of industrial development etc. Psychic distance is often correlated with geographic distance and it changes because of the development of the communication system, trade and other kinds of social exchange. In addition to psychic distance, the size of the potential market is often considered the most important factor in international operations. (Johanson & Wiedersheim-Paul 1975, 307-308, Ojala 2008, 136)

## **2.2. Internationalization process of SMEs to China**

Bradley (1995, 116) argues that once the decision to grow through internationalization has been made, it is necessary to determine the international marketing resource allocation which should be adopted to achieve the required critical mass. For an SME going international for the first time from a small home market, a reasonable span for a concentration strategy would appear to be two or three markets. (Bradley 1995, 116) The smaller the firm and the more limited export experience it has the greater are the benefits from using a similar strategy based on existing products in the domestic market. Cheng (2008, 2007) adds that the international developing opportunities and resource limitations of SMEs domestic market often drive them to invest in international markets. The appropriate route to internationalization of SMEs suggested by Bradley (1995, 118) is in the pre-export stage. Successful company exploits domestic market opportunities to build up company resources and focuses on developing a high-capability, broadly based management team and an efficient integration of the business system for a small number of products.

SMEs are an important economic sector in all over the world because they account for 80 % of global economic growth. SMEs also contribute a substantial share of the manufactured exports of East Asia; in China the



figure is over 40%. (Singh et al. 2010, 54) Since China started to reform in 1979, private businesses were allowed to set up but the government and society were anxious about negative consequences of capitalism such as unfair and unjust treatment of employees in case private businesses grew enough to replace state-owned companies. (Zhu et al. 2005, 243) However, the 20 years experience of reformation has confirmed that the free enterprise system is capable of contributing greatly to China's development and to a stable society. In 2002, The Chinese Central Government realized that in maintaining market competition, creating job opportunities, increasing fiscal income, promoting technology innovation and initiating entrepreneurship SMEs are playing a significant role. Therefore China's governments at all level announced a series of policies to promote the growth of SMEs in 21<sup>st</sup> century.

Today SMEs are dominating most industrial sectors in China with over 70 % of the gross output value of the food, papermaking and printing industries and over 80% of value in the garment tannery, recreation, sports outfit, plastic and metalwork industries and over 90 % in the wood and furniture industries. In foreign trade and exports, the total export value of China in 2003 amounted over USD 430 billion and China was ranked fourth in the world in the total import and export values in 2003. In science and technological innovation, SMEs in China have achieved great progress in technological innovation to become the driving force behind the spread and application of new technology and innovation. (Singh et al. 2010, 56-57)

Zhu et al. (2005) studied the environmental conditions effecting to the growth of SMEs and their major difficulties in business development in the western part of China. Their study indicated that most SMEs are profitable since great business opportunities existed in China and therefore SMEs could switch to other industries with less costs and risk compared with

large state-owned enterprises. In addition, the results of the study showed that an important factor for success of SMEs is to increase the market share and realize the product with exchange in China. On the other hand, the major factor for the failure of business was the lack of capital and funds. This is due to the strict rules for private companies to raise funds from public or to get loans from bank. (Zhu et al. 2005, 251)

Singh (2010, 58) notes that Chinese government has focused on improving the operating environment of SMEs in the mid 2000s. The Chinese SMEs Promotion Law in 2003 was a milestone in policies and laws specific to SMEs. According to the law, the government would support SMEs actively, improve the quality of service for SMEs, create an environment where enterprises could compete fairly and promise to encourage the development of SMEs with more effective policies especially in the fields of finance and taxation.

In case SMEs are choosing foreign direct investment (FDI) as an internationalization mode, Cheng (2008, 208) reminds that in order to cater such needs, many integrated economic regions such as NAFTA, EU and ASEAN are making it easier for an SME to operate within these economic zones. Consequently, SMEs will be more and more flourishing all over the world based on their competitive advantages in flexibility and speed.

### **2.3. Characteristics of Chinese business environment**

Valovirta et al. (2007, 12) claim that there are several on-going processes in globalized world economy which create pressures in internationalization of Finnish business and innovation activities. The dependence of companies of global markets is growing as economical activities are

integrating into world-wide production networks in more and more open markets. Most of these changes are reflected into the opportunities and challenges which the rapid growing Chinese economy is setting up for the Finnish economic life, innovation activities and society. This chapter discusses the factors which make China an opportunity as well as a challenge for foreign companies in the world economy.

Cateora & Ghauri (2000, 194) list the fundamental issues that has to be taken into consideration by anyone doing business in China. First of all, because of China's size, diversity, political organization and the return of Hong Kong to China, it is better to regard it as a group of seven regions rather than a single country. Each region is at a different stage economically and has its own investment patterns, taxation and links to other regions as well as to other parts of the world. Therefore there is no one single growth strategy for China. Secondly, distribution, manufacturing, banking, transportation and other infrastructure segments of business are out of date and inefficient. (Cateora & Ghauri 2000, 194) For example, the traditional distribution system for over-the-counter drugs consists of large local wholesalers divided into three levels. First level wholesalers supply drugs to major cities such as Beijing and Shanghai, second level ones service medium-sized cities while the third level distributes to counties and cities with a population of 100 000 people or less. Therefore it can be profitable for a company to sell directly to the two top-level wholesalers and leave them to sell to the third level which is so small that it would be unprofitable for the company to seek out. (Cateora & Ghauri 2000, 345-347)

### **2.3.1. China as an opportunity and challenge**

According to the latest economical figures, China replaced Japan as the world's second biggest economy in 2010 after the United States.

(Nieminen 2011; Kauppalehti 2011c, 15) This was due to the weak consumer demand in Japan in 2010. Even though economists claim that Japan's economy will recover during 2011 and reach its former place, the fact that China will eventually become the world's largest consumer market makes it an unmissable opportunity. (Torrens 2010, 1; Taulamo 2011)

Torrens (2010, 1) lists that there are about 480 Fortune 500 companies which already operate in China and more than 90% of multinational companies say that China is important to their strategies, with 52% calling it critical for them. The combination of low-cost manufacturing, modernizing infrastructure, increasingly standardized tariffs, political stability and attractive consumer market are making China one of the best options in the world for sourcing operations. While other markets offer cheaper manufacturing costs, they fall down on supply chain costs and security compared to China. The rapidly opened, fast growing and potentially huge markets are offering significant opportunities for foreign companies to create new business activities. (Valovirta et al. 2007, 12)

Kivelä (2011) reminds that even though one of the biggest challenges in China is currently related to transportation, on the other hand the country is investing strongly on infrastructure. In addition, the minimum wages are rising in the eastern provinces which are making the western provinces more attractive to foreign companies. At the time, 27% of the inhabitants are living in western provinces but their quota of the consumption is only 17%.

### 2.3.2. Guanxi and trust

Networking is a complex phenomenon which can be approached meaningfully only in relation to particular economic, political, social, historical and cultural context. Although every society is built around patterned relationships among individuals, groups and organizations, personal networks are predominant in most emerging markets. (Michailova & Worm 2003, 509) Confucian societies are some of the most relationship-focused societies in the world. Establishing and nurturing connections has been pivotal to business success in all Confucian societies. The need for personal networks in China has increased due to the fact that China has been ruled by a communist party for the last 50 years and has a planned economy for most of this period.

Guanxi describes the personal networks that underpin all business relationships in China. Michailova et al. (2003, 510) describe guanxi networks as transferable, reciprocal, intangible and utilitarian. Torrens (2010, 17) states that guanxi combines other social behaviors including “face”, the emotion of personal interaction and sentiment and the moral duty inherent in maintaining a relationship. The business relationship which is implicit in guanxi requires mutual co-operation by each party associated within. This kind of co-operation is personal and cannot be transferred to other people.

According to many authors and multiple researches (e.g. Michailova & Worm 2003), there is a widespread belief among Chinese that to succeed in business in China, personal networking and social connections with the appropriate authorities or individuals are often more important than the price and quality of the product or service or the technological expertise offered. Chinese invest serious effort and considerable time in building personal relationships but these investments only pay off in case the

relationship can be sustained over a longer period. Since guanxi is based to a great extent on trust, China provides a distinctive context for research on trust. Child & Möllering (2003, 69) argue that among emerging economies China is the most important destination of direct investments by foreign companies. This statement lends a practical significance to the degree of trust that the managers of those companies can invest in local personnel.

Chinese culture is often noted for its particularism and insistence on building up trust through cultivating personal relationships into which it is difficult for foreigners to enter. A study conducted by Child & Möllering (2003, 69) suggests ways of overcoming the barriers that managers of the foreign companies are facing in reaching trust. The focus of their study is in the notion of active trust development which concerns the innovative ways in which foreign managers can seek to build trust with Chinese partners and personnel in a context where they cannot yet benefit from the close personal relationships. Based on Child & Möllering's analysis, there are three unique strategies in overcoming the barriers of trust. These are establishing personal rapport with the staff of operations in China, recruiting local managers and attempting to substitute company's own micro institutionalization for the lack of foundations, through importing its familiar practices, rules and standards into its cross-border operations. (Child & Möllering 2003, 72-73)

The results of the study done by Child & Möllering (2003) indicate that contextual confidence variables are consistent predictors of trust. Trust in local personnel tends to be higher when the legal system in China is seen to provide an effective system of support for transactions and where there is a low level of arbitrary behavior by government officials. The findings of the study hold important implications both for Chinese government policy makers and for managers and investors dealing with China. Chinese

authorities should feel encouraged to strengthen their efforts in building effective institutions and rooting out corruption and therefore increase the trust of investors towards their Chinese colleagues. On the other hand, investors and foreign managers are urged to commence or reinforce active trust development initiatives instead of pointing at the current inadequacies of Chinese institutions. (Child & Möllering 2003, 76-78) To sum it up, the findings of the study give clear evidence that developing personal rapport and transferring business practices will ultimately increase trust in Chinese business environment.

### **2.3.3. The role of government and bureaucracy**

Although market reforms have opened the way for private businesses, the Chinese government and bureaucracy are still main concerns in most business activities. Both foreign and domestic companies in China have been continuously complained of the interference of government in business activities. (Blackman 2001, 26) China's tax collection system is uncoordinated because there is no centrally managed processing mechanism. Instead, provincial governments collect taxes on behalf of the central government. Even though the concept of equal treatment was introduced in the tax system in 1994, it has not been implemented yet. Because of the inconsistency of taxation system, foreign companies have to apply local government taxes and regulations into their forecasts and projections in China. More surprisingly, taxes are administrated by a quota system and they are not imposed on all enterprises as would be expected by Western managers.

Blackman (2001, 27) argues that foreign investors must deal with local governments whose officers exercise discretion in interpretation of central laws and regulations. Blackman (2001, 27) notes that in practice this means that foreign investors who have ventures in several cities may find

each venture subject to different regulations and interpretations. Laws are broadly drafted at the central level but rulemaking and implementation based on those laws are left to the lower levels of bureaucracy.

Chinese bureaucrats are often described by Western business people as risk-averse. The result of such a behavior is that decisions are postponed or passed up the hierarchy. Bureaucrats make their decisions based on rule books and if an issue is not according to the rule books, bureaucrat becomes personally responsible about it in case problems occur later on. In addition, the Chinese bureaucracy is highly personalized meaning that the officials rarely give information freely to those with whom they do not have good personal relationships. (Blackman 2001, 30)

#### **2.3.4. Corruption**

Like other emerging markets, China suffers from official corruption and financial crime. The way it differs from the others is the scale of the bureaucracy and the pace of economic development from a low base – both of which have created conditions ideally suited to the growth of corruption and opportunities for massive financial gain by underpaid local government officials. Corruption and anti-corruption has become a debated issue in China, both among scholars as well as common people. The authorities of China define corruption as the “abuse of public power by occupants of public office”. (Torrens 2010, 144-145)

Changzheng (2010, 58) reminds that the roots for corruption in China can be traced back thousands of years and it is historically a part of daily life. Even though it has existed for long time most people, including the State and Party leaders, didn't suppose that it would spread so rapidly and become so serious. Despite of the hatred towards corruption, its



prevalence has resulted in two defeatist attitudes: pessimistic resignation that there is nothing that can be done and that corruption is actually an efficient mechanism to smooth the path to development.

The increasingly serious corruption situation in China today has caused wide social dissatisfaction and outcry. Great effort has been made and various measures have been taken to prevent the situation from worsening. The outbreak of high-level corruption scandals prompted Communist Party of China, the CPC's Central Committee to launch a five-year anti-corruption plan focusing on preventative measures including educating and supervising officials and improving the judicial system. (Torrens 2010, 147)

### **2.3.5. Overcoming the barriers and dealing with the challenges in China**

Heikura (2003, 114) emphasizes that the person representing his company in China must be China-minded. By this Heikura means that the person has to be able to show interest towards Chinese history and culture outside of the business context. He claims that personal networking is as important in today's China as it was during the Cultural Revolution. Patience is needed but it can be rewarded. Those Finnish companies which entered China in the 1950s are still functioning there and have been able to develop quite successful businesses.

Blackman (2001, 27) offers some guidelines for dealing with the bureaucrats in People's Republic of China. According to Blackman, Western managers should accept differences in the procedures and discuss about the regulations with different authorities. They should also recognize that Chinese officials may find it frustrating to deal with non-

Chinese-speaking foreigners but still try to make personal approaches to people with a status in the hierarchy.

Kivelä (2011) defines the keys for success in Chinese business environment. These include successful marketing and segmenting, focus on pricing, building geographically proper distribution channel and its structure and emphasizing on branding rather than product. Saarela (2011) adds that the competition between both domestic and foreign companies is becoming extremely tough and hard work has to be done to be successful and grow in China. The companies with best innovations are more likely to succeed. Investing in competent personnel is crucial.

Saarela (2011) reminds that the level of English language skills varies in China. Therefore all the agreed issues in negotiations should be repeated and it should be ensured that the interpreter understands the whole concepts. Chinese negotiations often consist of many people and one should figure out who really is the decision maker in the group. The Chinese are hard working and they have different holidays so the contact may turn up in unexpected time. Answering to e-mail etc. in negotiation situations is expected to happen in a short period of time and deliveries are expected to start fast. There has to be always an honorable way out of every situation without "loosing face" and it is wise to practice different situations beforehand. In order to avoid problems with custom and government, it is important to find out in advance which kind of certificates and testimonials the product of one's company needs. Chinese dine three times in a day and the relationships are formed during the dinner. Saarela (2011) sums up that networking is the key to success in China.

## **2.4. Market entry patterns of SMEs in China**

In a study of 1006 Finnish manufacturing firms with foreign operations of any type, Luostarinen (1979, 122-123) found out that 98% had used non-investment marketing operations such as direct or indirect exports as their first operation abroad; 64% had used direct investment marketing operations like sales or marketing subsidiaries as their second operation method; non-investment production operations such as licensing, contract manufacturing etc. were used by 44% as their third operation mode and 60% used direct production investments as their fourth market entry mode. The research revealed a process of evolutionary development not only in terms of the depth of operation mode but also in terms of the diversity of modes used, as well as in product offerings and the range of markets penetrated.

This chapter introduces different entry mode strategies based on the division by Welch et al. (2007). While some researchers divide entry modes by equity and non-equity modes, Welch et al. (2007) classify the modes as contractual, exporting or investment modes. Contractual modes, for instance, include franchising, licensing, management contracts, international subcontracting, project operations and alliances. Exporting modes consist of own sales office or subsidiary and indirect or direct exporting. Investment modes, on the other hand, include 100 % owned, majority share, minority share and 50/50 share. In this chapter different entry modes based on the categorization by Welch et al. (2007) are introduced and reflected to Chinese business environment and SMEs operations.

## **Exporting**

A company might decide to enter the international markets by exporting from the home country. Exporting represents one of the main mode options used to achieve international market penetration because it's the easiest way and the risks of financial loss can be minimized. (Welch et al. 2007, 237; Terpstra & Sarathy 1994, 260) Exporting is most commonly used by companies particularly in the field of manufacturing and those in the agricultural and mining sectors. In a study of Finnish manufacturing SMEs, it was found that almost 96% began outward international operations via non-investment marketing operations which basically mean exporting. (Welch et al. 2007, 239)

Exporting is divided into three main modes: indirect, direct and own export. Indirect export exists when the manufacturing firm is not taking direct care of exporting activities. It is mainly used in the beginning of the internationalization process since it is costly, it blocks the information flow and it can be inactive. Direct export, on the other hand, is applied when the producing firm takes care of exporting activities and is in a direct contact with the first middleman in the target country. It demands international business knowledge and greater financial resources. Own export is used when there is no domestic or foreign middleman between the producer and final customer. (Luostarinen & Welch 1990, 20-28)

Generally, early motives for choosing exporting are to skim the cream from the market or gain business to absorb overhead. Terpstra & Sarathy (1994, 261) agree that even though such motives might appear opportunistic, exporting is common form of operating in international marketing. Exporting is often chosen if the company is small and lacks the resources required for foreign joint ventures or international direct investment. (Luostarinen & Welch 1990, 22) The other reasons for choosing exporting as an entry mode is a situation if there is no political or

economic pressure to manufacture abroad and substantial commitment is advisable due to political risk or uncertain or otherwise unattractive markets. (Bradley 1995, 350-351) In China, the entry to WTO offered possibility for foreign companies to export in China but it also allowed the kind of competition Chinese economy has not experienced before. (Ho 2007, 21)

### **Licensing**

Licensing is a foreign operation mode that covers a wide range of activities, users and diverse roles. The span of users extends from individual investors to large multinationals utilizing licensing within a broad mix of modes. As in the case of franchising, both licensees and licensors have played an active part in the development of a vibrant international market for licensing deals. According to Welch et al. (2007, 94) and Luostarinen & Welch (1990, 31), licensing is an important means of penetrating foreign markets and it covers far more than technology including commercial rights to use famous names, symbols and entertainment vehicles.

Luostarinen & Welch (1990, 31-32) define licensing as a contractual transaction in which the owner of certain knowledge assets, intellectual or industrial property, sells to another organization or individual the right to use these assets for a defined purpose. However, the licensor does not give up ownership under the licensing arrangement. Instead, ownership may be established by legal means, through the registration of the form of intellectual property; whether the form is patent, trademark, design or copyright. Nevertheless, most of the intellectual property, or know-how, is non-registrable.

Sometimes licensing is used for physically and/or culturally distant markets. I.e. some Finnish firms which are in the development or growth stage of internationalization have sold licenses to Indian, Mexican and Japanese markets which are perceived to be full potential but physically too remote. (Luostarinen & Welch 1990, 45)

### **Franchising**

Franchising is a rapidly growing form of licensing in which the franchiser provides a standard package of products, systems and management services whereas the franchisee provides market knowledge, capital and personal involvement in management. (Terpstra & Sarathy 1994, 262) The advantage of franchising is that the combination of skills permits flexibility in dealing with the local market conditions and yet provides the parent firm a reasonable degree of control. The franchiser can follow through on marketing of the products to the point of final sale. Therefore franchising can be regarded as an important form of vertical integration. Franchising system can provide an effective blending of skill centralization and operational centralization and it has become an increasingly important form of international marketing. Terpstra & Sarathy (1994, 263) divide franchise agreements into three distinctive types used by franchising firms: master franchise, joint venture and licensing. The master franchise is the most common type used in more than half of the international franchises. It gives the franchisee the rights to a specific area with the authority to sell or establish sub franchises.

Shaw (2004, 27-29) claims that franchising is becoming a welcomed business strategy in China since it joined WTO and hence dismantled the barriers of global trade opening up opportunities for franchising. She adds that now is the time for franchise companies to cautiously consider franchising in China because it brings an advanced and systematic managing concept to China. This concept includes rich business

experience combined with acute market position and forecast, unique cultural background, correct brand decision, strategic direction, centralized quality control and training system. However, Shaw (2004, 29) reminds that franchising in China requires a tremendous commitment and there are key elements which are absolutely necessary for success as China is still an emerging market. These fundamental issues are a strong brand, a successful business format, solid franchise experience that can be taught, enough resources to support a master franchisee, a concept that will be accepted and utilized by Chinese, a master franchisee that has an extensive background in business and a large network and a master franchisee that is willing to work diligently to build the brand.

### **Management contracts**

Welch et al. (2007, 139-140) argue that management contracts are probably the least researched foreign operation method used by companies. Management contracts are long-term managerial involvement about running a foreign organization or a part of it on a contractual basis for a set period of time. They are often confused with management consulting which typically involves the provision of management advice but without a direct managerial role. They are also distinguished from franchising and licensing since they involve not just selling a method of operating a particular business but require the contractor to undertake the implementation process within the foreign organization. As a result, the contractor has more direct control over transferring know-how, foreign business activities and the final outcomes generated by the client organization. Management contracts are frequently used in association with other modes. For example, FedEx negotiated a management contract with its 50:50 joint venture partner in China in 1999. Prior to this arrangement FedEx had used a representative office and agents and the management contract was made to ensure daily control of the operation. Therefore management contract has a subsidiary role to the main mode, joint venture. (Welch et al. 2007, 150-151)

### **International subcontracting**

The potential of international subcontracting has tended to be viewed most strongly in terms of its contribution to the overall cost reduction rather than its ability to enhance the development of international operations. According to Welch et al. (2007, 162-163), international subcontracting can be defined as covering all export sales of articles which are ordered in advance where the giver of the order arranges marketing. In other words, the subcontracting activity means that the principal arranges for an activity are undertaken by another party in a foreign location. Kauder (1982, 37) argues that Chinese companies can benefit from subcontracting as do foreign firms that subcontract in the People's Republic of China; while parts are manufactured cheaply in Chinese plants, Chinese gain profits and technological knowledge. Therefore foreign firms can develop and maintain good relations with Chinese authorities which may lead to long-term access to Chinese market. On the other hand, many foreign firms cite poor quality and quality control to be the biggest disadvantages in this mode of doing business. However, the Chinese have shown willingness to improve quality by establishing quality control and a government bureau of quality control.

Poon (1996, 48) claims that no matter how the subcontracting system will change in the future, there are significant implications for employees. The problem of rising levels of unemployment as a result of skill displacement has already emerged in Hong Kong with more labor-intensive manufacturing processes transferring to low-wage countries, more foreign workers imported and newer technology being adopted for production. Thus, the employees working in SMEs have to upgrade their skills or to acquire new skills altogether if they wish to remain in gainful employment.



## **Project operations**

Project operations are a distinct form of international business operations since they may involve a broad mix of activities and mode combinations. There may be elements of foreign direct investment, contracts covering the transfer of technology such as licensing, international financing arrangements, product, system and service exports or imports and international personnel transfers. Typically the mix of project operations varies during the project cycle. For example, the Beijing Olympics in 2008 sparked a wide range of major project developments in buildings and infrastructure around the city and these have been a focus of strong marketing efforts by international project suppliers. (Welch et al. 2007, 198)

Skaates et al. (2002, 389) claim that project operations are a dominating mode of international business as industrial companies increasingly exhibit project-like features. This is due to the increased complexity and systemization of the offerings of many international companies. The study conducted by Skaates et al. (2002) examined Finnish-Chinese turnkey case and found out that relationships characterized by short-term interactions relating to minor contracting issues during the implementation phase of one project do not probably often require long-term attention on the part of the project marketer. Moreover, one might expect that for professional service partial project in i.e. architecture, engineering or advertising, the relationships between the client and selling firm would take primarily place at the level of individuals. The cases studied by Skaates et al. (2002), showed that many individuals would only be active in certain project phases and formal collectives generally would play greater role throughout the project marketing cycle.

## **Alliances**

Welch et al. (2007, 277) define alliances as arrangements where two or more companies engage in collaborative activity while remaining independent organizations. Alliances represent an important foreign operation mode option for internationalizing companies and they are extensively used but difficult to operate. They may vary from informal and agreed cooperation in a certain activity in one or more markets to formal and legally structured agreements. Tse et al. (1997, 779-780) argue that the formation of alliances is a crucial one because a firm can enter a foreign market by itself or by forming an alliance with another firm to reduce investment risks and enhance its competitive advantage. In addition, a non-Asian firm may form an alliance with an Asian firm to enter China since they need the Asian firm to bridge the cultural gap between the investing firm and the Chinese market environment.

## **Joint ventures**

A joint venture (JV) is a collaborative arrangement between unrelated parties which exchange or combine various resources while remaining separate and independent legal entities. (Bennett 1995, 75) JVs are usually formed to undertake a specific project in a certain period and they represent an example of strategic alliance. JVs are increasingly popular as a means for entering foreign markets since they are flexible, can be quickly entered into as well as abandoned, enable cost-sharing yet can be just as effective ways to gain market expertise as more direct forms are.

SMEs often suffer from limited financial, managerial and information resources. Joint venture appears to be useful mode in such situation and it can be seen as a device to gain access to resources embedded in other organizations as a means of acquiring local management expertise and connections in order to facilitate fast entry into new markets. The study

conducted by Kirby & Kaiser (2003) examined the activities of UK and German SMEs which have joint ventures in China. Based on the responses, it would seem that the UK SMEs decided to form joint venture because of the Chinese partner's business knowledge and ability to smooth the way through Chinese bureaucracy and its knowledge of customers. Apparently, the real motivation for UK SMEs was to seek the attributes of their potential Chinese partners believing that they could bring something to the venture that the SMEs couldn't provide. In contrast, the motivations for German SMEs were based on financial and managerial savings as the literature of SME internationalization suggests. (Kirby & Kaiser 2003, 232-233)

### **Foreign direct investment (FDI)**

According to Welch et al. (2007, 320), FDI occurs when the level of ownership via equity in a foreign enterprise reaches a certain level that is deemed to imply that the investing company acquires a significant influence over the key policies of the foreign entity through a long-term investment. The main reasons for selecting FDI as an entry mode include powerful means of foreign market exploitation and expansion, exploitation of intellectual property, access to unique local assets, reducing costs, responding to the actions of competitors and avoiding tariff and other barriers to trade to name a few.

The current heavy inflow of FDI to China reflects a strong market exploitation motive and the perceived ability of FDI to deliver most effectively in this regard. Tarzi (2009) states, that the rate of growth in FDI flowing into China has been astounding. However, Lian & Ma (2010, 184) argue that there is little doubt that FDI has contributed significantly to Chinese economic development and perhaps most of the growth of China's exports can be attributed to foreign-invested enterprises and per

capita the income growth in coastal areas where FDI is concentrated has been demonstrably higher than in other regions.

The reductions in barriers to foreign investment and adoption of other measures of preferential treatment have played a vital role in enabling foreign firms to leverage various pre-existing location advantages. The key laws and regulatory reforms adopted and implemented in the late 1970s through the 1990s created an elaborate legal framework for FDI and established a liberalized FDI regime designed to attract foreign investors. Furthermore, China's entry into the WTO and compliance with WTO rules including reciprocity in tariff reduction and expanding industries available for foreign investment fueled the liberalization. SMEs may gradually make a significant entrepreneurial contribution to the international markets through FDI. (Tarzi 2009, 275; 288, Cheng 2008, 208)

### **Inward-outward operations**

While there has been extensive research concerning the internationalization process of SMEs particularly through exporting, the connection to inward international activities has received only limited attention. Korhonen et al. (1996, 316) describe inward operations as the mirror image of outward operations which are similarly covering a multiplicity of forms. These include imports of goods and services, finance and technology through i.e. franchising, licensing, FDIs, alliances etc. In their study of a large number of Finnish SMEs, Korhonen et al. (1996) found that a majority of the studied companies began their international activities on the inward side rather than on the outward side. Typical inward operations were imports of physical products such as raw materials, machinery and component. Imported services like installation, testing, servicing and maintenance were also common although at a lower level compared to physical products.

### 2.4.1. The choice of market entry strategy

When a company makes the commitment to go international, it must choose an entry strategy. Terpstra & Sarathy (1994, 260) claim that this decision should reflect an analysis of market potential, company capabilities and the degree of marketing involvement and commitment management it is prepared to make. The approach to foreign marketing of a company can either require minimal investment being limited to infrequent exporting or a company can make large investments of capital and management effort in order to capture and maintain a permanent and specific share of world markets. There is a variety of foreign market entry strategies from which to choose and each has particular advantages depending on company strengths and weaknesses, the degree of commitment the company is willing or able to make and the characteristics of the market as depicted in Figure 2 below.

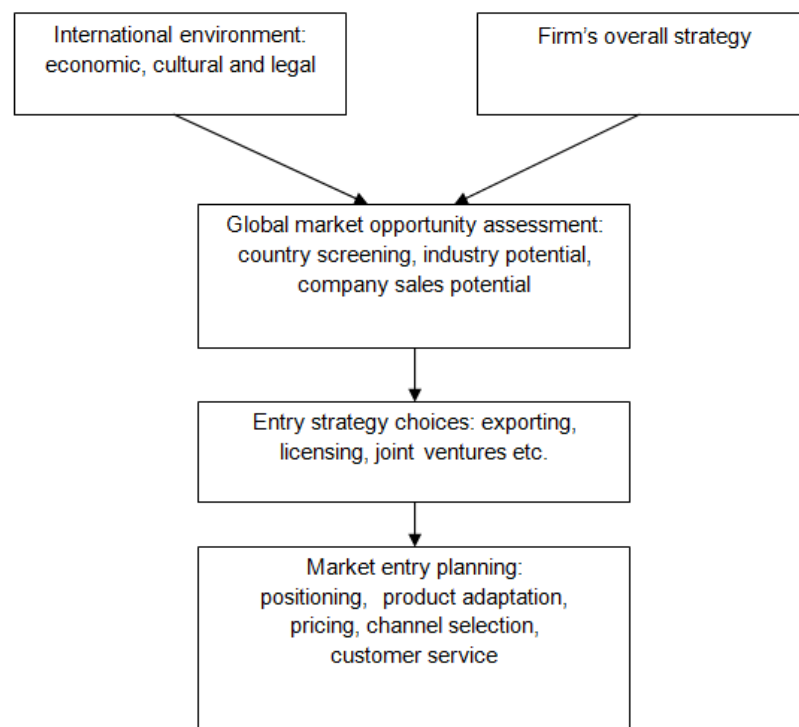


Figure 2 Factors influencing market entry strategies (Terpstra & Sarathy 1994, 261)

Cateora and Ghauri (2000) list the factors which are peculiar to the firm and its industry in entry mode selection. These are company goals, the size of the company in sales and assets, the company's product line and the nature of its products and competition abroad. In addition, Cateora and Ghauri emphasize that there are other criteria that relate more generally to the method of entry to foreign markets and they are relatively independent of the firm and its industry. This chapter discusses the aspects of these criteria.

The existing literature of entry mode choice (e.g. Tse et al. 1997 and Chen & Mujtaba 2007) suggest that there are country-specific, firm-specific, market-specific and industry-specific factors which effect on the entry mode decision. Host country-specific factors include country-specific economic, legal, political, institutional and cultural considerations. The most important variables of country-specific factors are country risk, government restrictions and cultural distance. Firm-specific factors are related to transaction costs in which the transfer of specialized assets between firms is influenced by market failures. The elements of firm-specific factors are asset specificity, international experience and firm's size. Market-specific factors consist of variables such as market potential, demand uncertainty and competitive intensity. Industry-specific factors include i.e. the scale of operation which varies across industries. In their study, Tse et al. (1997) claimed that when entering China, firms prefer to locate their operations in special economic zones where the infrastructure and market environment would provide better support for their investment. The size of these investments would likely to imply that the higher level of Chinese government be involved.

Different entry methods offer different coverage of international markets. Therefore the ambitions of companies practicing international marketing differ from each other, including the number of countries they are willing to enter. For example, wholly owned foreign operations are not permitted in some countries; licensing may be impossible in other markets because of the lack of qualified licensees; or a trading company might cover certain markets widely but has no representation in other markets. In order to gain the kind of international market coverage the company is seeking for, it probably has to combine different entry modes. The company should also choose an entry mode which provides feedback to gain the knowledge of its foreign market operation. In addition, entry mode should be chosen to help it gain experience and realize its ambitions. (Gateora & Ghauri 2000, 362-363)

According to Gateora and Ghauri (2000, 363), the management control over foreign marketing ranges from none to complete control and the extent to which such control is critical to the firm will bear heavily on its choice of entry method. The incremental marketing costs associated with international marketing should be considered in entry mode decision. Profit possibilities associated to each entry mode should be evaluated in the long run and investment requirements are essential determinants for most firms.

Administrative burdens and costs of international marketing vary by entry method. For example, indirect exporting or licensing may involve very little additional burden on management. Personnel needs also vary by method of entry; the more direct kind of involvement requires a large number of skilled international personnel. Direct involvement requires management to deal with different legislation, regulation, taxes, labor problems and other foreign market peculiarities. The characteristics of a company planning to operate in a long run in a certain foreign market have to

include flexibility and willingness to take risks. (Cateora & Ghauri 2000, 361-365)

Since the amount of different entry modes is huge, Luostarinen (1979) introduced a matrix (see Appendix 2) in which the modes are divided into four major clusters by using two dimensions as tools; functional and foreign direct investment. The first dimension pays attention to the function of the firm which is internationalizing and the second to whether the operation in question includes foreign direct investment or not.

#### **2.4.2. Mode switching strategies**

Luostarinen & Welch (1990, 251) claim that as companies increase their level of international involvement there is a tendency for them to change the method (s) by which they serve foreign markets. This change occurs in the direction of increasing commitment where a typical pattern is i.e. from no exporting to exporting via an agent/importer or to a sales subsidiary and finally to a production subsidiary. Furthermore, Welch et al. (2007, 361) argue that most companies with international operations will eventually experience switches of their foreign operation methods. Mode switching allows more intensive operations to be developed in the markets concerned. Luostarinen & Welch (1990, 253) note that it is difficult, if not impossible, to go far in the internationalization process simply by using one operational method. Therefore it can be argued that the future international success of companies will partly depend on their ability to master and successfully apply a range of methods of foreign operation.

Alternatively, mode switching might be used to resolve a problem or recover from a challenging situation in a foreign market associated with existing mode use. Welch et al. (2007, 361-363) highlight the importance



of company managers' awareness of the potential pitfalls in order to be able to avoid excessive switching costs. This requires managers to prepare the mode switch before the actual event and to formulate and follow a mode switch strategy. Even though mode switch can be used as a correction of managerial misjudgments or as an adaptation to new circumstances, the ideal mode switch strategy aims for more than eliminating switching costs. (Welch et al. 2007, 372)

### **2.4.3. Mode combination strategies**

Studies of changes in operation methods have tended to treat them as choices among discrete alternatives such as moving from direct exporting to intermediaries, from intermediaries to local sales subsidiaries and from joint ventures to wholly owned subsidiaries. Benito et al. (2009) have considered mode changes as additions to and deletions from existing operation modes and as within-mode adjustments. Their analysis shows that businesses wrestle frequently with the question of not just which mode to use but which combination of modes. (Benito et al. 2009, 1460-1461)

Welch et al. (2007, 393) agree that instead of switching mode or replacing it with another method, firms may add a different operation method to an existing one. The addition of one or several modes to an existing one may be a temporary arrangement when several methods are overlapping whereas in other cases the mode addition may take on the characteristics of a long-term or even permanent arrangement. However, combining different foreign operation methods raises a number of management issues, such as the challenge of coordination. Welch et al. (2007) utilize a value chain approach to tackle the management issues related to the mode combination. Mode combinations can be used to enter or develop a given foreign market for various reasons. (Welch et al. 2007, 395)

The Figure 3 introduces a framework presented by Benito et al. (2009, 1465) to illustrate the process of mode choice and change. Benito et al. (2009, 1464) argue that whereas previous studies focus on various factors influencing mode assessment and choices, the Figure 3 draws on the behavioral theory of the firm and acknowledge that decision drivers are themselves influenced by past experiences and current operations. Since there is a considerable wide array of possible operation mode options, managers tend to fall back on their experience and use modes that were successful in other situations or limit the choice set. Mode experience can be acquired first through international inward operations if a company for example accesses foreign technology via a licensing-in arrangement and uses that experience for outward foreign licensing deals. Undoubtedly, negative experience with a particular mode leads to bias against its further use. However, positive experience may result in mode inertia which means the tendency to use an existing mode rather than looking for alternative ones. (Benito et al. 2009, 1464-1466)

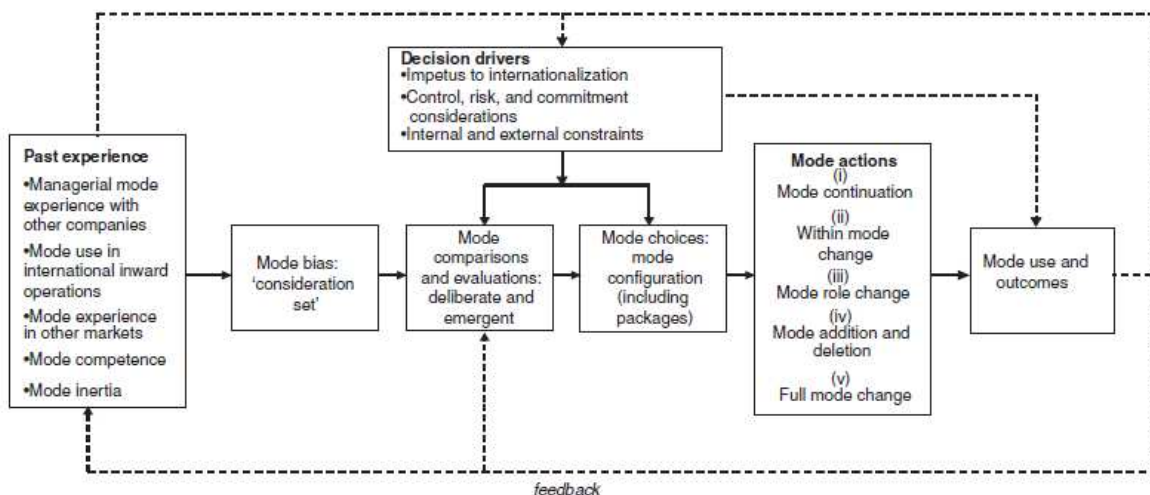


Figure 3 Mode choice and change (Benito et al. 2009, 1465)

### **3. THE INTERNATIONALIZATION OF FINNISH COMPANIES TO CHINA**

The history of Finnish enterprises and their relationship with Chinese business environment started relatively late compared to Swedish and Danish who started business with Eastern Asia already in the 18<sup>th</sup> century. After its independence Finland began to practice export of wood processing to China in 1920s and in 1930s but the official trade agreements were made with China after the foundation of the People's Republic of China in 1949.

Nowadays China is an important trade partner for Finland being the second biggest of the non-EU trade partner countries after United States. The value of the investments of Finnish companies in China was bigger than other Scandinavian countries in 2008. (Kettunen et al. 2008, 81; Heikura 2003, 114) This chapter describes the paths of Finnish companies in China and the cooperation in different eras between the countries.

#### **3.1. The activities in People's Republic of China before 1987**

The Republic of Finland established both political and economical relationships with China soon after the People's Republic of China was formed. Finland was one of the first western countries which recognized the communist administration of China already in 1950 and Finland-China Friendship Association was established during the following year in Helsinki. The Finnish embassy was founded in Beijing in 1952. (Kettunen et al. 2008, 82)

Heikura (2003, 112) states that the history between Finland and China begun when Kaukomarkkinat Oy sold the first set of newspapers to China in 1952. At the time, the trade was tripartite trade through the Soviet Union. Kaukomarkkinat Oy sent their first representative to China in 1953 and during the same year Finland was the first Western country which made bilateral agreement with the People's Republic of China. (Heikura 2003, 12; Toivola 2003, 117) The trade was focused in Beijing where the Ministry for Foreign Trade and import and export corporations of different industry fields were functioning.

### **3.2. The decade of the Open Door Policy 1978-1991**

The activities of Finnish companies in China were quite small in scale after the destructive Cultural Revolution in the end of 1970s. The foreign trade union continued to enhance its relationship with East Asia and started to organize for example Finnish technology days in Asian countries. In 1979 Finland made a deal with China concerning economical, industrial, technological and scientific co-operation. (Kettunen et al. 2008, 84; Toivola 2003, 117)

Finland and China made agreements also concerning protection of investments and avoiding double taxation. In addition, top executives were familiarized with Chinese market and its actors during the trips of the export delegations. Finnish-Chinese Trade Association was founded in 1985 in Helsinki and it was one of the first trade associations between China and foreign countries. The association established co-operation office in Shanghai in 1991 which was several years before commercial secretary or main consulate came to the city. At the time, the China-operations of Finland were handled only by few people who managed the work groups related to trade until the 1990s.

### **3.2.1. The period of joint ventures**

Kettunen et al. (2008, 85) notes that most of the Finnish businesses in China during the 1980s were still either direct or indirect export. The law concerning joint ventures in China was established in 1985 and three years later three Finnish enterprises – Raute, Schaumann and Puolimatka – have formed joint ventures with Chinese contracting parties. Due to China's reformations and rapidly growing economy the interest of Finnish enterprises towards China grew immensely in the end of the 1980s when about 70 Finnish-Chinese projects related to for example forest, energy and building industries were pending. Finnish Chamber of Commerce was founded in 1986 to support Finnish enterprises and their networks in Hong Kong.

### **3.2.2. The period after year 1989**

Despite of the promising beginning, the value of export decreased significantly whereas import grew in 1990. Only few Finnish companies were operating in China whereas for example the number of Swedish companies was already 20. When China started developing its own forest industry, Finnish forest industry enterprises saw the opportunity of selling paper machines and they started to transfer their production to the promising market of China. After that the trade between Finland and China developed rapidly. (Kettunen et al. 2008, 85-86)

### **3.3. The first years of market socialism 1992-2001**

Finnish enterprises established more and more joint ventures with Chinese after the famous visit to Finland by Deng Xiaoping in 1992. In 1994 Finland's export to China grew from the previous year for over 500

million Finnish marks. The main reason for the growth was the increasing trade of electric generators and motors, steam boilers, paper, lifting and loading machines and products of telecommunications. During the same year one of the high technology industries in Finland started market entry to China when a company producing products of dental medicine established a joint venture with a Chinese company and built a factory to Shanghai. (Kettunen et al. 2008, 87; 89; 94)

Despite of the increasing growth, the interest towards China was fading in 1995 because of tightened taxation, ongoing changes in the legislation, increased costs and negative attitude towards foreign operators. Finnish enterprises and the Foreign Trade Union started to establish chambers of commerce in continental China in addition to Hong Kong. (Kettunen et al. 2008, 87-88)

The financial crisis of Asia in 1997 didn't have a significant impact on Finnish enterprises and their decision to enter China since their trade was mainly based on dollars and therefore not very vulnerable if the value of the currency was declining. Instead, the crisis increased the interest towards China as a subject of export and investments.

#### **3.4. The period of steady growth and WTO partnership 2002-2008**

In 2001 China joined to WTO which reinforced the belief of investors in the steady development and standardized operational environment based on the international regulations. For Finnish industry, WTO partnership meant a decrease in tariffs which allowed Finnish companies to export the most important Finnish products to China and enabled the establishment of WOFEs. (Sitra-Tekes-Finpro 2003, 79)

The building industry continued its growth especially in elevator production which was mainly organized in China. In addition, ICT and electronic industry were growing rapidly and employed Chinese workforce; in November 2005 the number of Chinese working for Finnish enterprises in China was already over 30 000. Paper industry widened its operations in China while other industries such as chemistry, metal, clothing and workshop industries were reinforcing their position in China. (Kettunen et al. 2008, 94-104)

According to the research conducted by Finpro Marketing in the years 2004-2005 (Kettunen et al. 2009, 105), the most well-known Finnish industries based on the answers of Chinese respondents were electronics, paper and wood industry, ICT and environment protection. Finns were regarded as honest and reliable business partners and the economy of Finland was estimated to be stable. In 2004, Finland and China made an agreement concerning the contribution of new investments and bilateral protection. The agreement protects Finnish investments from political risks and requires treatment of discrimination. (Finpro 2010, 19) FinChi Innovation Centre was opened in May 2005 at Technology Park in Shanghai to support Finnish companies operating in the area.

### **3.5. Current status and future of Finnish SMEs in China**

According to Heikura (2003, 116) the future opportunities for Finnish enterprises in China might be in northern China where there are similarities in climate and habits. Fei (2011) adds that Finnish companies should also concentrate to the western area of China, not only to the coastal and eastern parts of the country. The five-year plan announced in spring 2011 includes the development of the western provinces of China which have been left behind during the rapid economic growth of the coastal area. Kivelä (2011) notes that many western provinces are planning to double their GDP in next five years and the growth is expected to be around 15%.

Kivelä (2011) suggests that different districts in China can be divided into tires which represent the dimensions of each city. I.e. Wuhan and Nanjing belong to the second tire after biggest cities in first tire and their market opportunities are huge having over 7 million inhabitants in both of them. However, they have been shadowed over by the development of the first tire cities. Companies operating in China should take into consideration the cities in inland areas and the distinctive features and differences of them since the focus is transferring to the smaller cities. (Kivelä 2011: Herrala 2011)

The biggest change in China during the next years will be a transition from production into services. Presently the consumption is targeted in commodities whereas the amount of China's service sector in GDP is internationally compared extremely small, even smaller than in India, but it is expected to grow rapidly in the future. Especially premium class consumption products are opportunities for Finnish enterprises in Chinese market. Kivelä (2011) specifies that the following service industries can be regarded as fields of opportunities for Finnish firms: tourism, IT services,



clean functional food and raw materials and middle priced mass products in case the supply strategy is functioning well. Herrala (2011) points out that China is not anymore the source of cheap workforce, its domestic markets are becoming increasingly important and Chinese financial markets are opening. Pollution continues to be a huge problem but the government is making an effort on improving the quality of the water. China has survived from the worldwide international crisis by granting credit for domestic demand and investments. Inflation is accelerating after the depression and therefore China has tightened its monetary policy already during the last six months. The emphasis of the growth will be in consumption. (Herrala 2011)

Herrala (2011) lists the risks and challenges for China in the near future. The nuclear crisis in Japan might have some impact on Chinese economy as well and the other challenge is how much does the monetary policy has to be tightened in order to control inflation. On the other hand, the growth of China tends to exceed the expectations.

According to Fei (2011), the main difficulty Finnish SMEs are facing in Chinese markets is to find appropriate partners in China. He reminds that Finnish companies should be confident because they are pioneers in many fields such as ICT, machinery, clean tech etc. Chinese are interested in Finland's capacity and Finnish SMEs should promote Finland and make it more attractive in Chinese business.

In a report by Bank of Finland concerning the economic forecast of China for the years 2011-2013, the GDP in China is expected to grow 9% in 2011 and in 2012-2013 about 8 %, which is less than in 2010 when the number was 10.3 %. Huge credit granting resulted of the recovery package and inflation pressures have led the focus in economic policy to

transfer into tightening the monetary policy to contain the inflation. (BOFIT 2011)

Härkönen (2011) argues that for many SMEs the major barrier for expanding their operations to China is the lack of funding. BENCH aims at providing the Chinese information about investment opportunities in the BENCH region. In 2012, BENCH is sending its own delegation of SMEs to China to meet potential partners, government officials and investors.

### **Bench project**

BENCH (Beneficial Business Contacts between the Central Baltic Region and China) is an EU-funded project in helping SMEs to take advantage of the growing Chinese markets. Its second major goal is to attract Chinese businesses and investment in the BENCH region. This region includes two provinces in Finland, one in Sweden and Estonia. In Finland the BENCH provinces are Uusimaa and Päijät-Häme. BENCH is a multinational project led by the County Administrative Board of Östergötland in Sweden. Its partners are three universities, two regional development entities, one science park, Center for Environmental Technology and the Estonian Chamber of Commerce and Industry. BENCH conducts surveys and interviews among CEOs and top management and visit their factories, facilities and offices to learn about their products and skills. The results are analyzed and published in a form of reports, case studies and handbooks which are used for designing workshops, seminars and individual consulting sessions. These results are made available to SMEs, representatives of national public organizations and to EU officials who may use them when designing support strategies for SMEs entering the Chinese market. (Härkönen 2011) SMEs can benefit from the information offered by BENCH i.e. giving information about opportunities to network and find potential business partners.

## **4. EMPIRICAL ANALYSIS OF FINNISH SMES IN CHINA**

The aim of this research is to examine the market entry patterns Finnish SMEs have used in entering China. Usually the entry mode studies are focusing mainly to the entry phase and ignore the mode actions after the entry. However, many SMEs are forced to change their entry mode strategies or combine different strategies to meet the needs of the changing business environment in China.

The first part of this chapter consists of an introduction to the research method, case selection process and case descriptions featured with within-case analysis. The second part of the chapter is a cross-case analysis which includes a comparison of the similarities and differences between the cases.

### **4.1. Research method**

The selection of suitable research methods is the main decision in the research process. Ideal approach comes as close as possible to the phenomenon in question, aims to understand it and gives answers according to the objectives of the research. This study is a qualitative within-case and cross-case research aiming to examine patterns Finnish SMEs have used in their internationalization process in China. Since the purpose of the research is to compare different entry mode strategies and to understand the relevance of the entry mode choice, qualitative research method is most suitable method for this study. Hirsjärvi et al. (2008, 27) claim that qualitative research brings out the respondents' observations of the situations and gives an opportunity to acknowledge the issues related to their past and development.

Heilmann (2009) describes the characteristics of a qualitative research as non-numeral, guided by research problems, multi-level, complex and narrative. The research data collection method consists of formulation of the problem, collection of the data, analysis, interpretation and reporting which are all intertwined together. Qualitative research includes small amount of cases which are analyzed as precisely as possible. Typical for qualitative research is also that the researcher does not have any prejudices and he or she is able to find new aspects from the collected data.

Qualitative research does not aim to statistical generalization but the purpose is to describe a certain case, understand certain activity and provide theoretical interpretation of the phenomenon. The study is conducted with a semi-structured questionnaire and recorded telephone interviews. Semi-structured questionnaire consists of the same questions for all the respondents but there are no ready answer choices giving the respondent opportunity to respond in their own words. (Eskola & Suoranta 2003, 61, 86)

Qualitative methods consist of three kinds of data collection: in-depth, open-ended interviews, direct observation and written documents. (Patton 1990, 10) This study is collected by interviews which consist of direct quotations from respondents about their experiences, opinions, feelings and knowledge. Direct quotations are a basic source of raw data in qualitative inquiry revealing respondents' depth of emotion, the ways they have organized their world, their thoughts about what is happening, their experiences and their basic perceptions. Patton (1990, 11) claims that the validity and reliability of qualitative data depend to a great extent on the methodological skill, sensitivity and integrity of the researcher. Although method used in this study is conducted by interviews, the interviewer may also act as an observer who is able to read the nuances of the interviewer-

interviewee interaction and relationship. Therefore the interviewer can act as a mirror where interviewee can reflect their thoughts related to the discussed topic.

The data collection process included contacting the possible respondents via e-mail and asking the permission for the interview. In the next phase, the respondents which agreed to participate received the questionnaire in advance in order to get familiar with the questions. One of the respondents answered by filling the questionnaire sent via e-mail and returned it to the researcher. This was due to the limited time the company had in order to be able to arrange a recorded telephone interview. With the rest of the respondents, interviewing time was arranged and respondents were called via Skype recorded telephone call. After that, the answers were collected in tables, compared and analyzed.

#### **4.2. Case selection process**

According to Eisenhardt (1989, 534-537), selection of cases is an important aspect of building theory from case studies because the population defines the set of entities from which the research sample is to be drawn. In addition, the selection of an appropriate population controls variation and helps in defining the limits for generalizing the findings. The study is also easier to be observed if the cases chosen represent extreme situations and polar types. In this study, the cases were selected after comprehensive consideration of alternatives which emerged during the process.

The case choice process was relatively multi-phased and included data collection from multiple sources. First of all, several organizations including Kuopio Innovation, Innovation Centre of Lahti University of Applied

Sciences, Finpro, Helsinki Region of Chamber and Commerce and Finland-China Trade Association were contacted. The organizations were contacted based on the recent articles in Kauppalehti (2011a, 4-5; 2011b, 16; 2011d, 13; 2011e, 14), ESS (2011, 12) and TEKEL (2011). All organizations have been co-operative and they have provided useful data for this research including contact information, links, lists of the companies and invitation to seminar (BENCH, see page 50).

Härkönen (2011) argues that the government of China is investing strongly to new environment technology. Also medicines, development of construction and infrastructure and high-quality consumer goods are considered interesting. Finpro (2010, 7-8) lists industry fields Finnish companies would have potential in China. The list includes i.e. information and communication technology, pharmaceutical and nutrition technology, wood construction, environment protection technology, bio technology, machinery technology and environment technology.

### **4.3. Case descriptions and within-case analysis**

A case study is a research strategy which focuses on understanding the dynamics present within single settings. (Eisenhardt 1989, 534-535) Case studies can involve either single or multiple cases and numerous levels of analysis. Furthermore, case studies may include multiple levels of analysis within a single study. Typically case studies combine data collection methods such as archives, interviews, questionnaires and observations and the evidence may be qualitative, quantitative or both. Eventually, case studies can be used to accomplish various aims: to test theory, provide description or to generate theory. This study focuses on providing description of the entry mode patterns Finnish SMEs have used in entering China.

Patton (1990, 429-430) argues that description and quotation are the essential ingredients of qualitative inquiry. Sufficient description and direct quotations should be included in the study to allow the reader to enter into the situation and reveal the thoughts of the people interviewed in the report.

Analyzing data is in the center of building theory from case studies. One key step in it is within-case analysis which is driven by the volume of the data. Since the research problem is often open-ended, the volume of the data is often questionable. Eisenhardt (1989, 540) argues that within-case analysis can help the examiner to cope with such data. Within-case analysis typically involves detailed case study write-ups for each site. These write-ups are usually pure descriptions but central to the generation of insight because they help in dealing with the analysis process of enormous volume of data. Ultimately, the idea is to become intimately familiar with each case as a stand-alone entity. This kind of process allows the unique patterns of each case to emerge before generalization of the patterns across different cases.

On the other hand, the tactics in cross-case analysis are driven by the reality that people are poor processors of information. Eisenhardt (1989, 540) states that people leap to conclusions based on limited data, are influenced by vividness or elite respondents, ignore basic statistical properties or sometimes accidentally drop disconfirming evidence. The main problem is that researchers may reach premature or even false conclusions as a result of these biases. Thus, the key to good cross-case comparison is to replace these tendencies by examining the data in many diverse ways. Eisenhardt (1989, 540-541) divides these ways into three different tactics. The first tactic is to select categories or dimensions and then search within-group similarities coupled with intergroup differences. Second tactic is to select pairs of cases and then to list the similarities and

differences between each pair. The results of these comparisons can be new categories or concepts which the researcher did not even anticipate. Third strategy by Eisenhardt (1989, 541) is to divide the data by data source, i.e. one researcher deals with observational data while another reviews interviews and still another one works with evidence provided through a questionnaire.

The overall idea of these cross-case searching tactics is to force investigators to go beyond their initial impressions and to improve the likelihood of accurate and reliable theory. In addition, cross-case searching tactics may enhance the probability that researchers will find novel findings in existing data.

The cases studied in this research are selected based on the recent articles, published academic journals, existing literature and seminar speeches concerning the most interesting industry fields Finnish SMEs are operating and exporting their knowledge to China. These are listed on pages 53-54. All in all 14 companies were contacted via e-mail and 5 of them answered with recorded Skype interview and 1 of them by filling the questionnaire received by e-mail and sending it back. The appendix 1 introduces the questionnaire of this study.

This chapter introduces the six cases examined in this research followed by within-case analysis of each case. The respondent of the case A answered by filling the questionnaire sent via e-mail whereas cases B, D, C, E and F were recorded Skype based interviews on the basis of the questions in the questionnaire. Table 1 below summarizes the industry fields, position of the respondents in the company and the time of the interview.



Table 1 Summary of the interviews

<b>Company</b>	<b>Industry field</b>	<b>Position of the respondent in the company</b>	<b>Time of the interview</b>
A	Architectural design	CEO	8 <sup>th</sup> of April 2011
B	Consultancy, development and import of molds and components for plastic industries	Owner	11 <sup>th</sup> of April 2011
C	Pharmaceutical research and development	CEO	18 <sup>th</sup> of April 2011
D	Pharmaceutical development	The manager of Chinese business operations	20 <sup>th</sup> of April 2011
E	ICT	CEO	29 <sup>th</sup> of April 2011
F	Investment services, fund management and financial services in the field of clean tech	EVP, responsible of China project origination and management	4 <sup>th</sup> of May 2011

#### 4.3.1. Case A

The CEO of the company A was interviewed via e-mail questionnaire which the respondent sent back by e-mail on 8<sup>th</sup> of April 2011. Additional questions were answered after receiving the questionnaire via e-mail since few of the answers needed to be defined more accurately. The company A is an architect office currently employing approximately 40 employees with a turnover of 2.9 million € in 2010. In 2003, it entered to China and established an office to Shanghai in 2008. The company is operating in 20 different cities in China which are mainly located in the east coast. The main ongoing projects are currently in Chengdu and Wuxi. The company is initially based in Helsinki and had 10 years of international experience about operating in Germany and Russia before entering China.

The CEO of the company describes the motivations behind the decision to invest in China and the market entry process as following:

*“The main motivation was the huge construction volume and possibility to do extraordinary projects. We are operating on the field of consultancy and projects so the natural mode for us was to choose project operations as an entry mode. The alternative would be to participate in some larger consortium such as Finnish DigiEcoCity project but it’s not our strategy. Our objective is to design single, notable buildings and to increase our brand and recognizability in China. Establishing a consulting WFOE in Shanghai is currently on progress and we are expected to have business license in June 2011. The entry mode has been the same and we are developing it step by step. We used Chinese partner companies in our internationalization process which is a must in our sector.”*

Challenges the company faced and overcoming of them:

*“The business environment is tough. There are endless amount of challenges and problems. It takes several years to get it – for us it was six years. We have been able to overcome the challenges with hard work and a lot of money. Based on my experience Finnish SMEs in our industry field dare not or are not able to invest in China and they expect to have result in a short period of time. Chinese business culture has to be learnt by practice.”*

The company has transferred all of its product and services they are offering in Finland to China. They have used Finpro and TEKES as experts in examining the Chinese business environment. The company is employing currently five Chinese but after the WFOE is established, they will probably hire more Chinese workforce. There will be extensive construction in the future of the industry in China and it is expected to continue next 20 years including some smaller recessions. The CEO of the company estimates that the growth of the company is continuing.

### **Case analysis**

The entry mode chosen by the case company A was in line with their industry field. It is also in line with the study of Skaates et al. (see page 33) where they listed architecture to be one of the main industries using project operations as their entry mode in international operations. The company has not changed their entry mode yet and they are implementing it step by step. However, in near future they are planning to use WFOE as an additional entry mode combined with project operations. This strategy follows the same patterns as RBV theory which suggests that over time firms gain experience in foreign markets and move from simple operations

to more complex organizational structures. It is also in line with the theory by Welch et al. (see page 33) that project operations often involve a mix of activities and mode combinations.

Bradley (see page 16) argued that a reasonable span for a concentration strategy of an SME going international would appear to be two or three markets. Company A has international experience before China from operating in Germany and Russia which are huge market areas. Therefore entering to China may not have been such a big step since they have been able to compare their actions in different market areas beforehand.

Additionally, as Cateora & Ghauri (see page 19) and Kivelä (see page 20) emphasize, the infrastructure in China is out of date and inefficient. Even though the government is investing to improve the infrastructure, there is potential for the Finnish architecture firm to take advantage of the situation. Since the company is currently operating mainly on the east coast, there could be possibilities for them to widen their operations to west coast and northern China as well as Heikura, Fei, Kivelä and Herrala on page 48 note.

### 4.3.2. Case B

The owner of the company B was interviewed with recorded Skype interview on 11th of April 2011. The industry field company B is operating in is consultancy, development and import of molds and components for plastic industries. The company B is employing 4 persons at the time and in 2010 the turnover of the company was approximately 1 million €. Even though the company is only four years old, the owner has experience of Chinese business environment for 15 years in three different enterprises. Currently the company is operating in Hong Kong, Shenzhen and Ningbo. The international experience the owner had before entering China in the field of telecommunications expands to Brazil, USA, Hungary, Netherlands, France and Germany in 1996.

The owner describes the motives for investing in China as following:

*“This was started from the fact that I had been in China for a period of time and had experience from the area. The development of Finland and Asia was seen already at the time and the role of China was clear to increase in the future. Therefore there was a need to be there where the source of growth was. “*

The company has not transferred all their products and services to China. Instead, they evaluate the suitability of each project for Chinese markets. If the work is craftwork it is natural to transfer it to China. The company has mainly used local contacts in examining the Chinese business environment. In the beginning of the entry to China they used Finpro but it wasn't necessary anymore in case of the current operations.

The entry modes have changed during the last four years of operating in China. The owner explains the mode patterns:

*“The entry mode was originally exporting, but we are also using international subcontracting, project operations and alliances to a certain extent. The entry modes were chosen since they seemed natural and were suitable for our industry field and experience. The entry modes have changed after entering China and they are still altering continuously since the focus has changed during the four years of operation. Initially the focus was around plastic molds and it rapidly grew around metal and aluminum components and finally we imported whole products i.e. medical machinery.”*

The company didn't use intermediates, partners or agents in their internationalization process because it was not necessary as they were among the first movers. Even though the company has faced pitfalls during the years, there have not been remarkable challenges or problems. This was due to using experienced locals. Problems with bureaucrats were mainly with the former assembly when they established factories in China.

Overcoming the challenges and future of the company:

*“We have been able to overcome the main challenges but it has lengthened the time line for moving forward. Finnish are quite naive and Chinese are functioning in a different way than Westerners. Using Chinese workforce was a necessity*

*for us. The company is expected to grow in the future and we will contribute our actions in China. “*

According to the owner of the company B, the main challenge for Finnish companies in China is to adapt in the way Chinese are doing business. I.e. the reaction times differ considerably between China and Finland:

*“Chinese activity and enthusiasm is on the different level and they expect actions within hours whereas Finnish reaction time is much longer, normally few days. Finnish should understand the relevance of this issue and make changes since this is an issue which most companies are facing on weekly bases. Finnish companies have two choices: either they can reject China or be part of its growth. In case it is rejected, we will fall from the development. In case we are willing to be partners and build the bridge between Finland and China, there are important opportunities for us. “*

### **Case analysis**

The initial motivation for investing China by company B was due to the fact that the owner had been in China for a period of time and had experience from the area. Therefore the company has used ownership or firm-specific advantages as Dunning's OLI framework (see page 14) suggests. The possibilities and role of China was seen and there was an urge to benefit from the source of growth.

The company B has changed their entry mode after first penetrating China by exporting. They are still using exporting as a method but since the focus of the company has changed from plastic molds to metal and

aluminum components, they are implementing also international subcontracting, project operations and alliances to a certain extent. The company changed their entry strategy based on the new circumstances which may be used for eliminating switching costs as Welch et al. (see page 40) argue. Figure 3 on page 42 illustrated the mode choice and change process and company B might be considered to be in mode actions stage between stages iii-iv.

The company entered to China in the beginning by exporting which is one of the main modes used and the financial risks can be minimized. Based on the study of Finnish manufacturing SMEs, almost 96% began their outward international operations via non-investment marketing operations, meaning basically exporting (see page 28). China's entry to WTO has enabled foreign companies to export in China. The company B used international subcontracting as combined entry mode which is normally used for covering export sales of articles. As Kauder (see page 32) argued, both foreign companies and Chinese counterparts can benefit from this arrangement. This is due to the fact that while parts are manufactured cheaply in Chinese plants, Chinese gain profits and technological knowledge. On the other hand, foreign firms can develop and maintain good relations with Chinese authorities which may lead to long-term access to the market. The third mode company has used is project operations and as mentioned in the analysis of case A, project operations are usually used as additional mode in international business operations. Fourth mode, alliances, may be formed to bridge the cultural gap between the foreign firm and Chinese market environment (see page 34).

The owner of the company B argues that Finnish are too naive and slow in their reaction time compared to Chinese counterparts. This experience is following the same path that Saarela (see page 26) indicated. Finnish



might not realize that Chinese expect quick answers and in case partners are not able to deliver them, they may “lose face”.

The company B has used experienced locals in their internationalization process to China which may be behind the fact that they have not faced remarkable challenges or problems. As the analysis conducted by Child et al. (see page 22) indicated, using experienced locals is one of the strategies in overcoming the barriers of trust in China.

#### **4.3.3. Case C**

The CEO of the company C was interviewed via recorded Skype call on 18<sup>th</sup> of April 2011. The industry field the company C is operating in is pharmaceutical research and development. The number of personnel is currently 130 and the turnover in year 2010 was 10.2 million €. The company entered to China in 2006 and is mainly functioning in the area of Shanghai. The international experience of the firm leads back to the beginning of 1990s when it entered to Nordic and Baltic countries, USA and middle Europe.

The main motivations for investing China according to the CEO:

*“Our business activity differs from other Finnish companies in China since we are importing works to Finland and not exporting them to China. The main motivation for investing in China was to acquire new customers because China is a new market area for us. Additionally, partnering, networking and seeking for new associates are important for us. We can have customers who want their work to be done in China and*

*therefore we need to have functional networks in China. Works are primarily done in Finland and because the nature of it is consulting service, we are serving Chinese customers in Europe where we are familiar with the legislation. An example would be that if our customer needs research in China, we are helping them to find appropriate partners. Therefore finding few good partners from China is crucial for us. “*

The company has participated in projects and used Finpro, FinChi, Tekes and local experts in examining the general issues related to the Chinese business environment. In addition, the company has been part of national program with universities, pharmaceutical companies and different organizations from Finland and China which have enabled them to network and create contacts. At the time the company is seeking for Chinese partner company and the possible market entry strategy for them would be either strategic alliances or joint ventures. The main idea is to find a suitable partner company which is familiar with Chinese markets and customers and reciprocally benefit from each other.

Problems and challenges in Chinese market:

*“Main problems relate to the cultural differences which have to be learned and getting to know the market takes time. We offer services which may be more difficult than selling tangible products Chinese are used to. Competition between service companies is tough and local suppliers get access to help more easily whereas we offer help in Europe. In addition, physical distance is a challenge compared to European countries and it is important for Chinese to meet face to face. Creating quanxi requires patience, persistence and lots of*

*money and time. Despite of the challenge related to the physical distance, we have been able to overcome the challenges by learning something new every time. The more experience is gained, the easier it is to understand the Chinese procedures and thought patterns and ultimately interpret them. “*

The company does not employ Chinese at the moment aside from the ad hocs they use from time to time. The CEO perceives the future of the company to be optimistic and that there will be opportunities in China for them. This will be challenging and needs plenty of work but there are possibilities for a Finnish company in China.

### **Case analysis**

The activities of the case company C differ from other companies from different fields of industry since they are using inward operations as their operation mode. As described by Korhonen et al. (see page 36), inward operations are the mirror image of outward operations. Since the company C is using Chinese partners and associates, the mode is indirect importing. Although the study conducted by Korhonen et al. indicated that typical inward operations were imports of physical products, also installation, testing, servicing and maintenance were common. Even though the industry field the company C is operating is pharmaceutical research and development, they are primarily offering consulting services for customers.

In case the company C finds an appropriate Chinese partner company, the possible market entry strategy for them would be strategic alliances or joint ventures. These modes can be used as well as in outward or in inward operations. Strategic alliances and JVs are both arrangements where two

or more companies engage in collaborative activity but remain independent organizations and legal entities. Therefore they may be the most suitable modes for a consulting company.

The company C estimated cultural differences and physical distance to be the major challenges in China for the Finnish SMEs. As TCA framework indicates (see pages 11-13), external uncertainty is constructed by market-specific factors such as country risk and cultural distance. Then again, the internal uncertainty of the company may be lower since they have international experience leading back to the beginning of the 1990s and covering several different markets.

The CEO of the company C mentioned that creating guanxi requires patience, persistence and lots of money and time. It is very difficult to create since it is important for Chinese to meet personally but the physical distance makes it complex.

#### **4.3.4. Case D**

The manager of Chinese business operations of the company D was interviewed via recorded Skype call on 20<sup>th</sup> of April 2011. The company is operating in the field of pharmaceutical development. It is currently employing 5 employees and the turnover of the firm in 2010 was 90.000 €. In 2006 the company entered China and their Chinese business partners are operating in Shanghai, Hainan, Nanjing and Shenyang. Before entering China the company has made license agreements with many European countries but the personnel is located in Finland.

The manager of the Chinese business operations describes the motivations for investing in China as following:

*“Initially the CEO of the local technology center was interested in China and the chairman of our board went to China and visited local big pharmaceutical companies and research institutes. It was obvious that Chinese pharmaceutical companies will become international. There was either a possibility to go with the flow or to be overrun by it.”*

At the time China is the source of products for the company and their most developed pharmaceutical product is manufactured in China. The company has used experts in the private sector in examining the Chinese business environment. Even though the company has a subsidiary in Hong Kong, it does not have employees at the moment. They are building a rep office to continental China but the purpose is not to enter to Chinese market but to search good products to Europe. They have used judicial experts in making international contracts but there has not been a need for experts of international business operations.

The challenges the firm has faced in China:

*“Our target is to choose our partners based on the criteria that they understand the demands Western companies have not only from the business aspect but also from the regulatory aspect. This is due to the fact that our sector is highly regulated from authority view. However, there are still challenges in communication and room for improvement also with the long-term partners in order to get access to the right*

*information. Then again, we have gotten access quite well to open discussion with the current partners but the problem may occur in the beginning of our relationships with potential partners. In addition, most of the Chinese companies are not in the same phase than European countries from the regulatory aspect. We haven't faced bureaucracy or corruption maybe because we haven't made physical market entry to China. Instead we are seeking for partnerships and products to Europe. We are not employing Chinese workforce but we are using consultancy services."*

The future of the company:

*"People's Republic of China is tightening its inner regulatory which means that there will be consolidation inside the country. Our industry field is becoming more and more interesting in China and therefore we are investing in making deeper market entry there and looking forward to increase our profitability. "*

The manager of the Chinese business operations of the company describes the differences between Finnish and other European actors in China:

*"I've been visiting there several years and met dozens of enterprises. This means that I've also seen how the public actors of other European countries really operate there. They have been clearly more successful in making their companies*

*known to the public and representing them. Finnish companies have a lot to learn from them. “*

### **Case analysis**

The initial motivation for the case company D to invest in China was the internationalization of Chinese pharmaceutical companies. Therefore both firm-specific and location advantages of the Dunning's OLI framework (see page 14) can be applied to the firm's entry mode decision in Chinese market. The company D used inward operations, particularly indirect import, as their entry mode to China.

The main challenges in Chinese business environment according to the CEO of the company D are related to the regulatory issues. However, they have not faced bureaucracy or corruption maybe because they have not made outward internationalization to China. Even though Blackman (see page 23) argued that both foreign and domestic companies in China are complaining of the interference of government in business activities, the company D considers that the consolidation inside the country is positive since the regulations will become better.

#### **4.3.5. Case E**

The CEO of the company E was interviewed via recorded Skype interview on 29<sup>th</sup> of April 2011. The company E is operating in the field of ICT. Currently there are 34 employees working in the company and the turnover was 1.4 million € in year 2010. The company entered to China in 2007 and they are operating in Shanghai, Beijing and Shenzhen. The company was established as a spinoff of the previous company and the

CEO has international experience since 1998 from North America, Japan and Korea.

The main motivations for investing in China:

*“We saw that China is developing technologically and catching up Western countries. In addition, the market size is huge. We have transferred all our products and services we are offering in Finland to China. We have used Shanghai’s FinChi center as an expert in examining the Chinese business environment.”*

The patterns of the firm in China were following according to the CEO:

*“Initially we used exporting as an entry mode which included minimized risks to try if there will be demand for our product in the local markets. When we got the first big client, we got encouraged to make more commitment and understood that there is demand now and more in the future in Chinese markets. Then we made an agreement with a sales rep agent company and decided to hire the local Chinese employee who was working there. Last year we switched the mode to FDI and established a subsidiary to China.”*



Challenges the company has faced in Chinese business environment:

*“Mostly cultural differences. When we started operating 3-4 years ago in China, Chinese market was technologically behind. The Chinese liked our products but said that it is too early for them. Therefore the biggest challenge in the beginning was related to timing. We haven’t faced corruption and the amount of bureaucracy is same as everywhere in my opinion. Actually it feels that issues are organized more easily in China. Overcoming the challenges has mainly required patience. The registration of our subsidiary took a long time but one just had to be patient. “*

The company is currently employing five Chinese and they have been very satisfied for the Chinese workforce. According to the experiences of the CEO, the Chinese have high work ethic and they are hard-working.

The future of the company and industry field:

*“We went there in the right time and have achieved to make the first notable and big deal. Our operations are going to broaden and I’m moving there soon. China has become one of the major business areas for us. ”*

### **Case analysis**

The motivations for investing in China by the company E were mainly due to the technological development and huge market potential of China which are probably the most common reasons for entering China.

Kettunen et al. listed ICT as one of the fastest growing industry fields in China employing Chinese workforce (see page 2) The company E used initially the most common mode, exporting, as their entry mode but switched the mode by making an agreement with a sales rep company and hired locals. After that the mode was switched to FDI and now they have established a subsidiary to China.

The entry mode the case company E chose initially was exporting in order to minimize risks. According to Welch et al. and Terpstra & Sarathy (see page 28) exporting is one of the main modes used to achieve international market penetration namely because of the risks of financial loss can be minimized. Exporting is often also chosen in the beginning of the internationalization process. After the firm got the first big client, they were ready to make more commitment as they realized that there is demand for their product. Therefore they first switched the mode to FDI and finally established a WOS to China.

Surprisingly the CEO of the company said that the company E has experienced Chinese business environment to be much easier than they thought it might be. Patience was regarded to be the main challenge in cultural differences as implicated many times in this study (see i.e. page 25). One reason might be that the CEO had experience of operating in other physically distant countries; North America, Japan and Korea.

#### **4.3.6. Case F**

The EVP of the company who is responsible of Chinese business operations was interviewed on 4<sup>th</sup> of May 2011 via recorded Skype interview. The company F is offering investment services, fund management and financial services in the field of renewable energy and

other emission reducing projects. The company is employing at the time approximately 50 employees and the turnover of the company in 2010 was about 6 million €. The company entered China in 2007 and they have an office in Beijing but they have projects in about half of the provinces, mainly in the east coast. The company has international experience from Central Europe, Nordic and Baltic countries before entering China and they entered to Russia and Ukraine at the same time as China in 2007.

The motivations for investing in China based on the views of EVP:

*“For us it was mainly to find emission reducing projects from there. China is the biggest host country for CDM project. CDM is United Nation based project in which emission reducing projects are registered and they produce emission reducing units which can be used for example in EU emission trade. In Finland we are consulting both public sector and private enterprises and offering them i.e. advising and investment management whereas in China the focus is in finding the projects and carrying them through the CDM cycle. The focus is more and more in what we do in China so China is in the core of our activities. We manage funds which have Western investors but the projects in which they invest are in China. We don't have Chinese investors at the time but hopefully we will have them in the future. “*

The company has used mainly FECC as an expert in examining the Chinese business environment. Additionally they are part of the Cleantech Finland. FECC introduced the company in a seminar which led to co-operation and ultimately in establishing a JV.

The entry mode patterns in China:

*“Initially we had a rep office in China and one employee working there. Then we found a partner with whom we established a joint venture. However, they turned out to be unreliable and we couldn’t continue the co-operation with them. It took few years and we found a new partner with whom we established a joint venture and now it is working fine. We have also agreements with the local Chinese consultants who are dealing with the project development and we use Chinese subcontractors as well. We have noticed that having local partners is critical since they are well-connected and able to open doors we couldn’t open before. We are able to make contracts with enterprises with whom we couldn’t have even discussed earlier with. With JV it was possible for us. Additionally, our partner is a family company so the commitment level is higher and they won’t change the employer as easily as Chinese do usually nowadays.”*

The company has used judicial and accountant offices as intermediates and advisors in their internationalization process. The challenges and problems faced by the company in China and overcoming them:

*“Before finding the right partner which had the existing networks, we couldn’t do much in China. The network cannot be built if we have one Chinese working in a rep office and we are flying there from time to time. Therefore the main problem was that we didn’t have networks and we couldn’t create them. We don’t have these kind of problems with the new partner. There were signs of corruption with the former partner*

*which was the other reason for rejecting them. In the case of bureaucracy, the CDM mechanism is bureaucratic and demands acceptance from China. We are fighting with bureaucracy on a daily basis. Then again, we have been able to overcome the challenges and we have been able to cope with them with the help of external advisors.”*

The EVP of the company argues that it couldn't have been possible to cope without local workforce since business negotiations are done with the counterparts who only speak Chinese. Nevertheless, there are differences which should be taken into account. According to the EVP of the company F, many Chinese are not proactive or initiative and Finnish should acknowledge it. In the future a huge amount of money will be invested in renewable energy in China and the future of the company and industry field is expected to be bright. However the current unstabilizing factors are most certainly the ending of the Kyoto Protocol Commitment Period in the end of 2012 and the unclear future of international negotiations concerning climate change. Therefore the focus and role of the company is not necessarily very clear but there is strong belief for the ability to make the right decisions.

### **Case analysis**

The case company F is operating in the field of clean tech. As Herrala (see page 49) pointed out, pollution is a huge problem in China and there is a need for Finnish clean tech companies offering renewable energy and emission reducing solutions.

The company F chose JV as their main entry mode after having dysfunctional rep office. The first JV established was not successful since the Chinese counterpart turned out to be unreliable. The EVP of the company F said that after establishing a functioning JV with other partner, they have been able to benefit from the networks the other party has in China. The study by Kirby & Kaiser (see pages 34-35) implicated as well that joint ventures were formed because of the Chinese partner's business knowledge and ability to smooth the way through Chinese bureaucracy. The company F changed their entry mode in order to resolve the problem with unreliability and corruption with the other party. Welch et al. (see page 40) listed these kind of challenging situations as an alternative reasons for mode switching. For the company F, the problem with bureaucracy arises mainly from the complex nature of the CDM mechanism.

#### **4.3.7. Cross-case analysis**

Eisenhardt (see pages 55-56) suggested that cross-case analysis tactics can be divided into different tactics. Two of the tactics by Eisenhardt can be applied to this study. The first tactic is to select categories or dimensions and then search within-group similarities coupled with intergroup differences. The second tactic is to select pairs of cases and then to list the similarities and differences between each pair. This sub chapter analysis the cases based on these tactics.

The Appendix 2 summarizes the major findings of the cases studied. The number of employees between the cases varied from 4 to 130 and the turnover in 2010 varied from 0.9 million to 10.2 million €. All of the case companies or their representatives had international experience before entering China from 6 to 20 years. Case company A was the first one among the case companies to enter China in 2003 whereas cases C and D entered there in 2006 and cases B, E and F entered in 2007. The market entry patterns were different for all the firms studied and the modes covered all the other modes introduced in this thesis except management contracts and franchising.

The main entry mode theory which can be applied to this study and its findings is Dunning's OLI framework. The answers of the respondents indicated that both firm-specific and market-specific factors influenced to the entry mode decision. All the respondents mentioned also at least one of the factors related to psychic distance. Language and cultural differences were regarded to be the most difficult challenges as well as political system and industrial development. Case company E had a problem in the beginning in entering China since the Chinese thought that the markets were not ready for the products offered by the company. On the other hand, case company A can benefit from the non-functional

infrastructure in offering new solutions. Companies C, D and F are offering products which need acceptance from the authorities and may face problems with the political system and bureaucracy in China.

The case company E is operating in the field of pharmaceutical development as the case company D. Two companies from the same industry field were selected based on that it came across during the interview of the company D that they are using inward operations and the purpose was to make a comparison. Usually entry mode choice research focuses on physical entry or outward operations but as literature suggests, inward operations are more common than thought to be (see page 36). Surprisingly, both pharmaceutical development companies used inward operations as their market entry mode. The main reason behind this is probably the nature of the companies since both of them are operating through partners and China is mainly the source of the products which are imported to Europe.

The framework of the study was built by the factors which have most effect on the mode strategy. The factors influencing on the mode strategy in company's background were mainly the industry field the company is operating in and both international and market experience. Since all of the studied companies were SMEs, the company size did not have that must effect on the decision. However, there are differences between the cases in the turnover and amount of personnel so the resources might vary between the companies. Company mode concerns, on the other hand, were built by all the factors presented in the theoretical framework; risk and uncertainty, profitability, partners and intermediates. As Fei (see page 49) and Härkönen (see page 50) argued, the results of this study show as well that the major challenges for Finnish SMEs entering China are the lack of funding and difficulties in finding the suitable partners. Finpro, FinChi, TEKES, TEKEL, FECC, BENCH etc. are assisting in finding



partners and problems with funding. However, the country risk is obvious in physically distant markets for SMEs. Most impact on the entry mode choice, or entry decision itself, was based on the Chinese market conditions, government and the way of doing business. China became the world's second largest economy in 2011, and two of the companies (B and D) mentioned that the choice - already few years ago when they entered China - was either to go with the flow or to be overrun by it. The competition is becoming tougher but there are still huge amount of possibilities for Finnish SMEs and their expertise in Chinese business environment. Regarding to the government, the companies haven't faced as much difficulties in bureaucracy, corruption, legislation or taxation as the literature suggests. This is most likely due to the fact that the companies with outward operations (A, B, E and F) had used local experts and the companies with inward operations (C and D) didn't have a need to deal much with the government since they haven't entered physically in the market. The way of doing business, particularly culture and networking, were seen as a challenge but not as a problem that can't be solved and guanxi was not seen as such a big problem than the literature indicates.

Both case companies, E and F, mentioned that China has become the core of their business operations. As noted earlier in this study, both industry fields, ICT and clean tech, are the kind of industries in which China is investing increasingly and they are interested in Finnish expertise and innovations. Finnish SMEs should invest also in entering to the smaller cities in the western and northern area of China where the provinces are planning to increase their GDP notably in the next five years. Nevertheless, Finnish SMEs should be aware that the results might not show after a short period of time and succeeding in China requires persistence and commitment.

## **5. DISCUSSION AND CONCLUSION**

The rapid economic growth of China has continued for three decades and in 2011 China became the world's second largest economy leaving Japan behind. Currently China is continuing to improve the business environment for foreign firms and aims to provide them a stable and predictable market environment as their Chinese counterparts are entitled. The Chinese Central Government realized in 2002 that in maintaining market competition, creating job opportunities, increasing fiscal income, promoting technology innovation and initiating entrepreneurship SMEs are playing a significant role. Therefore the government announced a series of policies to promote the growth of SMEs in the 21<sup>st</sup> century.

Today SMEs are dominating most industrial sectors in China and they have achieved great progress in technological innovation. This chapter is a conclusion of the study including summary of the major findings, managerial implications and limitations and suggestions for further research.

### **5.1. Summary of major findings**

In the previous chapter the major findings of the empirical study were introduced and discussed both using both within-case and cross-case analysis tactics. Table 2 summarizes the major findings of the study.

Table 2 Summary of major findings

Company	Industry field	Number of employees	Turnover of the company in 2010	International experience before China (countries & years)	Entry to China (year)	Market entry mode (s)
A	Architectural design	30–40	2.9 million €	10 years in Germany and Russia	2003	Project operations
B	Consultancy, development and import of molds and components for plastic industries	4	1 million €	15 years mainly in Brazil, USA, The Netherlands, Hungary, France and Germany	2007	Exporting, international subcontracting, project operations and alliances
C	Pharmaceutical research and development	130	10.2 million €	20 years mainly in Nordic and Baltic countries, USA and middle Europe	2006	Inward operations, seeking for a partner company to form an alliance or joint venture
D	Pharmaceutical development	5	0.9 million €	6 years in several European countries	2006	Inward operations, building rep office to China
E	ICT	34	1.4 million €	13 years in North America, Japan and Korea	2007	Exporting, switched to FDI and WOS
F	Investment services, fund management and financial services in the field of clean tech	50	6 million €	10 years in middle Europe, Nordic and Baltic countries and entry to Russia and Ukraine in 2007	2007	Rep office, switched to joint venture

The initial research question was following:

*What types of market entry patterns Finnish SMEs use in China?*

Based on the results of this study, the entry modes Finnish SMEs are using in China differ. The architecture company (case A), used project operations whereas the plastic industry company (case B) and the ICT company used initially exporting. Both pharmaceutical development firms (cases D and E) used inward operations, more particularly indirect importing, as their operation mode. On the other hand, the clean tech company (case F) used joint venture as an entry mode.

Sub questions of this study were following:

*Q1. Which factors affect Finnish SMEs in their market entry mode decision concerning their internationalization to China?*

*Q2 Have Finnish SMEs changed or combined their market entry strategies after entering China?*

According to the results presented in the previous chapter, Finnish SMEs have used different entry modes when entering to China. The main reason for choosing an entry mode was based on the industry field the firm is operating (industry-specific) and the international experience of the firm and its management (firm-specific).

All of the case companies studied in this research have either switched or combined different market entry modes after entering China. Luostarinen & Welch (see page 45) claimed that companies tend to change the foreign operation methods as their level of international involvement increases. As studies of changes in operation methods have tended to treat them as

choices among alternatives, analysis by Benito et al. (see pages 46-47) showed that businesses are not struggling only with which mode to use but which combination of modes to use. Welch et al. (see page 46) add that mode combinations can be used to enter or develop a given foreign market for various reasons. Therefore the results of this thesis are in line with the previous studies concerning entry modes.

In analyzing the nature of different foreign operations, useful matrix is one previously introduced in this study on page 40 and originally presented by Luostarinen in 1979 (see Appendix 2). The matrix is divided according to the type of operation: NIMOS (non-investment marketing operations), NIPOS (non-investment production operations), DIMOS (direct investment marketing operations) or DIPOS (direct investment production operations). The y-axis in the matrix consists of the characteristics of these operations. These include financial commitment, management commitment, market control, financial risks and political risks. In case of NIMOS operations, the characteristics vary from very low to small/large whereas DIPOS operations are either very large or very high. NIPOS and DIMOS operations fall between the extremes. The matrix might be helpful for a Finnish SME entering China to compare commitment, control and risks associated with every foreign operation mode.

## **5.2. Managerial implications**

The decision making powers of managers had an important influence on the entry mode strategies the companies chose to enter a foreign country. Therefore managers need to obtain and enhance their knowledge and management skills in order to gain sustainable competitive advantage. High-control entry modes are more efficient and enable the company to minimize the costs and diminish the risks associated with the foreign environment. Since the characteristics of a host country with volatile

environment and increased uncertainty will affect management control and investment risks, MNEs could utilize a low-control entry mode in order to minimize risks and retain flexibility. Ultimately the entry mode choices depend on the characteristics of a foreign market such as increasing ownership levels by the greater market size and growth. (Chen & Mujtaba 2007, 334)

Entry mode choice plays a significant role in international management. The nature and character of the management process including aspects such as control, coordination and staffing are driven by the type of foreign operation method. For example, there are substantial differences in management demands in licensing and WOS. A company is able to integrate and control WOS in a totally different way than in the case of licensing arrangement since the extent of formal control over the activities of the licensee is dependent on the terms of the licensing agreement. Staffing moves between parent and WOS as a way of supporting control and coordination of the subsidiary which may be out of question with the respect to a foreign licensee. Therefore informal methods of control may be more effective. In contrast, management contract arrangement means that the contractor will have its own staff within the foreign contractee. (Welch et al. 2007, 5-6)

### **5.3. Limitations and suggestions for further research**

The limitations of this study arise most notably from its qualitative nature which does not allow generalizations. According to Patton (1990, 461) the credibility issue for qualitative inquiry depends on rigorous techniques and methods for gathering high-quality data which is carefully analyzed with attention to validity, reliability and triangulation. The techniques used in this study were both questionnaire sent by e-mail and recorded Skype interviews. In addition, in case there were unreliable, unclear or too short

answers, the respondents were asked to explain them more specifically by e-mail. Therefore at least two issues increase the credibility of this study. These are the responsiveness between the interviewer and the interviewee diminishing the misinterpretations and recorded interview which allowed the interviewer to check the answers repeatedly and make corrections later on.

Although the entry patterns of few of the most interesting industry fields were studied, there are many other Finnish industry fields which could be studied further on. These include i.e. nutrition industry, wood processing industry, luxury consumption products and satellite positioning industry. (Finpro 2010 & BENCH 2011)

Additionally, one of the industries studied in this thesis could be studied more widely, i.e. as a comparison between different Finnish clean tech SMEs or ICT companies in China. Therefore some generalizations could be drawn from the results if there would be similar entry patterns within one industry. On the other hand, it would be interesting to study if there are totally different market entry patterns inside one particular industry. Also, since the companies studied in this research have been in the Chinese market only few years, interesting aspect would be to study their situation after few years from now on and see whether there will be any major changes. The later phases of the firms might as well include exit patterns when a company decides to leave the market for various reasons. Furthermore, cross-national comparison of market entry patterns of SMEs in China could reveal differences related to for example cultural context or behavioral aspects. Willingness to take risk and dealing with uncertainty might vary between different countries and therefore have an impact on the entry mode decision.

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## Appendix 1

### **QUESTIONNAIRE**

Dear respondent.

I'm studying in Lappeenranta University of Technology and writing my Master's Thesis about "Market entry patterns of Finnish SMEs entering China". The study includes empirical part which I'm conveying based on the answers of this questionnaire. Your answers are extremely important for my study. Answering is voluntary and the answers are handled confidentially. The name of your company is not mentioned in the study. The last day to respond is 22.4.2011.

Thank you for participating!

#### **Preliminary information**

Company industry:

Number of personnel:

Turnover of the company in 2010:

Position of the respondent in the company:

The year your company entered to China:

Area of China that your company is operating in:

International experience before China (including number of years and year of market entry):

## Market entry patterns in China

- a) Which were the motivations for investing in China?
- b) Have you transferred all your products/services you're offering in Finland to China?
- c) Have you used experts in examining the Chinese business environment? If yes, then which kind of experts?
- d) Which market entry mode you used (exporting, licensing, franchising, management contracts, international subcontracting, project operations, alliances, joint ventures, foreign direct investments)? Why did you choose that specific entry mode?
- e) Have you switched the entry mode or combined different modes after entering to China? Please explain why or why not.
- f) Have you used intermediates, partners or agents in your internationalization process? Please explain why or why not.
- g) What kind of challenges and problems have you faced in entering to Chinese market?
- h) Have you been able to overcome the possible challenges? If yes, then how?
- i) Are you using Chinese workforce? If yes, then what are the advantages and disadvantages of it?
- j) How do you perceive the future of your company and industry in China?



If You have any questions concerning the filling of the questionnaire,  
please don't hesitate to contact me:

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The School of Business

International Marketing

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## Appendix 2

Table 3 Foreign operation matrix and their characteristics (Luostarinen 1979)

Type of operation	NIMOS				NIPOS				DIMOS				DIPOS	
Characteristics	Indirect export	Direct export	Service export	Know-how export	Licensing	Contract manufacturing	Turnkey	Co-production	Sales prom. unit	Warehouse unit	Service unit	Sales unit	Assembling unit	Manufact unit
Financial commitment	Very small	Small	Small	Small	Very small	Small	Large	Large	Large	Large	Large	Large	Very large	Very large
Management commitment	Very small	Small	Small	Small Large	Small	Small	Large	Large	Small Large	Small	Small Large	Large	Very large	Very large
Market control	Very small	Small	Small large	Small Large	Small	Small Large	Small	Small Large	Large	Small Large	Small Large	Very large	Very large	Very large
Financial risks	Very low	Low	Low	Low	Low	Low	Very high	High	High	High	High	High	Very high	Very high
Political risks	Very low	Low	Low	Low	Very low	Low	Low High	Low High	High	High	High	High	Very high	Very high

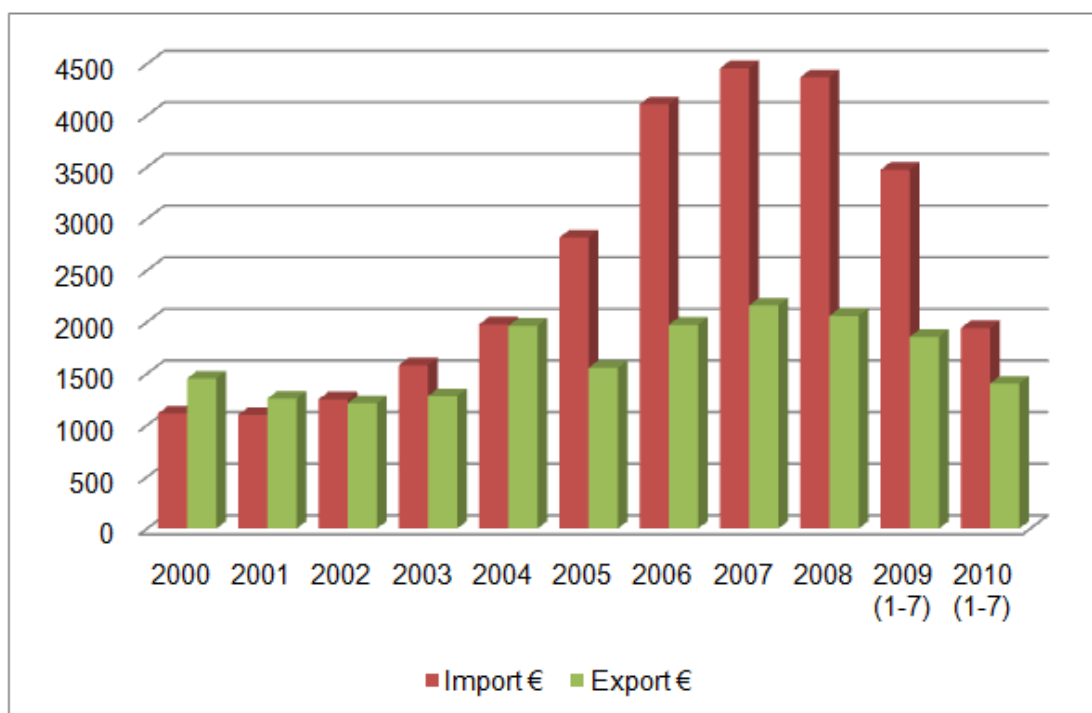
## Appendix 3

Figure 4 Map of China (Finpro 2010, 4)

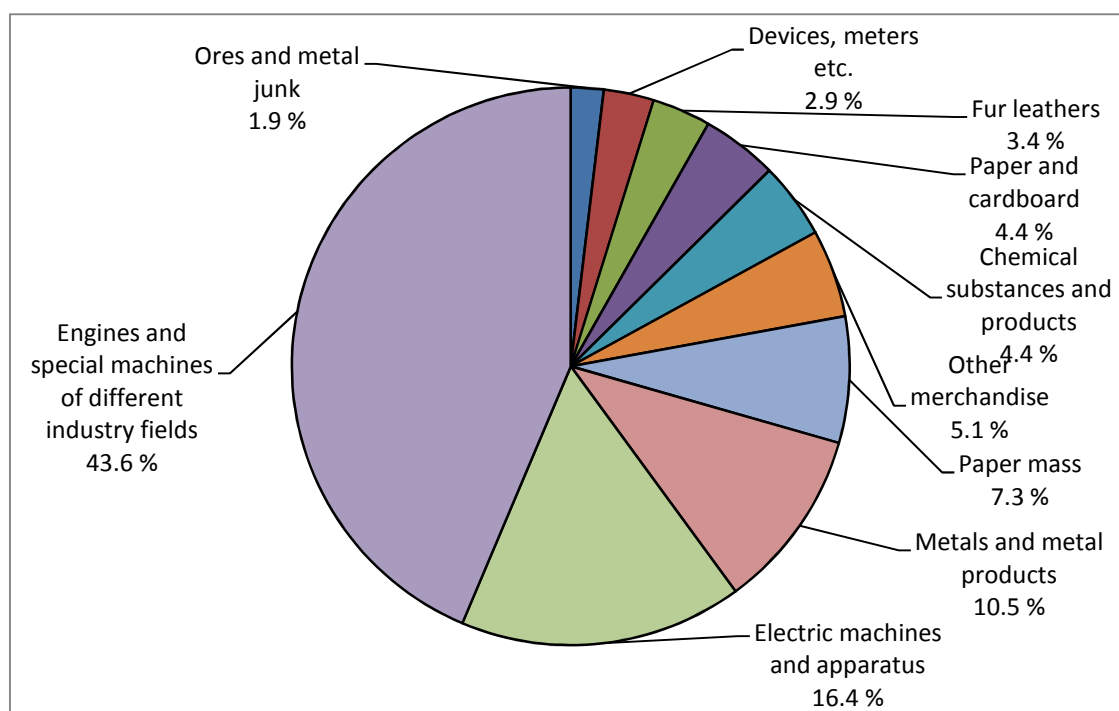


## Appendix 4

Table 4 Trade between Finland and China 2000-2010 (Tullihallitus 2010, 1)



## Appendix 5

Table 5 Export to China from Finland by product category in 2010 1-7  
(Tullihallitus 2010, 3)

## Appendix 6

Table 6 Import from China to Finland by product category in 2010 1-7  
(Tullihallitus 2010, 5)