

# China`s economy

Economics



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## Introduction

After entering into the World Trade Organization, China's economy will deeply and broadly get involved in international division of labor. To develop and establish a stable foothold in the competition, Chinese enterprises should learn and grow in the face of competition and challenges. Chinese enterprises have also realized it and explored reasonable international strategy for their development and management. Some outstanding Chinese enterprises have used mergers, acquisitions or strategic alliance with foreign companies to achieve the dream of being multinational corporations. The most representative enterprise is the Lenovo Group. Based on analysis of the international road of the Lenovo Group, the report is aimed at discuss Chinese enterprises' choice of internationalization. The structure of the report is described as follow: Firstly, it introduces the background of global PC industry and the Lenovo Group. Secondly, SWOT and PEST model are used to analyze internal and external environment of the Lenovo Group. Motives of Lenovo to go international are listed in third part. Fourthly, chooses Japan to expand its international markets and analyzes the Lenovo Group's entry model. Then the report will give advice of Lenovo's international competitive strategy. Recommendations and conclusion will be given in the last part.

## **1. The background of Lenovo Group**

Lenovo group was established in 1984, it was originally invested by Chinese Academy of Sciences and it was called ' Legend'. It is a highly innovative, international technology company formed by Lenovo and the former IBM Personal Computing Division. Lenovo Company mainly produces desktop

computers, printers, projectors, laptops, mobile phones, servers, and other goods. In a very first stage, Lenovo have to occupy the most domestic market share in China, changes from single product to wide range products. In the one hand, Lenovo made its business to meet specified customer needs, changes from product model to solution model. In the other hand, Lenovo increased its service range, changes from value added service to a full standard service. Moreover, the three stages of transformation enhanced its business integration and improved their competitiveness. In 1996, Lenovo ranked No. 1 in China's domestic market, along with its rapid development in recent years. Then in December 2004, Lenovo purchased IBM's personal PC business in a total price of \$1.25 billion dollars. The IBM personal PC business integration helps Lenovo to gain experience, especially in new product development, talent reserves, management and sales. Moreover, these insist the transformation of Lenovo from a local enterprise to become multinational corporations.

## **2. The internal and external environment of Lenovo**

Business environment consists of the internal and external forces under which the organization operates (. Stephen, 1997). It shapes the abilities of enterprises in order to keep successful relationships with their customers. Successful enterprises pay more attention to constantly watching and adapting to the changes of the business environment (Richard, 2003). Generally speaking, most enterprises can control their internal environment such as customers and suppliers, but external environment is uncontrollable, such as political factors, economic factors etc. In order to gain the unbeatable position in the market, enterprises must strive hard continuously

to adapt to the changes in the external environment (Zhao, 2004). SWOT and PEST analysis are effective tools to monitor and evaluate the internal and external environment of companies.

### **Strengths**

#### Strong market share

Lenovo has a prominent advantage on market share in Asia- Pacific PC market (not including Japan). Figure 1 shows the data about market share in the PC market of Asia in 2007. In the one hand, Lenovo`s market share is dominant compared to other competitors like Dell and HP in Chinese PC market. The Lenovo Group reached a new height of 34. 5 percent in the fiscal year 2007, and achieved 24 percent year on year growth in PC shipments (Lenovo Group, 2008). In the other hand, Lenovo is one of the leading brands in China and has maintained this leading place for over 10 years. Lenovo can fully understand the local consumers` needs as a localized enterprise and adapt to the market changes successfully.

Figure 1

Source: Internet Data Center

#### Brand advantage

The strong market share enhances the brand image of the Lenovo Group. In the PC market, the leadership of Lenovo has exceeded many other competitors in China, and is in an industry leader position. Since Lenovo has acquired the IBM`s PC operations, the advantage of Lenovo`s Dual-brand strategy appeared increasingly. The company could use the ThinkPad brand

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on existing Lenovo products. Therefore, a strong brand portfolio of Lenovo laptop was established in the domestic PC market, and it has taken a complete coverage of business and consumer market. The brand influence is improving gradually. In addition, Lenovo plays a leading role in cost control and Channel Architecture as a domestic enterprise in China. The Group is able to adjust its strategies and directions to the market development and pass its products' consumptive value to consumers quickly in order to have the advantage of time difference.

### **Weakness**

Small market share in global PC market

Although Lenovo has achieved great success in China, the market share of Lenovo in the global PC market is still very little. Market share is a comprehensive reflection of the products competitiveness. The performance of Lenovo in America and Europe is very unstable. Lenovo lags far behind Hewlett-Packard in the global PC market share. And the gap of international operational experience between Lenovo and Dell is much bigger in the US market. It will be difficult for Lenovo to catch up with Dell and HP.

Lack of scale

The Lenovo group is lack of scale to compete with its major competitors effectively. Table 1 shows the revenues and unit PC shipments of the major competitors in the fiscal year2009. It is easy to find that Lenovo falls behind its competitors.

Table 1(million)

HPAcerDellLenovo

Revenues\$114, 552\$17, 397. 4\$52, 902\$16, 604. 8

Unit PC shipments59403725

Source: Lenovo Group, Ltd. 2010

Laptops and desktops are the main products of Lenovo, but its competitors have a wider range of product portfolio. For example, Acer offers the products including notebook computers, PCs, liquid crystal display (LCD) monitors, and high-definition televisions etc. HP has various kinds of products and service, such as PCs, imaging and printing-related products and services, and technology services (Lenovo Group, 2010). Although it has expanded the product portfolio with Lenovo mobile, Lenovo needs to expand its products and service continually. Because the weak scale of the group will limit and affect its operating performance.

### **Opportunities**

Growing PC demand

The global PC market is expected to grow rapidly in the future. With the rise of the notebook market and the popularity of PC, the consumer market will show annual growth in geometric progression. And small-medium business segments of the PC markets are also expected to drive the growth. Table 2 shows the data about the demand of PC markets from 2007 to 2010. It can be seen that the demand of PC growth rapidly from the year 2007.

Table 2

20072010

Global PC shipments 250 million 350 million

Consumer segment 120 million 170 million

Small-medium business 55 million 80 million

Source: Lenovo Group, Ltd. 2010

Lenovo plays a leading role in global PC market, and the brands of PC products include IdeaCentre, IdeaPad, Essential, ThinkPad and ThinkCentre. Positive outlook for PC market will contribute to steady revenue flows for the Lenovo group in near term. This is no doubt that providing a good opportunity for the development of Lenovo in consumer market. Lenovo can be in a good position to benefit from the growing PC demand.

Olympic strategy

It is the best opportunity for Lenovo to break into the global market. Lenovo has many sports marketing cases in past few years, including signing a contract with the World Player, and cooperating with NBA. It also sponsors F1 Williams. Lenovo's Olympic marketing is the most impressive and prospective strategy. Relying on the various advantages of Olympic sponsor, Lenovo can appeal to the public's attention from the Olympic to the Lenovo's products. It will help Lenovo enhance the brand image and awareness.

Threats

As China had joined the WTO, the market is gradually opening up. It is easier for foreign companies to access to the Chinese market. More and more famous computer manufacturers have established in China, the competition

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will become fiercer. And the mid-range market and the low-end market will be the target markets for international brands, so Lenovo will face the threat from gradually reduced price. Lenovo needs to know how to develop the advantages in scale, cost, channels and service when faces intense competition. In the consumer market, Lenovo faces stiff competition from Dell, HP, Acer, Apple and Sony For example, HP became the world's first position by the success in the consumer PC market. And Dell also broke the years of single direct sales into retail stores. Lenovo will face a big challenge of Hewlett-Packard, Dell and other manufacturers in the world.

### **PEST analysis**

Analysis the external environment is very helpful for a company to achieve long-term improvement and strategic planning. Following part will focus on analyzing the Lenovo's external environment by using PEST tool including political, economic, social and technological factors.

Political- With the development of IT industry, some problems have emerged, such as environmental pollution and energy consumption. Therefore, the Green IT has been encouraged by Chinese government. Green IT refers to low energy consumption and low noise pollution. As a leader in Chinese PC market, Lenovo has achieved the task of Green IT in noise pollution. The noise index of a Lenovo brand-' Kai Tian S' was lower than 30 dB (Lenovo, 2005). In addition, the IT industry's export tariff has decreased to 9.1 percent in 2005 since China joined the WTO (Global M&A Reach Center, 2006). So these policies are tends to encourage Lenovo to expand its global market.



Economic- The world economic has a tendency to decline because of the economic crisis in 2008. However, new economic policies were announced by Chinese government at that time. The policies were loose monetary policy and positive financial policy. And Chinese government offered 400 million RMB to motivate economic growth (The Marketing Surveillance Center of China, 2008). It is a great opportunity to develop IT industry. The demand of IT products in China has also increased by the growth of GDP. What's more, the economies of some developing countries grow rapidly so that provides more opportunities for IT industry, while the IT industry in developed countries has become saturated.

Social factors- It contains education, population, income levels, lifestyles and other cultural factors. Brand awareness of the computer manufacturers will be affected by the income and education level of consumers. Firstly, education level and the demand of IT products are increasing in China with the development of society. Secondly, Chinese people become more international because of the globalization. The lifestyles of Chinese people changed a lot with the influence of developed countries. So it provides a better external environment for Lenovo's development.

Technology- Lenovo Group was established by the Chinese Academy of Science. There are more than 1, 800 computer professionals in this governmental organization which owns the highest level of computer technology in China. After the acquisition of IBM's PC operations in 2005, Lenovo took full use of the IBM's advanced technologies to produce high quality products and make the R&D activities (Lenovo, 2005). And remote work of Internet offers a good opportunity for enterprises to share their

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advanced technologies. Therefore, Lenovo Group can enhance its competitive ability in order to expand the scale of global market based on the analysis of internal and external environment.

### **3. International Expansion Rational**

Kotter (1980) pointed that two important factors decide the reason why enterprises choose to go international. First is the force of circumstances, due to market price in easy or government control, there are fewer opportunities for enterprises in home market. Second is attractive factor, the demands for enterprises' products are getting greater and greater overseas. Luftman and his colleagues (1992) described the distinction between primary motives and secondary motives. Primary motives include market-oriented investments, cost cutting investments and overseas investments for the purpose of reducing raw material costs or other reasons. Secondary motives include internal investment environment, the ability to respond to the external environment, or factors relate to the country to invest.

By 1999, the company held 21.5 percent share was the best known brand in China and had some brand presence in Asia. Having keeping the domestic PC market leadership for five following years, the company faced new challenges when China entered the World Trade Organization. The company owned 30 percent share in domestic PC market far outdistanced other competitor's 10 percent share, but it could no longer depend on local player advantages such as tariffs on imports or foreign companies' distribution channels. For example, Dell used a direct sales model to enter China. Also by 2003, the company faced an increasing domestic competition of rising

Chinese PC giants, for example Haier, the appliance maker, introduced their own-brand PCs.

Besides, seeking and capturing broad overseas markets have been the basic motive. When the company has grown to sizable scale, it will face pressure of growing markets. While domestic market cannot offer opportunities, the company has to extend to external markets. The company can expand scale and scope of product operation to enhance its competitive advantage due to external markets. On the whole, as the limitation of internal market capacity and gradually while-hot competition, also Lenovo's growth rate has been declining, internationalization has become the inevitable choice for Lenovo.

In addition, Lenovo aimed to develop its core competence by going international. In international market, Europe and other developed countries pioneer in the fields of global information technology and network technology. Lenovo has set up the research laboratory in Silicon Valley, and through IBM Deal built strategic business partner relationship with IBM, the company pursued high-tech to ceaselessly strengthen its core competence and occupy a position in the fierce competition of high-tech area.

#### **4. Country Selection**

Lenovo's next move for expansion is Japan and to focus on personal PCs. In 27th January 2010, the announcement was given by Masato Yamamoto (NEC President) and Yang Yuanqin (Lenovo CEO): A new company called B. V. established which registered in Netherland. Lenovo owns 51% shares and paying \$175million US dollars for the initial IPOs. And rest of the combination activities will be completed in June 2011.

**Country Attractiveness**

Japan is a small island located at the Pacific Ocean near China, the Japanese own a tradition of strong electronic industries, and some major world-class brands are came from there such like: Toshiba, NEC, Fujishu, Panasonic and SONY. In the Asia-pacific region of personal PC business, when competing with MNES such as: HP, dell, Acer and Asus, Lenovo is clear that it leads 20 percent of market share, however, in order to keep their position and secure their business in Asia, the opportunities for Lenovo to entry Japanese market beyond its cooperation. As a part of Lenovo`s global strategy, the market share combination will benefit NEC from the Chinese market and Lenovo from the Japanese Market, especially both brands will have a strong partnership facing the competition in a global stage. As the pie chart showed below:

**Strategic Consideration**

Meanwhile, Japan is a country with complexity, even in the business relates areas: Japan has cumbersome regulations, a deep cultural background and special business practices. The consumer market is very competitive, and consumers prefer domestic goods.

In Japan, the majority of sales channels controlled by large corporations in Japan, this increase distribution cost and impact foreign products to be less competitive in the Japanese market. Japanese consumers have the taste of high-quality products and product design.

Figure 3. Japanese market characteristics: A positive spiral of Japanese market

Source:

In the electronic industries, Yasushi (2006) mentioned the ideal cycle mode for growth as an electronics manufacturer in Japan, for several years, the negative cycle relied on saturated market limits and share competition in Japan market, and the solution for Japanese companies is to go overseas to gain more cost competitiveness. The positive cycle shows more about the relationship between market expansion and capture global market share. For Lenovo, facing these challenges, the product line could be localized in Japan or even in China, and sell computers in the Japanese market.

Figure 4: Target country's attractiveness and risk involvement

Target country's attractiveness

Lenovo

Strength (Benefit)

Weakness (Harmful)

Potential Market Growth and high end users

Good quality control and research design can fulfill Japanese customer needs, especially with IBM as one of the core brand

The gap to specifically define the locations of different sales network

' Home bias' ecosystem

Partnership with NEC will increase their brand name as PC product line were built in Japan

Lenovo still a new brand that need certain time of acceptance by JP customers

Government policies and the hardware bias over software

Hardware sales might booming according to industry gap

Software might stands alone as Lenovo want to create more added value

The absence of alternative forms of financing: banking loans and venture capital

More direct investment will have more direct control and free hand from banking operations

Foreign business have less banking backup and the bottleneck may harm the business long-term

Japanese companies preferred to develop long-term relationships

with their hardware suppliers and to depend on those suppliers

Chinese business people could more familiar with the high context culture in Japan

Relationship building with different destination dealers may lower the efficiency on new product promotion

Different concept on fitness or adaptation between computer software and operations

Lenovo`s own research center in Japan used as technical support, and further cooperation with NEC could easily modify software to fit operations

Lenovo cannot adapt their operations in order to take advantage of the software, this might increase its spending on research

## **5. International Market Entry Mode Selection**

There are many critical issues of a multinational company to be successful in internationalisation process. The entry mode selection is one of the most important issues which many scholars have been investigated in factors of the entry mode decision (Osland et al 2001). Transaction and the cost of uncertainty will be increased if the entry mode decision is inappropriate. (Meyer et al, 2009). Therefore both country level factors, (i. e. institution, exchange rate and cultural distance), and industry level factors, (i. e. market size and structure, product maturity, type and sales service) need to be considered (Meyer et al, 2009). In addition, objectives of the market entry will frame level of involvement, level of control, time spending and ownership arrangement, which lead a company to make a proper entry mode decision (Figure. 1). Since PC is a manufactured product, the foreign operating mode could be classified into wholly owned subsidiaries, export and joint venture.

Figure 6. 1 Level of involvement and time in order to choosing the entry mode

Source: Adapted from Zhu (2010)

The first entry mode, wholly owned subsidiary is a foreign business that fully operates under the parent company's control. The parent company performs self-handling operation, owns resources and its particular assets with anticipation to take high risk and generate high profits (Zhu, 2010). Level of equity arrangement to host country is 100 percent ownership. Thus, an interest of the parent company is a major. The second entry mode, exporting, is a low level of internationalisation. Products and services made by a company in one country and sent to another country (Rugman and Collinson, 2009). There is none-equity arrangement to the host country. The third entry mode, " joint venture is a special type of strategic alliance inwhich the partners share in the ownershipof an operation on an equity basis" (Griffin, 2008, p. 122). Moreover, to select the best entry mode for Lenovo expansion in Japan, advantages and disadvantages of the three kinds of entry modes is considered and displayed in the table below.

Table 6. 1 Comparisons of Advantages and Disadvantages of three entry modes

Advantage

Disadvantage

Wholly owned subsidiaries

-high power of management

-not share profit

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- chance of high political risk
- high capital investment and resources obligation
- need operational facilities in host country

#### Exporting

- no need operational facilities in host country,
- gain economy of scale
- limit opportunities to gain knowledge of local market and competitor
- slow response to customer demand
- high transportation cost
- face trade barrier

#### Joint Venture

- share investment risk, i. e. profit and loss with local partner.
- combine data, information, complementary resources and know-how
- possibility of reducing political or governmental condition risk
- lack of fully control
- possibility to face inappropriate contractual term, also argument and conflict
- loss of competitive advantage through imitation.

-managing the relationship with foreign partner

Source: Adapted from Johnson, G et al (2005) and Zhu (2010)

Japan is a country with both low physical and psychic distance from China, Lenovo's home country, so, the wholly owned subsidiaries seems not to be very risky, furthermore the country ranks 17th freest economy out of 179 countries, the economy scores above the world average and it is found none of trade barriers (Datamonitor, 2010a). However, Japan has 'Home bias' ecosystem, the absence of alternative form of finance, government policies, particular way of develop long-term relationship with suppliers and different concept adaptation between computer software and operation, which the authors have stated in Chapter. 5 before, that is, become an obstacle in the nature of competition in Japanese local market. In joint venture, the company will combine the market know-how within partners to understand market needs. Moreover the partners will bring in additional resources to assist each other in operating at the particular marketplace to overcome the new entry dilemma (Yui and Makino, 2002).

With regard to objectives in internationalisation of Lenovo in Chapter. 3, the country analysis in Chapter. 5 and review of market entry mode conditions, joint venture can be identified to be the most suitable entry mode of Lenovo in Japan. On 27th January 2011, Lenovo, (the fastest growing top-five global PC maker, who is a manufacturing and technology expertise), has announced \$175million in joint venture with NEC (new company formation structure is illustrated in Appendix. 1). NEC is number 1 Japan PC market share, who has superior brand name in Japan with strong market position.

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Evidences: benefits of the joint venture entry mode regard to objectives of international business expansion is illustrated below:

(1)Sales expansion

NEC is the strongest PC brand in Japan. Lenovo could benefit from extensive distribution channels in order to expand customer based (Lenovo, 2011). Lenovo could focus on twenty two thousand local subsidiaries of NEC around the world to expand its overseas sales as it's showed in figure 6. 4 (NEC, 2011). NEC Lenovo Japan Group become number one PC Company in Japan with approximately 25% market share as it's showed in figure 6. 2 (Lenovo, 2011). NEC Lenovo Japan Group in worldwide position at the third quarter of 2009 and 2010 is compared in table 6. 3. The company increased 1. 9% of its market share, from 9. 3% to 11. 2% after the integration (Lenovo, 2011).

Figure 6. 2: Market share of PC in Japan on 2010

Source: Lenovo (2011)

Table 6. 3: Market share of PC in worldwide on 2010

PC Manufacturer

3rd Quarter 2009

3rd Quarter 2010

+/-

HP

19.6%

17.8%

-1.7%

Acer

13.5%

13.1%

-0.3%

DELL

12.6%

12.6%

0.0%

NEC & Lenovo

9.3%

11.2%

+1.9%

Source: IDC Japan, Japan Personal Computing Quarterly Model Analysis Q3 2010 (Cited in NEC, 2011)

Figure 6. 4: NEC's sale network

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Source : NEC (2011)

(2)Resource acquisition:

It is known that PC companies have razor-thin margins which could be improved by economies of scale and cost savings. Profit margin of Lenovo is about 1.8 percent in the last reporting quarter, meanwhile their competitor, Acer, generate its profit margin at 2.9 percent. (Soh, 2011) Joint venture with NEC will perform resource acquisition and formulate economies of scale. Refers to figure 6.4, Lenovo not only has determined to improve its supply chain, R&D and sales & marketing by increasing scale, but also plan of decreasing in service, product and information system cost (Lenovo, 2011) NEC also agreed that PC product strength through the joint development. Leveraging the scale of both company will enhance PC price competitiveness (NEC, 2011). Vincent Chen, an analyst with Yuanta Securities in Taipei also claimed that 'most of NEC's PC production is out sourced'. This means that NEC have a good relationship with suppliers, cause, Lenovo would gain more bargaining power with the contract manufacturers. (Soh, 2011)

Figure 6.4: Benefits of joint venture in terms of resource acquisition.

Source: Lenovo (2011)

(3) Risk minimization:

At industry level in current period, there is a global expansion of commercial PCs manufacturers (NEC, 2011) However, PC sales dropped due to increasing of global popularity of tablet PCs such as Apple's iPad (Soh, 2011). Also, touchscreen tablets from Research in Motion(Blackberry maker) and Dell, will

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be launch soon in this year. This will cause a PC market size reduction. (Soh, 2011) Similarly, Acer(Taiwan-Based) and Asustek hit PC market with low-cost netbook PC and plan to produce touchscreen tablet(Soh, 2011). This could reflex that, PCusers' need are varies and unstable. PC makers need to develop new innovative products continuously to maintain its position in order not to drop out of the market.

At country level, there was a research of Gartner that many multinational companies, such as HP, was struggled to break in to Japan. They could not compete with a local company, such as Toshiba (Soh, 2011). Distribution channel This joint venture could help Lenovo to break in to Japan with lower risk than wholly own subsidiary or exporting entry mode.

There are many successful joint ventures in Japan. Japan's regulation attracted investor to invest in the country for example reducing trade barrier, such as lowest import tax. In contrast Meschi (2004) claims thatfailurerate of the joint venture is high. However, the successful of the cooperation depends on following agreement of the partners and the ability of partners to perform their values.

## **6. Challenges and Strategies**

### Differentiation Strategy

If there is no financial crisis in 2008, apparently NEC would not face such as loss in 2009 and 2010. Lenovo's huge opportunity appears from its product diversifications, so after the joint venture NEC could give strong support to Lenovo on its new product innovations, in order to prevent customer impression of low cost Chinese production, and making their products with <https://assignbuster.com/chinas-economy/>

more added values to attract more customers. Because the natural of personal PC industry relies on new cutting edge design, highly practicable functions and digitalized lifestyle integrations. Compare to other traditional industries, this trend would lead to Lenovo apply the differentiation strategy, but before ensuring the validity of this strategy, it is very necessary to look at what is the actual strength of NEC.

### Coordination

According the announcement given by Lenovo and NEC, they are willing to share key research centers in Japan, so, if NEC give more emphasis on personal PC division, both engineers could work together in the new joint venture company, in order to increase the speed of new product development process, especially for Lenovo, except their mainstream product ThinkPad, other product series also could get effective technical support, and boost sales. Furthermore, it is expected that both of Lenovo and NEC's brand and products could be more competitive in the marketplace, such as good research, development and innovation. As a result, Lenovo is very likely to adapt a differentiation strategy that brings the new product design back to China or other overseas market: by using the manufacturing bases in developing countries, and then integrates them with advanced technology, and Lenovo's future shows a clear path than ever before.

## **7. Conclusion and Recommendation**

In summary, Lenovo is one of most outstanding Chinese enterprises who have adopted mergers and acquisitions or strategic alliance with foreign

companies to achieve the dream of being multinational corporations. Lenovo has a dominant market share in China and prominent advantage on market share in Asia- Pacific, unfortunately not in Japan. An attractive strategy to internationally expand the firm to Japanese PC market is joint venture. Even Japan has ' home bias system', lack of financial support for JV. It is obviously a high technology development country. Lenovo could gain sale expansion, resource acquisition, especially complementary knowledge from this market entry. It is enhancing Lenovo's mission to be the global innovation leadership, refer to their mission statement.

Stepping forward into Japan is a challenging move for Lenovo. However, it is not a finish line of its internationalisation. The company needs to decide the next move strategically and appropriate entry mode. Moreover, how the company operates successfully in different market and different cultures is more important. Adjusting to a new market should be less ethnocentric. Although, joint venture is an appropriate entry mode to Japan, market research is still essential. Sustainable growth is an approach to dominate global PC market.

#### Appendix 1: PC Business Alliance Scheme

Source : NEC Japan web site (2011)

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