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Ort, Datum

Unterschrift
“Risks, Requirements and Chances of Austrian companies operating in China”

Author: Tuan Trieu Ha
Supervisor: ao. Univ.-Prof. Dr. Franz Silbermayr
Vienna, November 2011
Vorwort

First of all, I would like to thank my supervisor, Prof. Dr. Franz Silbermayr, for his support and professional advice.

Furthermore, I thank, in particular, Mr. D, Mr. W and Mr. Somweber for providing me crucial information.

Finally, I truly appreciate the help from all the interview partners.
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<th>Description</th>
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<tbody>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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<tr>
<td>DIHK</td>
<td>Deutschen Industrie- und Handelskammertages-umbrella organization of 80 chambers of commerce in Germany</td>
</tr>
<tr>
<td>AWO</td>
<td>Außenwirtschaft Österreich- the official Austrian Foreign Trade Promotion Organisation</td>
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<tr>
<td>SOE</td>
<td>State owned enterprise</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>VDMA</td>
<td>Verband Deutscher Maschinen- und Anlagenbau - German Engineering Federation</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-added taxes</td>
</tr>
<tr>
<td>SEZ</td>
<td>Special economic zones</td>
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<tr>
<td>TRIPS</td>
<td>Traded-Related Aspect of Intellectual Property Rights</td>
</tr>
<tr>
<td>WIPO</td>
<td>World Intellectual Property Organization Convention</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational corporation</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>WHO</td>
<td>World Health Organization</td>
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1 Introduction

The People Republic of China, as one of the world's fastest-growing economies, is not only the largest exporter but also the second largest importer of goods in the world (PRC National Bureau of Statistics, 2010 cited in USCBC, 1966-2011). Since 2010 China, moreover, surpassed Japan and has become the second biggest economy after the USA. The World Bank expects promising growth rates of 9.3% for 2011 and 8.7% for 2012 (World Bank Group, 2011).

Austrian firms realized the potential of the Chinese market very early. One of the pioneer businesses in the 1960s began with the export of a complete steel mill by the company Voest. Some years later Elin and Voith constructed a hydroelectric power station in Hunan (Andesner, 2011, p. 17-18).

With a volume of 8 billion euro in 2010 China has become Austria’s largest trading partner outside Europe (Andesner, 2011, p. 24ff). China, as the 4th major Austrian import and 9th largest export partner, exported goods and services valued about 6 billion in 2010. Austrian export to China, on the other hand, accounts for approximate 2.5 billion euro (Statistik Austria, 2011).

Austria’s high technology industry is a good completion of China’s technology demand. Therefore, there is still promising potential for additional cooperation, especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, paper and pulp, environmental protection as well as in the service sector. Thus, in 2011 already more than 500 Austrian companies from different sectors represent Austria in China and the number is expected to rise constantly in the next few years (Andesner, 2011, p. 4ff).

My thesis will be structured as following. First I begin with a short overview of the existing literature about internationalization and provide some results of my survey in order to explain Austrian firm’s motivation of operating in China. The next chapter focuses on the Chinese environment and risks foreign investors face, in general, when doing business in China, followed by special risk management and managerial implication. Market entry decision will be addressed in Chapter 7 and finally a short case study of Andritz Group completes the thesis.
2 Research methods

There are basically two kinds of research methods. While inductive approach focuses on generating theories starting with some observations, deductive approach concentrates on testing the theory.

Most theories of internationalization seem to be obsolete and basically focus on the competitiveness of the home country, but neglect important factors such as political, legal and cultural issues in the host country, especially in China. Therefore, my thesis, based on the deductive research tries to test following hypotheses:

**Hypothesis 1: The existing literature does not offer plausible explanation why Austrian companies operating in China.**

In recent years the production cost has increased significantly in China. Roland Berger even believes that total production costs in Czech Republic, Hungary and East Rumania is only marginal higher than those in China (Terplitz, 3.3.2011, p.21). Thus, the Austrian management consultant Professor Helmut Karner stressed out the fact that: “The time in which corporations could relocate production capabilities to China to reduce cost ended 4-5 years ago.” (Benisch, 2008, p. 77)

Hence,

**Hypothesis 2: Austrian firms do not operate in China mainly due to cost reasons.**

To date, in 2011 only few literatures deal with Austrian companies in China, since most official publications and researches focus on German and other European enterprises. Austrian entrepreneurs, thus, face some difficulties to obtain sophisticated information. Thus, besides testing the mentioned hypotheses, another target of my thesis is analyzing risks and opportunities of Austrian companies in the Chinese market and providing a basic guideline for future investors in China. Further research questions include: What are the main reasons why Austrian firms are operating\(^1\) in China? What requirements are necessary for successful business? What kind of entry mode do Austrian firms prefer in China? Finally, what can be done in order to minimize external influences, such as political, legal, cultural and economic risks?

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\(^1\) Only joint venture and wholly owned subsidiary were researched for this question
I attempt to answer the questions either with the existing literature, current publication of China experts, statistical data and reports from Austrian Foreign Trade Promotion Organisation, WTO, World Bank and Deutsche Bank or with an empirical approach. Thus, from June to the end of August 2011 800 surveys were sent to 500 Austrian companies\(^2\) and data from 107 Austrian enterprises with experience in doing business in China were collected (see appendix for results).

Due to the small response rate the results of the poll, unfortunately, cannot be seen as representative. Moreover, frankly speaking, the questions are not very specific, but more general. Future research, thus, should consider the two weaknesses. However, the survey, certainly, shows a certain tendency of Austrian companies’ concern and motivation in China. Additionally, the results are quite consistence with surveys in Germany or reports from the World Bank and basically supports the existing current literature.

Furthermore, two short interviews about Austrian-China relationship are made with Mag. Werner Somweber, Regional Director Far East of The Austrian Federal Economic Chamber and Mag. Dr. Marcus Bergmann, LL.M, Head of Unit III.3b Multilateral Trade Policy of Austrian Federal Ministry of European and International Affairs. Finally expert surveys were conducted with the Mr. W. (Austrian architect) and Mr. D. (Austrian sales manager)\(^3\) both, with sophisticated experience in doing business in China (see appendix for results).

### 3 Motivation of internationalization

There are several definitions of internationalization. While Welch and Luostarinen (1988, p.36) described internationalization as “the process of increasing involvement in international operations” Calof and Beamish (1995, p116) explained it as being “the process of adapting firms’ operations to international environments”.

Many theories and tons of books are dealing with the question why domestic firms operate abroad and which risk they general face, but the question why Austrian companies discover the Chinese market, especially in recent years, is not enough researched in the literature. Nevertheless, this chapter tries to explain Austrian enterprises’ motivation of

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\(^2\) Austrian companies with foreign ownership were also interviewed as long as they were directly involved in business activities with China.

\(^3\) both do not want to be mentioned by their full name
internationalization in China, first with the existing literature, then finally with an empirical approach.

3.1. Theory of internationalization

There are many theories in literature explaining internationalization of companies, including: trade theories by Smith, Ricardo and Hymer, diamond model, eclectic paradigm, product life circle theory, transaction cost theory and many more. This chapter, summarized the most important theories of internationalization, which are primary based on the competitiveness of the home country.

3.1.1. Internalization by Buckley and Casson

According to Buckley and Casson (1976), firms operate in foreign countries if transaction costs can be minimized by internal strength. Entering overseas market is desirable when companies are able to enjoy economies of scale, minimizing information asymmetries, uncertainties, coordination and opportunity costs etc.

This theory, however, neglects costs which arise from political, legal risks and cultural differences and is thus not very suitable for explaining why Austrian firms operating in China. Additionally, costs are increasing very fast in recent years, especially costs of production and transport. Therefore, Roland Berger even believes that total production costs in Czech Republic, Hungary and East Rumania is only marginal higher than those in China (Terplitz, 3.3.2011, p.21). Finally, empirical studies clearly show that costs are far less important than expected why firms operating in China (see next chapter).

3.1.2. Internationalization by Porter

Porter (1990) further, stressed out that the home country influence the international competitiveness of firms. The home nation shapes the character of the top management, affects strategy and organization and provides availability and quality of resources. International competitiveness, thus, is affected by four variables: factor conditions, demand conditions, related and supporting industries as well as firm structure, strategy and rivalry.

In order to be successful, firms need supply of certain factors from its home nation. While unskilled labor and climate etc. are basic factors, skilled employees, infrastructures etc. are known as advanced factors.
Demand conditions in the home country, on the other hand, influence the companies’ international competitiveness. Basically, firms have advantages in market segments which are more important in their domestic market. Moreover, high standard need at home forces them to supply high quality as well. Finally the demand of local market anticipates the foreign demand, which gives the firm a competitive edge against foreign rivals.

Having good related and supporting industries, such as clusters in the home nation, give firms the ability to compete in the international market. Important Austrian clusters include: Automotive, Health Technology, Renewable Energy, Environmental Technology and Mechatronics (bmwfj, 2011).

Finally competition force firms to innovate and to focus on efficiency again resulting to international competition.

Even though some characteristics apply to the Austrian market, such as availability of skilled labors, industrial cluster, infrastructure and sophisticated demand of the local market, the theory explains, at most, the strong export orientated industry of Austria. However, Porter’s theory alone does not really give the whole answer why Austrian companies are operating in China.

3.1.3. Eclectic paradigm by Dunning (1980)

The OLI paradigm is based on the transaction cost theory but include three additional factors. In general, a firm is successful overseas when it has certain advantages to minimize the operating cost in the foreign market. Ownership advantage such as technology, brand name, networks, economies of scale and export knowledge can offset the additional costs. These are, indeed, advantages of Austrian enterprises differentiating from others. Without any doubt Austrian firms are strong in technology and brand name, especially due to technology clusters and high commitment in R&D (Prazak, 28.6.2007, p. 26; bmwfj, 2011; Andesner, 2011, p. 13). Besides being part of clusters at home, many Austrian companies have already participated in firm pools to combine resources in China (Wirtschaftsblatt Sonderthema, 28.6.2007, p. 47). Finally, due to the central location of Austria, international relationships and EU expansion Austria has become a strong exporting country (Andesner, 2011, p. 41). High exports rate, above 90% of a company are more and more common (Haller and Schedl, 2009, p.154), which on the other hand again guarantees sophisticated knowledge in export.
Location advantages include: access to capital, human resource, market and technology in the host country. Although China does not provide all location advantages à la Dunning, potential of the market and availability of human resource play a significant role for internationalization of Austrian firms. Austria’s high technology industry, moreover, is a good completion of China`s technology demand, especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, environmental protection and in the service sector (Andesner, 2011, p.26). Providing niche and customized products is another advantage how Austrian players differentiate from others (Andesner, 2011, p.42ff; see survey).

Finally internalization advantage gives the companies the benefit to gain particular know how. Firms, moreover, internalize when they already own certain skills. Part of the theory is quite useful to explain Austrian companies operating in China. But the theory still neglect external influences of the host country such as such as political, economic, legal and cultural issues, even though Dunning revised his theory several times.

3.1.4. Product life-cycle theory by Vernon

Vernon (1966), on the other hand, explained internationalization as a result of extending the life cycle of a product. Basically, if the domestic market is saturated, firms begin to export their goods in foreign markets. The final step of internationalization is FDI. However, the product life cycle theory might not be a good explanation of Austrian companies in China, since trade barriers and especially the different Chinese consumer preferences are not considered in the theory. Especially, in the supply industry (key focus of many Austrian firms), high quality and innovation are demanded. Thus, commodities which are already obsolete and saturated in the Austrian market won’t fulfill the expectations of the Chinese industry either. Besides, one can also assume that a high number of Austrian companies nowadays do not only produce for the domestic but also international market. That’s why the theory by Vernon don’t give a suitable explanation for Austrian companies operating in China.

3.1.5. Location theory (e.g Welge/Holtbrügge 2003)

Location theory explains internationalization based on the assumption that companies choose locations to maximize profits.

The quest to reduce costs is an important reason for FDI. Climate conditions, resources and especially labor costs are often different between countries. Transportation costs, foreign
government policies and laws also have a deep impact to produce and distribute in oversea markets. Moreover, the aim for profit encourages firms to look for new markets and sources of demand. In addition, consumers attract companies operating in other countries to meet their demands. Because of the shorter distance firms can also better explore the taste of the local market.

This approach seems to be a better explanation for Austrian firms in China, even though it is not only the costs that matters but closeness and access to the promising market. Furthermore, the theory also considers the external factors, such as political, legal and economic environment.

3.2. Motivation for operating in China from the empirical view

Since the theories alone do not give a good explanation why Austrians companies actual operate in China, this chapter, thus, deals with the empirical approach.

There are different reasons while firms operate in China. While some are using China as location to distribute to Asian countries, others especially big sportswear and equipment suppliers have their own production plants to reduce the dependency on Chinese manufacturers (Hofer, 21.7.2011, p. 26-27).

Gaining access to resources is becoming more and more important in recent years, since China taxes and imposes quotas to their exports (Knoll, 2011, p.13-14). According to a survey of the DIHK, about 50% of the German companies already have difficulties to access resources (Rauner, 2011, p.73). The situation might get worse, since the Chinese government even planned to ban selling of the scarcest earth (The Economist, 10.10. 2009, p.65; see chapter 5.1.1).

A German survey in 2002 indicated that 94.4% of medium-sized businesses, which are already investing in China, are attracted by the future potential of the Chinese market. 82.5% of the respondents operate in China because of its actual market potential. The poll, further, revealed that less than 50% move to China because of lower production costs. In addition, the

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4 for example: Isovoltaic, Andritz etc.
study also showed that the main reason for representative office in China is accessibility to the customers (Zinzius, 2006, p.3).

My results, actually, are quite consistent. From the opinion of the investigated Austrian firms, the main motivation for them operating in China either with joint venture or wholly owned subsidiary is “the potential of the future market (79.6%)” and “potential of the current market (76.2%). Customer accessibility (30.5%), cost factors (28.8%), and supply purposes (22%) are further important reason for doing business in China. In compare to the German survey “cost factors”, however, is only a minor motivation for Austrian companies. A possible explanation is that the results of the German poll from 2002 might be obsolete, because cost in China has increased significantly in recent years.

The findings clearly show, that “lower cost” is not the main incentive anymore why foreign firms, finally enter China but distributing in the Chinese markets, since expenses for employee are often higher than expected, especially those for high qualified staffs (Hofer et al, 3.3.2011, p. 20).

### 3.3. Chapter summary

There are several theories of internationalization trying to explain the incentives of firms operating overseas. Generally, one can say that no single theory alone is perfectly suitable to clarify why Austrian companies set up overseas subsidiaries or joint ventures. Some are too general and others neglect important factors such as political, legal and culture issues. The empirical view revealed other insights. While the theories of internationalization are primary based on the competitiveness of the home country, the empirical research considers factors of the host country, such as cost, market potential and closeness to the customers. It seems that serving the current and mainly the future Chinese market is the key triggers why foreign firms operating in China. Consequently, the potential of the market will be analyzed in the next chapter.
4 Chinese market as a big opportunity?

<table>
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<th>China`s GDP growth in the last 40 years</th>
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<td>growth in%</td>
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</table>

Figure 4-1: China’s GDP growth in the last 40 years. Source: Own illustration, figures are taken from World Bank- World Development Indicators (2010)

The People Republic of China is one of the world's fastest-growing economies, with average GDP growth of more than 10% for the last 40 years. It is not only the largest exporter but also the second largest importer of goods in the world (PRC National Bureau of Statistics, 2010 cited in USCBC, 1966-2011). Since 2010 China, moreover, surpassed Japan and has become the second biggest economy after the USA. The World Bank expects promising growth rates of 9.3% for 2011 and 8.7% for 2012 (World Bank Group, 2011). However, not everyone shares the China euphoria. The University of Pittsburgh for example questionsthe credibility of China’s GDP statistics and believes the official figures might be manipulated to fulfill the plan of the communist party. According to their calculation, the actual growth of the Chinese GDP must be 2 or 3% lower than official announced data, since China’s growth is not consistent with its energy consumption (Chee and West, 2006, p. 30; Holtbrügge and Puck, 2008, p.21).

Barry Eichengreen, a famous professor of Economics and Political Science at the University of California also has a more pessimistic view regarding future growth of the Chinese economy. According to his study, China’s economy might begin to slow down in 2015. He found out that high growth rates start to shrink when the per capita incomes reach about 17000 US$, which might happen in 4 years in case of China. He, further, explained that slowdowns always happen when allocating workers from the primary to the secondary sector is exhausted (Buhse, 16.5.2011, p.18).

Growth slowdown, in general, is not necessary a big deal, but in case of China economists believed that it needs annual growth of at least 8% GDP in order to stabilize its economy (U.S Commercial Service, 2009). Otherwise it is difficult to provide 15 million new jobs annually to avoid further social restlessness (Chee and West, 2006, p.33). Even though the official numbers show that unemployment rate is only slightly above 4% in 2009 and 2010 (CIA-The
World Factbook, 2011) some experts believe that the Chinese unemployment rate even reached the threshold of 15% already (Chee and West, 2006, p. 33; Sieren, 2007, p.9).

Nevertheless, according to the Annual Global CEO Survey of 2011, China was named as the most “important country for future growth” in front of the United States (Ministry of commerce People’s Republic of China, 6.2.2010). Another study from Advisory Partners presents similar results. According to their poll, more than 80% of the 600 questioned firms from Great Britain, France and Germany (with revenues more than 40 million) believe that China offers the best opportunities followed by India (Sommer, 26.4.2011, p. 20). A survey of German enterprises conducted by DIHK revealed consistent results with the other two empirical researches (Reuters, 31.3. 2011).

China, with a population of 1.3 billion, does not only offers an army of relatively cheap labor, but also a big potential market. Many western brands already entered the Chinese market. Even during the economic downturn in 2009 the sales growth surpasses 10%. (Deutsche Bank Research, 2010, p.3).

<table>
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<tr>
<th>Year</th>
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<td>2 mio</td>
<td>7.1 mio</td>
<td>9 mio</td>
<td>13.6 mio</td>
<td>19 mio</td>
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Figure 4-2: Number of new car registration in China. Source: Own illustration, figures are taken from Korea Automobile Manufacturers Associations cited in AWO (2011, p.7); Allich et al, (27.6.2011 p.26)

As shown on the table, the number of new cars increased more than 6 times between the year 2000 and 2009. Since 2009 the second-largest economy, hence, has become the biggest automotive market in the world. The sales in cars in the Chinese market account 13.6 million units in 2009 and 19 million are expected to be distributed in 2011(Allich et al, 27.6.2011 p.26).While the total number of vehicles in use in China is about 80 million in 2010 the government estimated a growth to 200 million by 2020 (AFP, 06.09.2010). Analysts of

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5 1201 CEOs were asked
6 a leading international consulting firms
Norddeutschen Landesbank even predict China`s total demand of vehicles will add up to 600 million in the long run\(^7\) (Wirtschaftswoche, 14.2.2011, p.107). But even if the expectations are not fully met, China car market still offers immense prospects for Austrian high quality suppliers of automotive components. For this reason Pollmann, a Lower Austrian car component supplier started its China`s presence already five years ago with a location near Shanghai. Another example is the Styria service company Engineering-Dienstleister-Gruppe AVL List GmbH, which found a battery test laboratory in Shanghai last year in order to participate in the potential of the China`s market (WOP, 10.12.2010). All in all, more than 700 Austrian companies with an export volume of 25 billion annually already supply the biggest automotive market in the world (Andesner, 2011, p. 41).

### 4.1. Chinese private consumption

Chinese private consumption is only about 16% of the US consumption and thus, has high growth potential, since the high forecasted GDP growth will have positive impact on per-capita income as well ( Deutsche Bank Research, 2010, p.1). Consequently, Euromonitor International expects China middle class to reach 700 million in 2020\(^8\) (Hodgson, 2007). A great number of Chinese are doing part time jobs. Since this additional income is not always included in official statistics (Zinzius, 2006, p.21), the number of the promising middle class, therefore, can be reached before 2020. A study from McKinsey supports this euphoria. According to their research, China could boost up its consumption rate from 36% in 2005 to 50% of GDP by 2025 (Woetzel et al, 2009b). Consequently, China is forecasted to become the second largest consumer market in the next 4 years (The Economist, 9.7.2011, p. 57). In order to participate in this promising development Dietrich Mateschitz for example, is planning to distribute Austrian Red Bull in China. He expects sales of 600-700 million cans annually (APA, 4.5.2011).

However, the Chinese market is very heterogenic, due to the income gap between urban and rural areas as well as east and west of China. The urban population which account about 50% (Xinhua, 30.7.2010) has an average income per capita of 18900 RMB (2770 USD) whereas rural citizens` represented only 7100 RMB (1050 USD) in the year 2009 (China Statistical Yearbook 2009 cited in Deutsche Bank Research, 2010, p.7). Respectively rural consumption

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\(^7\) They did not specify the term long run, but according to the context by 2025 or even later

\(^8\) (annual income between 60000 and 500000 RMB, own calculation: respectively about 6800 and 57000 Euro September 2011)
is about one third of urban households (Deutsche Bank Research, 2010, p.7). Therefore, it is a huge mistake for foreign companies to consider China as only one homogeny big market. Due to its geography size and, especially different ethnic groups and income distribution, it has the complexity\(^9\) of the European market. Hence, it is essential to do proper market research before entering the promising Chinese market.

According to Deutsche Bank Research (2010), urban households have high growth potential especially for the demand of mobile phones, automobiles, computers and Hi-Fi sets, while for rural population an even higher consumption for communication appliances is forecasted.

Nonetheless, the promising forecast does not automatically guarantee a successful operation in China. The ratio of household consumption to GDP was about 50% in the 90s but fall to 35% nowadays even with the increase of affluence (The Economist, 25.6. 2011 p.7). In addition, Chinese consumers are generally more price sensitive in compare to other developing countries (Magni and Atsmon, 2010) and local suppliers are cheaper and their quality are constantly improving. The Economist (17.10.2009), thus, suggests foreign enterprise to compete on quality instead of price. Levi Strauss, GM and Apple are some examples already enjoying an exclusive status and even charge higher prices in China than somewhere else (p.66). In fact, 81.31% of the interviewed Austrian firms are trying to differentiate by quality instead by cost (2.8%) (see appendix for further results).

Even though brands and quality have become more and more important due to the increase of wealth, foreign brands are not necessary preferred to local’s except for luxury goods\(^{10}\) (Schmitt, 2005, p.18). Consequently, the Austrian specialist in building fire-fighting vehicles, Rosenbauer retreated from China due to lack of demand of high quality fire-fighting vehicles\(^{11}\). (orf.at, 15.1 2009) Chinese brands are already dominating, especially in electrical and domestic appliance. Some local market leading brands are TCL, Haier, Lenovo and Little Swan\(^{12}\) (Zinzius, 2006, p.22).

\(^9\) About 70 region, 56 ethnic groups with 80 dialects (see chapter 4)
\(^{10}\) Thus, to date (2011) Swarovski and Frey Wille together have 200 boutiques in China (retrieved from their homepage)
\(^{11}\) Rosenbauer, however, carries on exporting to China (orf.at, 15.1 2009)
\(^{12}\) TCL (TV), Lenovo(Laptop), Haier(electrical and domestic appliance), Little Swan(washing machine)
4.2. Good opportunities for Austrian industrial good suppliers?

This chapter focuses on particular Chinese sectors which offer promising prospects for Austrian companies.

4.2.1. Water and wastewater treatment

China faces big problems of water pollution and water availability. According to China Environmental Statistical Yearbook 2008, more than 50% of major rivers and 70% of lakes and reservoirs in 2007 had water quality which is categorized as “unfit for human contact or industrial use” (Jun, 2010, p.177-178). The Chinese government realized the severity of the problem and set the goal to construct water saving society and treat water pollution. By 2010, thus, 48 billion USD was spent to fight against water pollution (U.S Commercial Service, 2009). According to the WKO, China will spent additional 600 billion USD for water and wastewater treatment in the next 10 years (Andesner, 2011). For Austrian high quality suppliers of water saving technologies and equipments as Aqua Engineering GmbH, Andritz AG, M-U-T etc., this can be a great opportunity.

4.2.2. Construction equipment market

Due to the growing of China’s economy more and more construction equipment is demanded. Chinese decision makers, for instance, planned to expand the railway system from 72000 (2004) to 100000 kilometers by 2020 (Zinzius, 2006, p.9f). Until the next decade urban subway network will also be prolonged from 1000 to 4500 kilometers (The Economist, 16.1.2010, p.59). Further big projects cover investment in real estate sector and infrastructure, which includes airports, in the west part of China to avoid further rural depopulation (Zinzius, 2006, p.10).

In the first quarter of 2010 China’s trade volume of construction equipments is 3.76 billion US$, which is 27.5% more than last year. The customs statistics also revealed that import of construction machines increase of 62.3%. The total import, thus, accounts for 1.77 billion US$ (Construction equipment and farm machinery, 2010).

Therefore, construction equipment market is another great chance for Austrian companies in China. Alpine Mayereder Construction Co, Ltd, Trotec, Andritz-Kenflo Foshan Pumpe
GmbH and Gruber Extrusion Technology Co., Ltd. are few examples, which already represent Austria (see Andesner, 2011, p 46ff). However, competition in the Chinese construction machinery market is quite fierce. Wheel loaders, as one of the most important construction equipment are mainly provided by Chinese companies. Excavators which are much more sophisticated are still dominated by foreign competitors, but Chinese companies have increased their market shares over the years (Perkowski, 2010). The Economist (16.1. 2010), moreover, warned: “The foreigners providing the equipment, however, may find that today’s returns have come at the expense of tomorrow’s” (p.59).

4.2.3. Manufacturing machinery

Likewise construction equipment, machinery for manufacturing experienced rapid growth in recent years as well. Therefore, China is projected to remain the most important market for machine tools (Plant Engineering, 2008). Local competitors, on the other hand, mainly supply machines with lower technology stage, although more complicated and specialized machineries are demanded for the Chinese future economic development. Thus, incentives of the authorities are already set to support modern and sophisticated machinery in order to boost Chinese efficiency (U.S Commercial Service, 2009).

Austrian firms, such as igm Robotersysteme AG, Andritz–Wolfensberger, Firma Franz Haas Waffel- und Keksanlagen-Industrie GmbH and many more have already participated in this market (see Andesner, 2011, p 46ff). Nonetheless, investors need to keep in mind that Chinese customers are not only asking for good quality but also fair prices. Therefore, Borgonjon and Kaiser (2011, p.22) recommend smaller companies to form joint productions or alliances to meet the demand of the Chinese market.

4.2.4. Medical Equipment

2000 pharmacy joint ventures already realize the market potential in China (2005) and the market is expected to grow 6-8% annually by 2015(Zinzius, 2006,p.30). According to China Daily, the Chinese government aimed to provide basic medical care network for everyone by 2020 (Wang, 17.3.2011). To improve the health care sector the government, hence, spends 124 billion US $ until 2012 (Wills, 21.1.2009). Only between 2009 and 2012 2000 new hospitals are planned and further 5000 will be enlarged. In addition, 290000 health care centers are constructed. Moreover, about 75% of the medical equipments in 2009 seem to be
obsolete and need to be replaced in the next years (Du, 2009 p.16-17). Consequently, the
demand presents a great view for foreign corporations.

Nevertheless, due to strong local competition and protectionism, global sales of foreign
pharmacy giants, such as Pfizer, AstraZeneca and Bayer are even less than 2% in China (The
Economist, 17.10. 2009, p.66). In addition, it’s essential to keep in mind that especially the
medical sector is prone to corruption (Naisbitt J. and Naisbitt D, 2009, p. 229). Therefore, not
only the chances, but also the risks you be evaluated before entering the market. Some
Austrian companies 13 already realize this opportunity and focus on providing medical
equipments in China.

4.2.5. Energy and Environment

In March 2011 the draft of the new 12th Five-Year Plan was released. One important goal of
the Chinese authorities is to improve the environment by reducing 17% CO214 emissions and
16% of energy consumption by 2015. (Seligsohn and Hsu, 2011) On the one hand, trillions of
yuan will be spent for cleaner and efficient power systems; on the other hand, industries will
be encouraged to lower the energy consumption. Private consumer will also be motivated to
buy more environment friendly goods (Ho, 27.4.2011).

According to Zhang Guobao, Director of the Chinese National Energy Administration, one
strategy to fulfill this objective is to boost non-fossil fuels development, (Seligsohn and Hsu,
2011) including building wind, water and solar power station. China’s commitment to the
environment again opens a really promising market for Austrian companies. To date, in 2011
China possesses most of the wind power stations in the world and nearly every second new
plants are built there (DPA, 7.4.2011, p.30). The market of green energy and environment
friendly technology, therefore, is expected to grow 15% annually in the next few years
(Andesner, 2011, p 42).

Some Austrian representatives such as Andritz Technologien GmbH, Aquan Engineering
GmbH, Austrian Energy&Environment AG & Co KG, Erema Engineering Recycling
Maschinen und Anlagen GmbH, Isovoltaic and many more already enjoy good reputation in
China (see Andesner, 2011, p 46ff).

13 Vamed Healthcare Co.Ltd, AME International GmbH, EV Group, GS Handelsgesellschaft mbH, Odelga
HandelsgesmbH, Plannsee SE and Reschreiter GmbH (see Andesner, 2011, p 46ff)
14 per unit GDP
However, investors need to bear in mind that especially the energy sector is heavily controlled by Chinese authorities and public bidding is not always transparent and fair. Besides, local competitors such as Suntech, Yingli Green Energy and Trina Solar already dominate the solar business. Moreover, by now more than 150 Chinese solar components suppliers already have the German TÜV-certification (Weishaupt, 10.8.2011, p.30). Hence, penetrating in this market is sometimes much more sophisticated than expected (see chapter political environment).

4.2.6. Pulp and Paper

China’s pulp and paper industry is quite promising. Chinese consumption of paper has increased 10% per year in average since the 80s (rpoth.at ,2007) and reached 72.90 million tons in 2007(Krause and Associates Home, 2009). However, per capital it is only 64kg in 2009. Given that the consumption per capital is 266kg in the US in the same year (Messenger, 2009) and about 260kg in Austria in 2007(Krammer, 2010, p.32 )\(^\text{15}\), China pulp and paper industry still has huge potential for future growth. Therefore, it is predicted that China, as the second biggest paper consumer now, will surpass the US in 2015 (rpoth.at, 2007).

Particularly, because of obsolete manufacturing procedures, as well as absence of high quality resources China’s local suppliers cannot fully meet the domestic demand (Zhuang et al, 2006, p.1) which again offers promising opportunities for foreign investors.

Some Austrian suppliers, thus, such as Mayer Melnhof, Andritz Group, Voith, TRIERENBERG HOLDING AG, Christof Group, GAW Machinery Technologies and many more are already benefiting from the growth of the Chinese pulp and paper industry.

4.2.7. Service sector

The Chinese service sector, in average, grew 10.8% from 1978 to 2004 (Wu, 2007). By 2015 it should reach roughly 48% of the GDP which is the objective of the new Five-Year Plan 2011-2015 (Jie, 2.3.2011). During the Chinese –Austrian Trade Forum in Vienna 2010 Chen Deming, the Chinese Trade minister not only praised the good trade relation of the both countries, but also welcomed Austria modern service industry operating in China. “\textit{Austria is

\[^{15}\text{Depending on sources the figures could be different in other statistics}\]
a service trade power, hope to play a dominant Austrian service enterprises expand cooperation with China in the field “(ETCN, 2010).

According to the Yearbook “2011-2012 Made in Austria” published by WKO, already a huge number of companies represents Austrian trade services in China including: financial service, architecture office, consulting, construction and logistic (see Andesner, 2011, p 46ff).

Notwithstanding, to penetrate the Chinese market following risks need to be considered: Economic, cultural, political, legal and general environmental risk (e.g. Cavusgil; Donald; Buckley). One should take into consideration that foreign investors are often surprised that the potential of the market is smaller and numbers of competitors are larger than expected (Chee and West, 2006, p.14ff). Thus, not only money and time, but also patient is required for successful operation of business in China. Other important factors include understanding the legal issues and having a good network (guanxi), reliable partners and competent employees. All these issues will be covered in the next topics.

4.3. Chapter summary and conclusion

As the second largest economy and one of the fastest growing nations in the world China offers enormous opportunities for foreign companies. At the moment Chinese consumption is still quite low in compare to western countries, but this might change in the near future, since a promising number of middle class will be developed over the next decade. Even so with the increase of wealth Chinese consumers’ preferences become more sophisticated. The heterogeneity of the market is another huge barrier.

Nevertheless, for Austrian companies the Chinese market provides good chances, especially in the construction, environment, pulp and paper, energy and health sectors. More than 500 companies already represent Austria with a physical presence in the Chinese market in 2011(Andesner, 2011, p.5). In addition, the Austrian Federal Ministry of Finance and Austria Wirtschaftsservice GmbH grant soft loans to support export and projects (Andesner, 2011, p.23; Wirtschaftsblatt Sonderthema, 28.6.2007, p.48). However, Austrian investors should bear in mind that China’s market is not as easy to penetrate as one might believe. 57.01% of the respondent Austrian firms already regard local competition as one of the main threats for the business. Besides fierce competition, legal and cultural issues as well as political influences need to be considered to successfully operate a business in China.
5 Assessing the environment and risks

“We are not fit to lead an army on the march unless we are familiar with the face of the country – its mountains and forests, its pitfalls and precipices, its marshes and swamps.”

Sun Tzu, Chinese

Since China has opened its economy the flow of foreign investment creates an enormous growth. Many investors regard China, thus, as the most promising country for investment. Nevertheless, businesspeople are still very vulnerable to external influences, such as regional political unrest, discrimination, corruption, intransparency of the business and legal environment and finally the uncertainty of the economic situation. Therefore, this chapter deals with the assessment of the environment and risks of operating in China. Since risk management involves knowledge of the culture, a basic insight of the Chinese culture will be focused as well.

5.1. Country specific environment of China

Assessing the Chinese geography and demographics environment is one of the first and crucial steps to understand the Chinese market.

Illustration 5-1 Map of China. Source: The University of Texas, 2011)
With a size of about 9600000 km² China is the 4th largest country in the world after Russia, Canada and the USA. China stretches across the East Asian landmass and bordering the East China Sea, Korea Bay, Yellow Sea, and South China Sea. China, further, is situated between North Korea and Vietnam (CIA-The World Factbook).

5.1.1. Topography

The northern part of the country is an area of agriculture, while Northeastern China is a region of mountains and forestland with important resources such as iron, coal, gold, oil, lead, copper and magnesium. China is rich of mountains and high plateaus in the Northwest. Central China with many rivers and lakes on the other hand is a fertile area. Due to the tropical weather in the South the land is very fertile as well, thus, the Pearl River delta has some of the richest agricultural land. Southwestern China, on the other hand, is famous for its mountains and especially benefits from mineral resources including coal, iron, phosphorous, manganese, aluminum, tin, natural gas, copper, and gold. Finally the biggest high plateau region in China can be found in the west (Lerner et al, 2003).

Mountains and rivers

60% of China’s land areas consist of mountains and plateaus which in fact makes transportation of goods more challenging. The People Republic has two major river systems. Yellow River also known as "the cradle of Chinese civilization" and Yangtze River that divides the physical and cultural line between Northern and Southern China. Both are one of the longest in the world. The rivers do not only serve many Chinese with water and energy, but have become crucial ways of transportation since the ancient times. Over the years more and more large and medium size vibrant cities were established along the rivers (Staiger et al, p.2f, 2006). More than one fourth of the Chinese population lives on the high fertility land of the Yangtze River basin. 50% of agriculture and 40% of industrial products stem from this area (Sieren, 2007, p.14).

Natural resources

Water, however, is not equally distributed among China. 96% of rainfall occurs in the east, while veldt and desserts are dominating in the west. China possesses 149 out of the 163 discovered minerals and resources, which include: coal, iron ore, petroleum, natural gas, 

16 Depending on the calculation of the United States some says that China is the third largest country
mercury, tin, tungsten, antimony, manganese, molybdenum, vanadium, magnetite, aluminum, lead, zinc, rare earth elements, uranium etc (Staiger et al, 2006, p.12ff). While coal is mainly concentrated on the Northern part of China (Shanxi), iron can be found on northeast, north- and southwest of China. Oil reserves are primary discovered in Northwest China, Northeast and Northern China (Holtbrügge and Puck 2008, p.8f).

Today 95% of the most rare earths world’s supply comes from China. The largest part of the minerals stem from the Inner Mongolia. These rare earth elements are mainly used for production of mobile phones, mp3, plasma television, green goods etc. (The Economist, 10.10. 2009, p.65).

5.1.2. China’s energy and environmental problems

Even though China is rich of mineral resources it faces severe energy problems. Energy demand is growing faster than its GDP. The authorities realized that energy development at the expense of environmental damage is not sustainable (see new 5-year plan). A study of the WHO in 1998 revealed that 7 of 10 most polluted cities in the world were Chinese (Jun, 2008, p. 176). According to Blacksmith Institute, in 2007 cities in China still belong to most polluted ones (Walsh, 2007).

Pollution has serious impact on the health of the people who are contributing to the wealth of the nation. Besides, it has been triggering water scarcities for years, which are not only used for private consumption, but also for agriculture and industrial purposes. A study of the World Bank, thus, shows that the costs caused by water pollution account 147 billion yuan or 1% of GDP per year. In addition acid rain leads to crop and material damage, a loss of 30 respectively 7 billion yuan annually (World Bank, 2007, p. 81ff).

Foreign companies, on the other hand, often complain about China’s energy shortages. If the situation carries on, some will even consider disinvesting from China. The Honda facility, as a famous example, was force to shut down in Guangzhou due to insufficient energy supply in 2004. Taiwanese authorities even encourage their companies to come back home to “better manufacturing, infrastructure, and lots of electricity” (Iyengar, 2004). After all, power outages, in average, cost 1.4% of lost in sales in manufacturing sectors (World Bank, 2006-2009). Loss of time and reputation are other consequences.
Energy shortage and pollution, thus, can be a serious threat to investors. Nevertheless, as already mentioned in the previous chapter, also bring new opportunity of investment, especially for “green-tech” Austrian companies.

However, it is unclear if China can provide enough energy without harming the environment in the short and medium run, since the hunger of energy continues to increase in 2011. In Cixi in the province of Zhejiang energy was even turned off every second or third days due to shortages. The situation might get worse. China Electricity Council (CEC) estimates a shortage of 30 million kilowatt in the summer months of 2011 (Kühl, 2011). Other severe shortages are reported in Yiyang, a city in South China in April 2011, where energy was supplied only on two days a week (orf.at, 04.06.2011).

5.1.3. Population

With more than 1.3 billion, China is the world’s most populous country. It has a moderate national population density of 133/km², slightly more than Austria’s (101/ km²). Nonetheless, the population is not equal distributed and the majority lives in the east area, where the density is more than 400/km² (China.org.cn, 2002; Trading Economics, 2011). While in 1978 urbanization rate is only 18% (Holtbrügge and Puck 2008, p.9), in 2010 the urban population accounts about 50% (Xinhua, 30.7.2010), and it is expected to rise to 66% by the year 2025. More than 1 billion Chinese will live in the cities in 2030 (Woetzel et al., 2009a)

The capital Beijing with 12.2 million inhabitants is the second largest city after Shanghai (16.5 million). Other big cities include: Chongqing 9.401 million, Shenzhen 9.005 million and Guangzhou 8.884 million in 2009 (CIA-The World Factbook, 2011).

5.1.4. Ethnic groups and languages

Han Chinese, as the majority of the people group, accounting 91.5% is one of 56 officially recognized ethnic groups within China. Other ethnic minorities include Zhuang, Manchu, Hui, Miao, Uighur, Tujia, Yi, Mongol, Tibetan, Buyi, Dong, Yao, Korean, and other nationalities (CIA-The World Factbook).

Beside the main language Mandarin (Putonghua, based on the Beijing dialect) about 600 Han dialects exist. The most popular ones are Cantonese, Hakka, Hokkien and Fukienese (OMF International, 2011). Interestingly, 45.76% of the respondents of the survey regard language barriers as one of the major risk they face when operating in China.
The Austrian sales manager, Mr. D\textsuperscript{17} explained in the interview: *A lot of dialects in China, meetings are in Chinese and only “relevant” parts in English. Furthermore, Chinese discuss in Chinese. English is an alternative sometimes – in regions far away from capital sometimes not*”

While Zinzius (2006, p.124) proposes employing Chinese managers with international experience, the US-Department of Commerce recommends using localized agents to break cultural and languages barriers (U.S Commercial Service, 2009). Similar to the suggestion of the US-Department of Commerce, Mr. D., further, revealed: “We have a sales agent in China who is always present when persons from Austria travel to China.”

5.1.5. Chapter summary and conclusion

The impact of geography, in general, results to uneven regional economic growth and urbanization. Business associates, thus, face the problem of a heterogeneity market, due to unequal income distribution between Eastern and Western China, difference in taste and needs, especially between inhabitants in urban and rural areas as well as Northern and Southern China. Understanding China’s geography is also essential when choosing company’s location. Due to the large size of the Chinese territory and since big parts consist of mountains and highlands, transportation is quite inconvenient. Moreover, the main access to the sea is on the east and south east coastal area and infrastructure is, despite fast improvement, still not well developed. Energy shortage and environmental problems, indeed, is a big challenge for China and foreign investors. Foreign entrepreneurs, hence, need to do proper due diligence of the location ex ante to prevent higher production costs ex post due to black outs. Besides, owning and sharing generators and if possible remote employment are very useful to bridge a blackout (Bremmer and Zakaria, 2006, p.23ff). Nevertheless, Austrian green and high-tech enterprises provide splendid solution of China’s geographical and environmental challenge.

5.2. Political environment and risk

The People Republic has a socialist market economy. Thus, even though President Hu Jintao announced to lower the state influence in the market during the 17th China Party Congress (Naisbitt, D. Naisbitt, 2009, p.93), the economy is still highly regulated and follows the

\textsuperscript{17} Mr D. does not want to be fully mentioned by his whole name.(see appendix for the rest of the interview)
guideline of a plan. Additionally, the 121 remaining state own enterprises still account for about 40% of the economy activity (Cheng, 2007). SOEs, mostly directly controlled by the central government, have become bigger than ever; 39 out of 42 Chinese companies in the Fortune 500 list of the biggest firms are owned by the government (The Economist, 25.6.2011, p.12.).

5.2.1. Impact of political environment on foreign companies

The government still has strong influence on the market. The former head of the American Chamber of Commerce in China, consequently, warns: "Everything is so political. This is a government that lets foreign companies build market share when it needs them." (The Economist, 9.7.2011, p.57). Party members have been controlling key industries for decades. At the beginning of 2010 Google declared that it would possibly shut down its search machines and offices in China due to censoring search results on Google.cn (ase/dpa, 13.3.2010). Other media companies such as Facebook Inc. and Twitter Inc. are victims of the government`s policy as well. Their social networking websites are banned in China (Wauters, 7.7.2009). Skype Limited that offers users voice calls and chats over the internet faced similar risk. According to the China`s state media, Skype was on the verge of being banned, apparently, only to protect the monopoly of the state owned enterprises China Telecom and China Unicom (DPA, 31.12.2010). Another popular case of political pressure happened in summer 2011 when the Chinese authorities threaten to block a billion Airbus deal to protest against the European plan that force airlines buying credits for greenhouse-gas emissions (Sieren et al, 24.5.2011, p.18-19).

5.2.2. Protectionism

Foreign investors have been complaining about the intransparency of the political and legal system. According to a poll provided by European Union Chamber of Commerce in China, 43% of European investors are moaning about discrimination and unfair treatment through business regulations in general (DPA, 26.5.2011). The disadvantages include “indigenous innovation” policy and unfair subsidies for local enterprises. Another survey conducted by the American Chamber of Commerce in Beijing revealed that about 25% of the respondents were losing business and 40% foresaw future losses due to indigenous innovation policies (The Economist, 25.6.2011, p.13.). According this policy: "A product must be produced by an enterprise that owns the intellectual property (IP) in China; has a trademark owned by a
Chinese company and is registered in China; embodies a high degree of innovation; and is certified by the Chinese National Certification Commission. Companies that have first developed IP outside China will apparently be excluded from the government procurement market in China.” (Lubman, 2010)

Even though another poll in 2011 indicated that Europeans firms were apparently excluded from a public bidding (Burkit, 26.5.2011), this inconvenience should not keep foreign investors from operating in China. Siemens AG, for example, received a big order of wind power plant after a highly competitive bidding process (Welshaupt, 2011 p.25) and Andritz Environment & Process won a big bidding process from the SOE Guangdong Guangye Environmental Protection Industrial Group Co. Ltd due to its superior quality and brand (Andritz 2010, 2011, p.57). After all, the survey from European Union Chamber of Commerce clearly shows that three out of fourth European enterprises were profitable in 2010 and more than 70% even forecast growth of not less than 5% in 2011(Burkit, 26.5.2011).

Moreover, after several complaints by foreign investors, China finally has repealed its controversial technology policy in 2011 (dapd, 1.7. 2011, p.16). Additionally, China experts Cole and Denk (2011, p. 93) have better opinions about the Chinese policy. They believe that one of the biggest advantages operating in China is its political stability. The findings of the research paper (Younis et al, 2008) provide similar results. The authors pointed out that the Chinese economic growth is primarily due to its political stability which is, on the other hand, based on its political system. In fact, only 6.54% of the interviewed Austrian enterprises think that China’s political instability affects their operation in China.

5.2.3. Corruptions

Dealing with corruption is one of the biggest challenges of the Chinese authorities, who are also seeking international cooperation. According to the World Bank Enterprise Surveys 2006-2009, more than 72% of firms in 2003 “expect to pay informal payment to public official to get things done” (World Bank, 2006-2009).

18 a regulation preferring local producers in government purchases of technology
In 2005 China, thus, ratified the UN Anti-Corruption Convention. Recently in 2009 the new Chinese anti-corruption law was enacted to prevent bribery of foreign officials and enlarge domestic anti-corruption enforcement (U.S Commercial Service, 2009).

The following two prominent cases should illustrate the seriousness of the government anti-corruption campaign: Chen Liangyu, former chief of the Shanghai Municipal Communist Party of China was sentenced to 18 month in prison for corruption. He was accused of being involved in bribery and the abuse of power (Macartney, 12.4.2008). Another example was the execution of a senior official Zheng Xiaoyu in 2007 who was pledge guilty of taking informal payment for approving untested medicine (Coonan, 2007). These two cases are only the tip of the iceberg. In average, 56 civil servants are convicted daily (Sieren, 2007, p.106). According to the Chinese Central Bank, they have defrauded 120 billion yuan since the 90s (AP, 20.6.2011).

So far, however, the battle against corruption is still not very promising. According to the Corruption Perception Index 2010, China is still prone to corruption. While Austria is ranked 15th from 178 countries Chinas position is 78th. To be more specific, the study also revealed that Austria received 7.9 and China 3.5 out of 10 points (Transparency International, 2010, p.4). Therefore, no wonder, more than 90% of the respondents of a poll in China think that all affluent Chinese families have political backgrounds (Anderlini, 12.3.2010).

Corruption, in general, does not only trouble the Chinese government but also foreign investors. Especially sectors19 which requires government approval is more sensitive to corruption. A survey shows that nearly 30% of firms expect to give gifts to secure government contract in 2003 and the value of the gift accounts 1.25% of the contract volume (World Bank, 2006-2009). Every fifth questioned Austrian companies, actually, regard corruption as one of the main risk when doing business in China. The Austrian architect, Mr. W. explained:”Many architecture competitions are not fair, the result of a bidding and the working process often smells like corruption. Nobody will confirm it, but the result is often very very clear!”(see appendix)

The problem is, according to Frank Sieren a famous author and China specialist, corruption is not only restricted in the public service but is also presence in day to day business life (Sieren, 

19 example banking, government procurement, medicine and construction sectors
Mr. D., an Austrian sales manager, thus, stressed out in the interview: A lot of people expect the so called “third party commission. Production managers or others want to have some extra money in the pocket. In some projects you have no chance to avoid, [but] we try to be very clear from the starting point on (see appendix).

Nevertheless, investors should keep in mind when providing any gifts, which is a common social custom in China, especially for building relationships (guanxi) with political authorities, social institutions and other business people. After all, bribery is a serious crime in China and given a bribe can cause 5-10 years punishment (U.S Commercial Service, 2009).

Despite corruption scandals investors should not be encourage doing business in China, since China is not “hopelessly corrupted” (Sieren, 2007, p 105; Chee and West, 2006, p. 152). Besides, it seems that Chinese authorities are seriously battling against corruption. In addition, special risk management within a company is helpful to hedge against this risk (see chapter risk management).

### 5.2.4. Social unrest

Another huge political challenge is dealing with social unrest, including protests, picketing, petitioning and recently even assault on government building (Mayer, 27.5.2011, p. 16). The Chinese Ministry of Public Security reports a rise in public order disturbances from 58000 in 2003 to 87000 in 2005. Land disputes, labor issues, environmental pollution are the key reasons for social riots (Kahn, 10.1. 2006; Wu, 2011, p. 18-32).

To recall, the protests on the Tiananmen Square in 1989 due to dissatisfaction of the past political and economic reform did not only cause the death of several hundred protestors, but also had a big impact on China’s reputation and economic development. The two following years after the incident the Chinese economy only realized a growth of about 4%, a downturn of two third (Davis, 11.4.2011, p.7).

Recent protests (Jasmine Revolution in China at the beginning of 2011) mainly because of high inflation and the enormous income gap between rich and poor triggered further debates by the authorities about the pace of economic reforms. Indeed, the gini coefficient in China is about 0.5 (Kamp, 2011a, p.35), nearly double as high as in Austria 0.27 (APA, 26.01.2009).

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20 measure of the inequality of income distribution, 0 means total equality and 1 total inequality
The response of the Chinese government is reflected in the new 5 year plan (2011-2015) which focuses on better income distribution, environment protection, moderate inflation and efficiency in energy consumption even at the expense of the economy growth.(Seligsohn and Hsu, 2011; Yingzi, T., 03.08.2011)

Nevertheless, social unrest in China is also a result of ethnic conflicts. In 2009 the mass protest of the Uighur in Xinjiang caused the death of about 140 people and several hundreds of injured (Buckley, 06.7.2009). Other riots in Tibet occurred in 2008. According to the exile group, more than 200 were killed (CBC News, 14.3. 2009). All this is a big challenge for the Chinese government and influence the political environment.

Impact of social risks on foreign enterprises

Social riots do not only affect the state, but particularly also investors, since they are usually not prepared. Especially in Southern China foreign companies are complaining about daily strikes and protests of the employees due to unsatisfied working conditions. Therefore, foreign investors anticipate considerable higher labor cost in the near future (Mayer, 27.5.2011, p.16). As a result of social tension and higher expenditure on wages, Kapsch Group, the Viennese technology company, has already begun to reduce Chinese suppliers. Furthermore, the corporation planed to move part of the production back from Suzhou to Vienna (APA, 30.03.2011, p.22). Most Austrian enterprises, however, do not directly regard social risk as a big threat for their business in China. Only 6.54% of the respondents are showing any concern. Nonetheless, it is recommended to evaluate the social risk and provide instrument to hedge them before doing business in China, since social tensions seem to increase constantly, especially in the last few years.

5.2.5. Summary and conclusion of the political environment

Still today the state has strong influence on the market. Foreign companies often complain being discriminated from public bidding process. In addition, particular Chinese regulations make operating in China even harder. Foreign investors, further, face political risks such as corruption and social unrest. However, businessmen should not give up operating in China for several reasons. First, China slowly moves away from protectionism due to pressure from abroad. Secondly, the world second economy is aware of its social and political problems and is trying hard to deal with it. Thirdly, the new Chinese policy aims to increase welfare and sustainable development with greener environment companies bringing other promising
chances for investors. Finally proper risk management is quite effective to hedge political risks.

5.3. Assessing the economic environment

China’s major economic reforms led by Deng Xiaoping has begun since 1978 with the aim to increase productivity, standards of living with reasonable deficits and unemployment rate. Special economic zones in South China (Shenzhen, Xiamen, Shantou, and Zhuha) thus were created to attract FDI. 14 other coastal cities (Shanghai, Tianjin, Qingdao etc.) and three regions (the Yangtze River delta, the Pearl River delta and the Zhangzhou–Quanzhou–Xiamen region) were opened up to provide tax and other incentives for foreign investors (Sun et al., 2002, p.82). In addition, the authorities combine central planning with market oriented policies and reforms were carried out step by step, first in the agriculture, then in the industrial and banking sector (Bureau of East Asian and Pacific Affairs, 2010).

Over the years, there is a huge structural change. The agricultural sector has kept falling from 60% in the beginning of 1950s to 10% in 2010. At the same period industrial sector has increased from 20% to about 45%. The service sector contributed less than 30% to the GDP, but has risen to nearly 45% in 2010 (Ehmer, 2011, p.2). China has developed itself from a poor developing to one of the most promising emerging country, with public debt of only 17.5% of its GDP in 2010 (CIA Factbook, 2011).

In recent years SOEs were renewed to focus more on global competition. In addition, the economy has been slowly deregulated since the participation of the WTO (2001). Today China has the second strongest economy after the United States and one of the world's fastest growing economies (CIA Factbook, 2011). With an export volume of 1778 billion and import which accounts 1395 billion US$ the number one manufacturer is not only the largest exporter but also the second largest importer of goods (PRC National Bureau of Statistics, 2010 cited in USCBC,1966-2011). Goldman Sachs Group, thus, believes that China will surpass the U.S. in terms of total GDP by 2027 (Adam, 15.11.2010). Deutsche Bank and Standard Chartered Bank have an even more optimistic view. According to their estimation, China may overtake the US already within the next 10 years (Oliver, 2009; Adam, 15.11.2010).
57.01% of interviewed Austrian enterprises, indeed, share the China euphoria and predict that China is the most important country for future growth and only 10.28% are actually worried about economic risk when operating in China.

However, as mentioned (chapter 4) not everyone shares the optimistic view. Some questions the credibility of China's GDP statistics and others doubt the sustainability of the future growth of the Chinese economy. Nevertheless, the World Bank expects promising growth rates of 9.3% for 2011 and 8.7% for 2012. (World Bank Group, 2011)\(^\text{21}\). A study of 814 business leaders conducted by Ernst and Young in 2010 revealed that China remains the most attractive FDI destination (Inchincloser, 2010), even though China is only ranked 135\(^{th}\) among 179 countries in the Index of Economic Freedom (The Heritage Foundation, 2011) and 79 out of 183 on the “Ease of doing business index” (World Bank Group, 2010, p 4)\(^\text{22}\). According to Bloomberg, China’s inflow FDI rose to 105.7 billion US$ in 2010 which is an increase of more than 17% to the previous year and new record (Avery and Panckhurst, 18.1.2011). China has become the second world’s largest recipient of FDI after the United States (CIA Factbook, 2011).

**5.3.1. The impact of inflation**

The People Republic is experiencing serious inflation. It rose up to 5.5% in May 2011, far above the government’s target of 4% (The Economist, 25.6.2011, p.7.). Food prices, as the main contributor, even surged by 11.7% (Kurtenbach, 2011). The protest on the Tiananmen Square in 1989 showed that inflation does not only harm the economy but also triggers social riots. Political unrest in China inspired by the Jasmine Revolution at the beginning to the year 2011 was mainly caused by continue rising of living costs (Mayer, 27.5.2011, p. 16). The Chinese government does not have much choice. Inflation, basically, can be offset by revaluation of the yuan and by raising the interest rates. Since the authorities concerns that an appreciation of the currency could harm the export heavy economy, they mainly focus on the interest rate. Both policies would slow down the growth (fmk, 15.6.2011).

Interest rate, thus, has been increased four times to 3.25% for one year deposit since October 2010(Webb, 5.4.2011). The Chinese economist Zeng from Guoyuan Securities expects further rise of interest rate by the central bank, but warns that medium size companies might face

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\(^{21}\) See appendix for the summary of China’s economic data

\(^{22}\) Austria ranked 21 respectively 32
financial problems because of higher credit costs. In addition, he predicts even higher inflation, at least in the short run, due to the flood and drought. (fmk, 15.6.2011). Besides social riots and a slowing economy, foreign companies face other difficulties as a result of inflation. On the one hand, they have to bear the rising input prices and labor costs, but on the other hand, the Chinese government imposes price controls especially in the food industry to stave off further inflation (Frangos and Burkitt, 20.5.2011, p.22). Therefore, Unilever was fined only for talking about price rises (Kamp, 2011d, p. 94). Even when foreign companies are allowed to increase prices, the Chinese price sensitive consumers compare the prices in the internet before finally buying. Thus, retailers such as Best Buy and Barbie Store had to close their shops in China (Hollman, 2011, p. 8).

Due to negative real interest rate many Chinese has no incentive to put their saving in bank deposits anymore, but to invest in real estates. That again causes a more serious economic problem, a bubble (Kamp, 2011b, p. 38-40).

5.3.2. Is the Chinese bubble coming?

According to Dragonomics Research, a famous Chinese consulting company, the real estate prices in 36 largest cities have increased by about 50% over the last two years (Davis, 11.4.2011, p.7). Due to easy access of credit and negative interest rate not only Chinese consumers, but also SOEs are speculating in real assets. In addition, some local politicians overinvest in infrastructure, as a result of the 400 billion euro economic stimulus package since 2008. Consequently, years after their construction they are still unused and more and more “ghost towns” have arised over the time (Kamp, 2011b, p. 38-40). Up to 64 billion! flats are unoccupied (Mayer, 27.6.2011, p.12). In the west and north metropolis of China nearly 70% are uninhabited (Kamp, 2011d, p. 94). Additionally, despite the investment has reached to nearly a half of the GDP, only 1% of new jobs were created (Davis, 11.4.2011, p.7). Because of excessive borrowing and investment Chinese banks, hence, face severe default risk which makes the situation even more complicated. Only within the last two years financial institutes of China lend 2.5 trillion euro (Mayer, 27.6.2011, p.12). Therefore, according to Fitch, the worst case scenario of banks bailout could cost 30% of China’s GDP (The Economist, 23.4.2011, p. 52). James Chanos, a famous hedge fund investor, thus, stated: ”China is Dubai times 1000, or worse” (The Economist, 16.1.2010, p. 63).

On the other hand, not everyone shares the same pessimistic view. Some argue that the difference between the US situation and China’s today is that GDP per capita in China is
growing faster than the housing prices, which is an important argument against the bubble. They, however, agree that construction rate is indeed higher than the population growth, but believe that high construction rate is justified because of the high urbanization rate. After all, 15 million people are moving into urban areas annually. In addition, China’s incremental capital – output ratio\(^{23}\) over the past 30 years does not show a significant increase according to the study of BCA Research. Furthermore, real estate boom in China is mainly being financed by savings and not by lending. Lending for the property boom only accounts for 17% of total Chinese banks’ in compare to 56% for US banks’. Moreover, the minimum deposit requirement of 20% and 40% for investors in China is much higher than in the US (The Economist, 16.1.2010, p. 63-65; The Economist, 10.10.2009, p.73-75). Hence, in an interview with the Handelsblatt the boss of the British Standard Chartered Peter Sands assured:” The fear [of overheating] is exaggerated. It’s true that sometimes the markets are volatile and there is inflation on assets, but that’s all manageable\(^{24}\)” (Landgraf, p. 30. 2011). The results of my survey, basically, supports this opinion, as already mentioned above, only 10.28% of the respondents are worried about economic risk when operating in China.

Nevertheless, in April 2011 Moody, finally, downgrades China property sector from stable to negative. The IMF shows similar concern and also warns against the real estate bubble of the world’s number two economy (Kamp, 2011b, p. 40).

The Chinese authorities, indeed, realized the problems and have increased the interest rate and lending controls. In addition, Chinese banks are required to raise higher reserve ratio to absorb liquidity surplus (Xing and Jia, 13.4.2011). However, the measurements of the government in Beijing do not always have an immediate effect. A survey conducted by the magazine, Century Weekly revealed that 14 out of 16 provinces will even increase their public invest spending of more than 20% in 2011, since local governments sometimes follow their own interests (Kamp, 2011d p. 94).

\section*{5.3.3. The impact of the yuan}

The yuan or also called renminbi is the official currency in mainland China. Since 2005 it is de-pegged from the US$ and now based on a basket of world currency (Frankfurter Allgemeine Zeitung, 2011). In recent years, especially the United States has been complaining

\(^{23}\) Ratio of annual investment and annual increase of GDP, thus measures the efficiency of investment

\(^{24}\) Own translation
that China keeps its currency artificially low to support China's exporters (Krugman, 12.9. 2010), even though the Chinese authorities have been appreciating their currency over the years. In 2006 one dollar was traded again slightly more than eight yuan, but since 2011 only for about 6.5, i.e the yuan has appreciated more than 23% in 5 years against the US$. Within the same time the renminbi has also increased 9% in value against the euro  

Undervaluation of the currency, in general, causes high import prices which again trigger inflation. China, therefore, has no choice but to revalue the yuan step by step to cool down its economy. Thus, it seems that the Chinese decision makers slowly open up and focus on free capital flows. In 2010, for instance, foreign companies such as McDonald, Hopewell, Caterpillar and Unilever have already issued yuan based bonds in Hong Kong, which is indeed a very cost effective funding alternative. Recently, Chinese exporters are also allowed to price their goods in yuan and soon also imports can be denominated in this currency (Osman, 2011, p.39) According to Wall Street Journal, Singapore will become the second yuan trading hub after Hong Kong which is another important step towards liberalization of the renminbi (Wei, 2011, p.24).

HSBC Trinkhaus is one of the pioneers, but soon German banks also offer yuan currency accounts for investors doing business in the world’s number two economy. To date, in 2011 only 3.5% of the Chinese trades are settled in their own currency. Mr. Krause, member of the Executive Committee of HSBC Trinkhaus, however, estimates that by 2015 half of the trade will already be settled in yuan. In addition, he believes that foreign companies who are willing to face the exchange rate risk might get better conditions when trading with the Chinese counterparts (Osman, 2011, p.39). Mr Mäder, the boss of Polymax explained in an interview in the German magazine Wirtschaftswoche that the biggest advantage of exports pricing in yuan is the reduction of calculation uncertainty within the company, because the risk will be finally transferred to the purchaser (Fischer et al, 11.4.2011, p.24). Indeed, nearly every fifth of the respondent Austrian enterprises regard the fluctuation of the currency as one of the main risk for doing business in China. Liberalization of the renminbi, in addition, will trigger extra trade volume with China, since there are still many Chinese companies which do not have access to foreign currency, such as the euro (Höhmann, 4.5.2011, p.59).

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25 Own calculation  
26 Polymax is manufacturing and sourcing garments operating in China
foreign investors should be aware that other risks arise when holding Chinese yuan, as holders still face legal and political uncertainty in China.

**5.3.4. The new 12th 5 year plan as big opportunities?**

The new 5 year plan from 2011-2015 mainly targets for a more sustainable development and a greener environment with shift from an export heavy economy to an economy of consumption. Not only will the income be raised but also social welfare benefits, such as healthcare, living and education (Feltstein, 28.2.2011, p. 38). In order to boost consumption Prime Minister Wen Jiabao even promotes taking loans for financing more sophisticated products, such as cars (Mayer, 11.3.2011, p. 6). To prevent further damages of the environment the government does not only encourage renewable energy facilities and green products but also tax the heavy industry to reduce carbon intensity by 17% by 2015 (Reuters, 11.4.2011). Other high ambitious targets include production of advanced trains, LED lighting and focusing more on promising information technology (Kirkland, 12.4.2011).

Therefore, despite annual target of 7% growth and the risk of greater environmental regulation the new 5 year plan brings new chances for foreign investors. Especially Austrian companies already enjoy good reputation in high-tech and green technologies (Andesner, 2011, p. 42). AT&S, as one of the leading printed circuit board manufacturers, thus, will build a 297 million US$ new plant in Chongqing to fulfill the high customer demand for high integrated circuit boards (Theyer, 16.6. 2011). The Styria firm Mides, a specialist in maintenance of medical technology, is another example. It recently discovers the potential of the Chinese healthcare market and signed a cooperation agreement with a Chinese company. The collaboration will bring 5-15 million US$ additional revenues (Kolb, 14.06.2011.)

However, Mao Yushi, the chairman of Beijing’s Unirule Institute of Economics and one of the most famous economists in China, is not too optimistic about China’s target as a more consumer driven economy. In his interview with the Wirtschaftswoche in 2011 he criticized the political environment itself as an obstacle for successful realization of the 5 year plan: “How can the government boost the private consumption on the one hand, when they are restricting home and cars buying on the other hand. That’s inconsistent.” (Kamp, 2011a, p. 35) Increasing private consumption, moreover, is only possible if the Chinese authorities can

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27 Own translation
guarantee certain social welfare and an increase of the real income despite high inflation and exploding asset prices (DPA, 2.2.2011).

5.3.5. Foreign Investment Catalogue

The Foreign Investment Catalogue, first issued in 1995 provides a guideline for foreign investment into China. Over the years it has been revised several times and the newest version was published in 2010. Basically, the Guidance Catalogue divides industries into three categories: encouraged, restricted, and prohibited. Foreign companies in the restricted sector have to form joint ventures with local firms. Investing in encourage category often goes along with some incentives. The prohibited industries are closed to foreigners. Finally investments in sectors which are not listed are in general permitted (U.S Commercial Service, 2009).

Mainly, foreign investments in high tech, environmentally friendly sectors and in less developed areas are encouraged (The China Business Review, 2007) while investments that is not “needed” for China’s national development are restricted and media related industries are prohibited (U.S Commercial Service, 2009).

According to the Ministry of Commerce’s Foreign Investment Department, the revised foreign investment catalogue in 2010 targets to attract foreign businessmen to invest in the Central and Western China. In addition, investors are welcome to participate in new energy, new materials, biological medicine, advanced manufacturing and the information industry. Furthermore, foreign enterprises are invited to build R&D centers and to expand their industry chains. Incentives include: shorter approval procedure, lower income tax and tariffs treatment as well as lower land prices. The latest revised investment catalogue also aims to open up the financial and capital markets to attract foreign firms to participate and acquire domestic’s (Davidson et al, 2010; Jie, 9.13.2010).

China’s Foreign Investment Catalogue is often being criticized by investors, since Chinese local authorities have much freedom, thus, do not necessary follow the guideline. They can restrict, permit and encourage for other reasons. In addition, the catalogue sometimes provides contradictions with other rules (U.S Commercial Service, 2009).

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28 News agencies, radio and TV network,
5.3.6. Labor market

Lack of employees

In general, foreign companies do not have any legal constraints in hiring staffs, as long as the designated minimum wage is not exceeded (U.S Commercial Service, 2009). The Chinese labor market, however, is a big challenge for foreign investors. Foreign companies already worry about hiring employees (Kamp, 2011d, p.60-61), although, one might think that in a country with more than 1.3 billion people and 55-220 million unemployed (Zinzius, 2006, p.114), there won’t be any problems finding good employees. The situation could become worse. Due to the one child policy since the 80s, the numbers of 15 to 34-year-old Chinese has begun to remain the same recently and will even shrink in the next three years (Kamp, 2011d, p.60). In the year 2000 60-years-old represented 10.3% and increased to 13.3% in 2011. Within the same time children under 14 shrank from 23% to 17%. While the number of 20-24 and above 65-year-old is nearly equal in 2011, both 110 million, the forecast of the Brookings Institution reveals that the gap will increase enormously in the next 20 years. In 2030 only 75 million Chinese will be between 20 and 24, but nearly 250 million becomes older than 65(The Economist, 7.5.2011, p.52-53). Additionally, farmers hesitate to migrate to the cities, because of the increasing living costs (Sieren et al, 2007, p.42). Mendi, supplier of the German discount clothing store NKD, thus, complains not to find any new employees despite raising incomes, and providing generous fringe benefits (Kamp, 2011d, p. 60-61). 35.5% of the interviewed Austrian firms, therefore, already consider human resource availability as one of the main criteria for location choice in China.

Even though 6.6 million Chinese graduated from the university in 2011, which is actually 5 times more than in year 2000, foreign companies have a hard time finding well qualified employees. Some international enterprises reported only 2 out of 1000 applicants are suitable and have the required skills (Kamp, 2011c, p.43). The Austrian architecture, Mr. W. explained the situation in his branch: “...it is very difficult to find good staffs. It is not only the education on a very low level also the live experience of the people...” (see appendix).

Especially skilled employees in Marketing/Sales and R&D are very scarce (Waldkirch, 2009, p. 50-51). VDMA, as one of the key association service providers in Europe, criticizes the lack of creativity and qualification of Chinese employees (Gillmann, 7.4.2011, p31). Chinese commentators such as Cole, Denk (2011, p. 102) and Sieren (22.6.2011, p.10) have similar opinions.
Jop hopping

According to the questioned Austrian firms, “loyal employees” (61.68%) is named as the second most important requirement after “guanxi” (77.57) for successful business in China. Unfortunately, enterprises operating in China face serious risk of job hopping. Some companies are complaining about fluctuation rate of 30% (Kamp, 2011c, p.43). While the employee turnover in Austria is about 9%, according to the Hernstein Institute (Mistlberger, 2008), the fluctuation in China is, in average, nearly double as high in 2007. In the metropolis such as Beijing, Shanghai and Guangdong the turnover rate is even between 25% and 30%. The main reasons for resignation of Chinese managers besides inadequate payment are low career prospects, dissatisfaction with supervisors and lack of additional professional training (Waldkirch, 2009, p.96ff).

Increasing labor cost

Another inconvenient situation foreign entrepreneurs face, is the rapid rising of the income. Wages nearly increased 69%! from 2005 to 2010 (The Economist, 14.5.2011, p.67). In the coastal areas the cost for labor even soars 30-40% annually (Kamigama, 31.5.2011, p.56). Especially high qualified staffs are quite expensive. While people in the assembly line earn 1000 yuan in 2009, in 2011 firms must pay them twice or 3 times more. Credit Suisse, hence, forecasts an annual increase of 20% in average (Hofer et al, 3.3.2011, p. 20). In addition, foreign companies usually have to pay more to recruit new staff and cost of fringe benefits accounts for 200% (Zinzius, 2006, p.120-121). Depending on segments, in average a consultant earns 54 000 Euro annually (Fröndhoff, 20.02.2007). Thus, Schmidt a consultant of Roland Berger even believes that total production costs in Czech Republic, Hungary and East Rumania is only marginal higher than those in China (Terplitz, 2011, p.21). Analysts of Boston Consulting Group yet goes one step further. They predict that China’s manufacturing cost for production for the American market will rise to the level of the US by 2015 and suggest investors moving on to other countries, such as Vietnam (The Economist, 14.5.2011, p.67). However, offshore to somewhere else does not necessary save costs. Indeed, countries such as Vietnam, Cambodia, Myanmar have lower labor cost, but infrastructure, productivity, and quality is still far behind China’s. Moreover, due to the export boom in the world second economy manufacturing and supply chain are already well developed (Kamp, 2011d, p.62). Even back to home country is not always without obstacle, since the necessary supplies and particularly the market is no longer at home (The Economist, 14.5.2011, p.67).
Nevertheless, as mentioned, the Austrian Kapsch CarrierCom already moves part of their production back to Vienna due to the high labor cost (APA, 30.03.2011, p.22). American’s (Catepillar, Sauder, NCR etc.), German’s (Adidas, Gerry Weber etc) and Taiwanese’s companies (Foxconn) followed the same retreat strategy as the Viennese communication enterprise, at least, for a part of their manufacturing(Hofer et al, 3.3.2011, p. 20).

5.3.7. Financing

Financing is a crucial step when operating abroad. There is range of financing solutions:

**Home country financing**

Basically, the “Österreichischen Kontrollbank” grants loans on commercial terms. Furthermore, under following condition it gives soft loans (financing at a more favorable terms) to Austrian exporters as well. The requirements are:

- firms must be located in Austria and
- have employees with relevant know how in the Austrian factory and
- oblige to prove that similar project are already realized with these workers at non concessional terms and will carry on future.

Österreichische Kontrollbank also provides project finance and structured finance for projects without sophisticated bankable securities, such as collateral or guarantee. Basically, the expected generated future cash flow, as the only security, will be used for repayment (Oekb, 2011).

Besides the Österreichische Kontrollbank, Austria Wirtschaftsservice GmbH, as Austria’s national promotional bank, further, support companies by offering loans with favorable terms, guarantees and grants (Wirtschaftsblatt Sonderthema, 28.6.2007, p.29).

In general, investors, however, need to bear in mind that foreign loans need to be approved by the State Administration of Foreign Exchange, unless the loan cannot be converted into Chinese yuan. An approval, is not just time consuming, but can also being denied depending on the foreign exchange policy (Werner, 2009).


**Equity Financing**

One way providing fresh money to the existing subsidiary in China is to inject new capital. However, due to strong bureaucracy this kind of financing can take several weeks. It needs to be verified by the authorities, registered by the Administration of Industry and Commerce and sometimes even requires the approval of the Development and Reform Commissions. (Werner, 2009).

**International financing**

The World Bank has a large loan program in China targeting to reduce poverty and to increase the standard of living. Thus, it supports investments, especially in environmental and agriculture areas. Moreover, the International Finance Corporation, as a member of the World Bank Group grants loans to private sector ventures and projects in China (U.S Commercial Service, 2010).

**Host country financing**

Commercial loans are also granted by Chinese banks. However, security arrangements such as collateral or mortgage are required (Werner, 2009). Additionally, creating and registering collateral can be quite time consuming and costly in some provinces (see chapter market entry).

As mentioned, China seriously faces high credit default risks, thus, Fitch estimates that the worst case scenario of banks bailout could cost 30% of China’s GDP (The Economist, 23.4.2011, p. 52). Therefore, local banks already hesitate to provide further loans, especially to small firms, which again raise money from the black market (Mayer, 27.10.2011, p.36).

Another option of legally financing is a trusted loan. Non financial institutions agree to deposit a certain amount of money to a Chinese financial institution which again are used for granting loans, since direct lending of non financial institutions is prohibited (Werner, 2009).

Despite some difficulties of financing, most interviewed Austrian firms do not really regard financing as a big obstacle when operating in China. The factor “money or capital” is ranked last according my findings, since only 18.69% believe that “having money” is a main requirement of a successful business in China (see appendix).
5.3.8. Austria-China economic relations

First trade between Austria and China has already begun in 1781. 90 years later, in 1871 the first treaty of diplomatic relations was signed. The cooperation has become more intense with the trade agreement in 1925 and 1956. A mutual treaty to establish commercial representative office in 1964 and eight years later the Agreement on Trade and Payment followed to tighten the Austrian-China trade relation (Austrian foreign ministry, 2011). In 1971, finally, the formal diplomatic relation was established and opened up a new chapter for bilateral ties. Austrian firms realized the potential of the Chinese market very early. One of the pioneer businesses in the 70s began with the export of a complete steel mill by the company Voest. Some years later Elin and Voith constructed a hydroelectric power station in Hunan (Andesner, 2011, p. 20ff).

Over the years collaboration in economy, culture, science and technology has continued to progress. Further, the “Agreement for Cooperation in the fields of Economy, Industry, Techniques and Crafts and Technology” was signed in 1996. Austria’s export to China included: technological equipment, machinery, products of minerals, chemical and light industry products. The import of China basically consisted of textile goods, garments, grain and oil foodstuff, animal husbandry products, arts and handicrafts as well as nonferrous metals (Wang, 12.5.2009; fmprc, 2003).

Since China has joined the WTO in 2001 the trade volume between both countries has increased significantly. As shown in the diagram, the total value grows five-fold to 8 billion euro within the last 10 years and China has become the largest trading partner outside Europe.
Furthermore, while Austrian exports to most other countries slow down during the financial crisis in 2009, export to China even increased 7.5% (Breuss and Landesmann, 2010, p.99). China, as the 4th major Austrian import and 9th largest export partner, exported goods and services valued at about 6 billion in 2010. Austrian export to China, on the other hand, accounts for approximately 2.5 billion euro, which is 2.6% of Austria’s total export (Statistik Austria, 2011). For further information about the balance of trade: see appendix 5.

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<td>Austria inward FDI from China</td>
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Figure 5-2: FDI between Austria and China. Source: Own illustration, figures are taken from OECD.Stat.Extract (2011)

As the table shows, China’s FDI to Austria is still in an initial stage. 12 out of 19 Chinese companies were established in 2009 and 2010. Important Chinese counterparts in Austria include Xi’an Aircraft Industry, Huawei Technologies Austria and ZTE. On the other hand, the volume of investment to China has become quite constant since 2006. To the end of 2010 already more than 980 investment projects with a total volume of 1.2 billion US$ were already realized from more than 500 Austrian enterprises (Andesner, 2011, p.5ff).

**Further outlook**

During the Chinese –Austrian Trade Forum in Vienna 2010 Chen Deming, the Chinese Trade minister, praised the good trade relation of the both countries. He, further, had four suggestions to continue the great cooperation. First Mr. Chen wants to reduce protectionism to improve the trading environment. Second, China will develop better investment possibilities and patent protection to attract more high tech companies from Austria. In addition, the Chinese government also will encourage firms investing in the Republic of Austria. Third, China hopes for stronger collaboration with Austrian small and middle class firms, since Mr. Chen, especially appreciates their strong technology and innovation potential. Finally he is looking forward for better partnership with Austrian service businesses (ETCN, 2010). Indeed,

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29 See appendix for other important investment and projects between Austria in China
exports to the number two largest economy have increased by more than 40% in the first half of 2011 (Austrian foreign ministry, 2011).

Austria’s high technology industry is a good completion of China’s technology demand. Therefore, there is still promising potential for additional cooperation, especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, environmental protection and in the service sector (Andesner, 2011, p.26). Thus, the Chinese Premier, Wen Jiabao expects to double the trade value with Austria by 2016 (Chinadaily, 5.6.2011).

5.3.9. Summary and conclusion of economic environment

There are several opinions about the Chinese future economic development. The majority of economists and businessmen, however, believe in China’s strong economy. Thus, in 2011 already more than 500 Austrian companies were operating in China. Not only the FDI, but also the trade volume between Austria and China has increased significantly over the years. The value for trade is even expected to double in the next five years. Especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, environmental protection and in the service sector, there are still big potential for further cooperation. Even though only 10.25% of responded Austrian firms show concern about the Chinese economy, investors, nevertheless, need to bear in mind that factors such as yuan, inflation, financing, labor market and the fear of the China’s asset bubble have strong influence on firm’s environment. Thus, it’s essential to find ways to hedge against the economic risk.

5.4. Legal environment

This chapter deals with the particularity of the legal environment of firms doing business in China including: general legal framework, contracts, intellectual property rights and taxation.

5.4.1. General legal framework

Within the last 20 years China has enacted many new laws. In 2006 enterprise bankruptcy law was adopted and one year later China’s property law followed (U.S Commercial Service, 2009) covering creation, transfer, and ownership of property. However, the People Republic is still far away to become a state under rule of law. Chee and West (2006, p.50) questioned the independence and transparency of the Chinese judicial system. They stressed out that even Chinese lawyers sometimes have trouble to understand the rules, due to many exceptions.
Another big issue is the enforcement of rights. The efficiency of courts in enforcing contracts even differs significantly between the regions, even though laws are passed at national level. A relative unsophisticated commercial case takes about 230 days to solve in the courts of south east coastal area while it would take one year to solve this dispute in north eastern regions (World Bank Group, 2008, p 4).

Sieren (2007, p.98ff) is not just criticizing the uncertainty of the Chinese law, but is also pointing out that only 10-20% of the judges have an adequate education. In addition, the jurisdiction is often influence by social impact, since the judges in China are “mediator” as well (Zinzius, 2006, p.155).

A study conducted by the American Chamber of Commerce in China (2011), shows similar concerns. US companies were mainly moaning about unclear laws and regulations, difficulty enforcing contract terms and especially China`s bureaucracy (The Washington Times, 22.3. 2011). In average, a senior manager spend about 20% of the time to deal with requirements of government regulation, while in East-Asia&Pacific regions only half of the time need to be spend on this issue (World Bank, 2006-2009). Red Bull Austria, as a victim of the Chinese bureaucracy, thus, has to delay months to operate in China due to the missing Chinese administrative decision (APA, 04.05.2011). The Salzburg energy beverage producer is not the only one perceiving legal restriction in China, but nearly every 4th of the interviewed Austrian firms regard legal risk as a main problem for their business in China.

5.4.2. The meaning of contracts

The meaning of contracts is a crucial difference between Austrian and Chinese interpretation of law. While in Austria and other western country contract is legal bounded, in China it has different meanings. The real negotiation begins and continues after a contract is set up (Holzmann, 2004, p. 219f). Indeed, this custom can be quite frustrating and confusing for foreign investors. Holtbrügge and Puck (2008, p.17.) stress out that taking legal action, however, is not always a good alternative. According to the authors, this option can lead to a loss of the partner`s face and this again will harm the future business relation. Nevertheless, they warn not to put up with everything, but to bargain out of court (see chapter 6 for other recommendation). In fact, more than 30% of all civil cases in 2006 are solve through mediation. In the Southeast and Bohai Bay nearly every second disputes is solved out of court, while it is even 60% in Nanjing, Fuzhou and Tianjin (World Bank Group, 2008, p. 24).
5.4.3. China`s tax system

Due to many exemptions, different interpretations and continuous changes of the legal framework China`s tax system is quite intransparent, especially for foreign investors. Basically, the tax law is enacted on the national level, however, local governments are responsible for the interpretation. Additionally, in order to fulfill certain economic goals local officials sometime impose illegal tax privileges to attract more investors. Thus, for foreign business people it`s difficult to predict the exact tax burden prior investment (U.S Commercial Service, 2009).

As a member of the WTO, China is supposed to treat domestic and imported goods and services with the same tax. VAT rate for sales, imported goods, services of processing, repairs and replacement accounts 17%, exceptions are made for certain essential products with a rate of 13%, such for agriculture, water, books, coal etc. Business taxes for provision of services, transfer of intangible assets or in sales of immovable properties account for 3-5%. Business tax for entertainment, however, is 5-20% (Beijing Local taxation Bureau, 2003). Companies, in addition, obtain VAT refund for exports as an incentive (Cui, 2003). The refund system, though, is quite intransparent (U.S Commercial Service, 2009).

Since 2008 the corporate income tax is 25% for both, foreign and local firms. Foreign companies set up before 2007, however, are still enjoying a 10% lower tax rate. But this reduced tax rate will gradually be increased to 25% in the next few years (Huang and Mou, 2007, p.2)

Start up tax incentive for foreign investors (Li, 2008, p.8ff and IHK Pfalz, 2011)

Foreign companies are free of corporate tax for the first five and a relieve of 50%, thus, 12.5% for the next five years, when operating at least 15 years in

- Hainan (SEZ) and engaging in infrastructure or agriculture.
- Pudong (Shanghai) and involving in communication or energy projects

Sino-foreign joint ventures constructing ports and docks have the same privilege.

Corporate tax free for foreign investors in the first two years and half rate for the next three years when undertaking:

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30 Previously 33% for local and about 15% for foreign enterprise
• production in China for at least 10 years (tax benefits can be prolonged in certain regions)
• projects in the encouraged category in the Guidance of Foreign Investment Industries
• energy, transportation, environment protection, radio broadcasting and television at least for 10 years.

Exempted from tax in the first 2 and a relieve of 50%, for the following three years for
• foreign firms in the service sector operating in SEZs, with at least 5 million US$ investment and 10 business years.
• foreign and Chinese foreign banks in SEZs or in certain approved areas by the State Council when foreign capital is at least 10 million US$ and minimum 10 business years are guaranteed.

High-technology Chinese-foreign joint ventures operating in SEZs or new and high technology industrial development zones are free of corporate tax in the first 2 years.

Since tax incentives constantly change it is recommended to contact the Austrian embassy or Austrian Federal Economic Chamber in China prior investment. Furthermore, negotiations with local governments are necessary to enjoy additional tax benefits. Investors should, further, keep in mind that the total tax burden in China is much higher than mentioned above, since other taxes and mandatory contributions are not included. However, this issue will not be discussed in this thesis anymore. But just to give some numbers, the total tax burden of firms in Austria, in average, is 55%, while in China it is even 8% higher (World Bank Group, 2010, p. 147ff). This is actually the tax burden foreign enterprises must finally bear when the tax benefits are over.

5.4.4. Intellectual Property Commitments

Since China’s participation of the WTO it has adopted and revised its legal framework to comply with the WTO agreement on the TRIPs. In addition, the second largest economy has become member of the “WIPO, Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Madrid System for the International Registration of Marks, the Universal Copyright Convention, the Geneva

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31 labor taxes, sales tax, property tax, property transfer tax, dividend tax, capital gains tax, financial transactions tax, waste collection tax and vehicle and road tax.
Even though the Supreme People Court and the Supreme People’s Procuratorate interpretations support the protection of intellectual property and progress has been made, China is still a haven for counterfeiters and pirates (Commercial Service, 2009). According to Taylor Wessing Global Intellectual Property Index 2011, measuring firms’ assessment of legal protection for intellectual property in 24 largest economies, the People Republic is ranked second worst (Taylor Wessing, 2011, p.5).

**Problem of enforcement**

One of the main problems, concerning protection on intellectual property, is the lack of effective enforcement. For example, companies will only be criminal prosecuted, if their profit from selling or distributing of plagiarism is higher than 8500 US$ (APA, 01.01.2011), which can be quite frustrating for foreign investors. The US, in addition, criticizes the lenient fines and penalties for copy cats, on the one hand, and, on the other hand, the overlapping and sometimes concurrent responsibilities of the enforcement authorities (U.S Commercial Service, 2009). Furthermore, judges were not always neutral and, especially older ones were members of the party or military, thus, have lack of legal education (Protector, 2008, p.16-19). Moreover, absence of “guanxi”, can make it more difficult to claim the right (Zinzius, 2006, p.149ff). A report by Taylor Wessing in 2011 also reveals unequal chances of patents enforcement between local and foreign enterprises (Taylor Wessing, 2011, p.22).

Finally, Chinese consumers have different idea of intellectual property rights, which stem from the Confucianism. They hardly realize that counterfeiters actual break a law and harm the company concerned (Chee and West, 2006, p.136-137). Other reasons for ineffective battling against corruption include: corruption as well as lack of resources and training for enforcement officials (U.S. Department of Commerce, 2003).

**Grey market industry**

According to the “Brand Eins” magazine, piracy of products accounts 8% of China’s GNP annually (förderland, 2006). The Chinese Development Research Council estimates revenues of 17 billion due to counterfeiting of merchandise (Chee and West, 2006, p.136). The grey market manufacturers sometimes even add innovations in the faked products, especially in the handsets market. Some imitated iPhones in China, thus, can handle two SIM cards at the same
time (The Economist, 21.11.2009, p. 68). Thus, it is estimated that about 20% of consumer`s goods in the Chinese market are plagiarism (U.S. Department of Commerce, 2003).

The problem, in general, is that the fakes are not only sold in China, but also exported worldwide. In 2009 75% of the 416000 confiscated products in Austria due to infringement, stemmed from China (Oswald, 2010). Most of the copies have good qualities and can only be identified by a few experts (Protector, 2008, p.16-19).

**Impact on foreign enterprises**

US firms lost $48 billion due to Chinese infringement in 2009. The US International Trade Commission, further, estimates that violation of intellectual property rights cost more than 2 million American jobs (Palmer, 19.5.2011). Besides, companies face loss of reputation. Customers, on the other hand, have to deal with monetary and emotional losses, in extreme cases injury and even death can occur (see China`s baby milk scandal).

The Austrian Architect, Mr. W., hence, complained in the interview: “…everybody is copying everything. They don`t care and the government also don`t care. State owned companies are often the worst. Mr. D., as an Austrian sales manager, shared similar experience:””Patents are not even worth the paper of the print. All technology is copied and sold as own invention.”” (See appendix for the whole interview)

China, however, is now trying hard to protect intellectual property rights, due to the pressure of the WTO, on the one side, and, on the other side, it has become a big innovator with 300000 Chinese utility patents in 2009 (Lohr, 2011). Not only foreign but also local firms, both are victims of counterfeiters. Moreover, the Chinese authorities are well aware that providing good legal environment is essential to attract further, especially high tech investors. Thus, during the visit of the Chinese Minister of Commerce, Chen Deming, in Austria, he promised to strengthen intellectual property protection (ETCN, 2010). Indeed, the Taylor Wessing Global Intellectual Property Index 2011 shows a huge improvement in China`s ratings in compare to 2009 (TaylorWessing, 2011, p.7). Nevertheless more than 41% of the Austrian respondents regard violation of intellectual property rights as one of the main obstacles when doing business in China.
5.4.5. Conclusion and summary of law

Even though China has been constantly improving its legal framework for the last two decades, foreign investors and Sino-experts criticize the dependency, transparency and uncertainty of the Chinese judicial system. The different interpretation of contracts among the cultures can be quite frustrating for western investors as well. However, an even more serious matter in China is the violation of intellectual property rights costing foreign companies millions of losses. Nevertheless, the current legal environment should not discourage investors from operating in China, since the Chinese authorities are aware of this problem and working on it. Court efficiency, for example, has been constantly improved (World Bank Group, 2008, p 4). Besides, generous tax relief can compensate part of the costs. Counterfeiting, indeed, a problem of foreign investors is also face by enterprises with no presence in the Chinese market. As stated by the former CEO of Zumtobel Andreas Ludwig: *The market is very competitive. It is not necessary to produce in China to become a victim of product piracy. Going to a fair is already enough.***

More importantly, is thus developing prevention strategy and taking proper action when realizing being victim of copycats or the legal environment (see chapter 6).

5.5. Cultural environment

Several studies suggest that culture can have deep impact on consumption (Kacen and Lee, 2008), and business processes, such as negotiation (Graham and Lam 2003), management (Aycan et al, 2000), trade (Grinblatt and Keloharju, 2001) and even entry mode (Bhardwaj et al. 2007; Kogut, Singh 1988).

A survey conducted by Berlitz Austria found out that cultural differences between China and Austria is the biggest challenge for their clients among all cultures (Klotz et al, 2007, p.121). My results, on the other hand, even reveal that cultural differences (46.73%) are the second major obstacles after local competition (57.01%) when doing business in China. This suggests foreign investors to prepare very well prior entering China.

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32 Own translation
5.5.1. The Chinese culture

The culture of China, as one of the oldest, is strongly influenced by Buddhism, Confucianism and Taoism. Especially the doctrine of Confucius still gives the framework of the Chinese thinking and acting (Schmidt and Sieren, 2007, p.257ff). His philosophy emphasized hierarchy structure, harmony, education, family and society (Holzmann, 2004, p. 219f).

Hierarchy

The social relationship is organized in a hierarchy structure. The five relations are between sovereign and subject, father and son, man and wife, older and younger brother, and friend and friend (Chee and West, 2006, p.62). To guarantee the natural order maxims such as loyalty, respect, reverence and obedience must be pursued (Holzmann, 2004, p. 219). Till today many Chinese civil services and SOEs still follow a strict hierarchy and bureaucracy organization structure (Zinzius, 2006, p.29; Sieren, 2007, p.54). Although the younger generation sometimes rebel against, in general, the acceptance of the authority is higher in compare to western countries (Chee and West, 2006, p.63).

Harmony

The principle of harmony means balance with the society but also with itself. Thus, compromise, arrangement and consensus are the guidelines to reach a harmony life (Holzmann, p. 219, 2004). Consequently, fit of rage or praising a subordinate in the public can disturb the harmony (Chee and West, p.75, 2006).

Education

According to Confucius, good education is not creativity and critical thinking but imitating an excellent teacher (Riegel, 2006). Still today foreign investors are sometimes complaining about the lack of creativity of Chinese employees and violation of intellectual property rights

Family and society

A human being is always a member of a family, society and finally the state. Each part of the society has a reciprocal obligation. The sovereign is responsible for welfare of its subjects. The subjects’ duty, on the other hand, is loyalty and obedience (Holzmann, 2004, p. 220). Collectivism is thus well distinctive in the Chinese society.
Even though China seems to adapt the western culture, the number two economy still has a society based on traditional Chinese values. A good example is the Chinese wedding. Even though the bride is wearing western wedding dresses, the act of wedding is based on traditional customs. The groom bowed before the tablets of heaven and earth as well as his ancestors, then to his parents (Chee and West, 2006, p.59). A requirement for successful operation in China, therefore, is to have at least a basic knowledge of the Chinese culture.

### 5.5.2. Guanxi-social network

While Austrian and other Westerners trust the system, such as law, financial and public institution, Chinese mainly rely on personal trust. Since China’s law system is still not so sophisticated developed, guanxi can reduce the uncertainty.

**Definition**

Guanxi as a particularity of the Chinese culture has several definitions: “*Guanxi refers to interpersonal relationship which, for the Chinese, is seen as crucial for facilitating smooth business transactions.*” (Kiong and Kee, 1998, p.76) Guanxi, of course, is not only related to business, broader definition was described by Luo (2000, p.2):”*The Chinese word “guanxi” refers to the concept of drawing on connections in order to secure favors in personal relations. It forms an intricate, pervasive relational network which the Chinese cultivate energetically, subtly, and imaginatively. It contains implicit mutual obligations assurance, and understanding, and governs Chinese attitudes toward long-term social and business relationships.*” Chee and West (2006, p. 94), on the other hand, defines “guanxi” simply as “trust”.

Similar to the German term “Vitamin B”, or English expression “Old Boys Network” or more general “social networking”, “guanxi” is reciprocal and neither time specific, nor conceding the same favor (Luo, 2000, p.2.). The difference is that “guanxi” has more intense socio-emotional components, resulting in giving presents and having meals together. (Pearce and Robinson, 2000; Trompenaars, 1994; Yang, 1988; Yang, 1994; cited in Chua et al, 2007, p. 490)

**Importance of Guanxi**

There is a Chinese saying:”*Duo yige guanxi, duo yitiao lu*,” which means the more guanxi one’s have the more doors are open. Luo (p.1. 2000) therefore stressed out:
“It [guanxi] is the lifeblood of both the macro-economy and micro-business conduct. Any business in this society, including both local firms and foreign investors and marketers, inevitably faces guanxi dynamics. No company can go far unless it has extensive guanxi networks in this setting.” More than 77% of the Austrian respondents seem to support this statement. “Guanxi” was ranked as the most important requirement for successful business operation in China.

How Guanxi influence business processes

Basically, some Chinese businessmen favor to do business with someone with whom they feel close to. Luo (2000, p.84) explained that “guanxi” is helpful to smooth the bureaucratic process. Still today government officials have the influence to grant projects and to assign resources. In addition, Chinese institutions regulate the economy and set up the rules of business activity.

This example should illustrate how guanxi smooth the bureaucratic process: China commentator, Scott D. Seligman, cited an example of his friend:”...a friend of mine who needed to clear a shipment of goods through customs in Shanghai...While my friend’s company was duty registered to do business in Guangzhou, his Shanghai office was technically a representative office, which was enjoined from profit-making activities. Because of this, Shanghai customs did not believe it was empowered to clear the shipment... It soon became clear that no amount of arguing with the customs official in charge was going to change his contention that the paperwork should be done in Guangzhou, and the goods just sat there. The solution came in the form of a friend of my friend who was in the freight forwarding business and whose guanxi with the Shanghai Customs Bureau was excellent. All it took was a quick phone call; the shipment cleared the next day.” (Seligman, 1999, p.184-185)

Especially firms in less open economic regions are required to develop good ties with government officials to increase their possibility of successful operations in China. Moreover, guanxi network, in particular, reduces the risk of market orientated companies and secures their required inputs (Luo, 2000, p.113). Finally “guanxi” might influence the strategic entry mode choice, especially the decision between joint venture and wholly owned subsidiary (see chapter 7).
The boundary between corruption and guanxi

Often foreign investors are confused and have trouble to distinguish between bribery and building personal relationship. Transparency International defines corruption “as the abuse of entrusted power for private gain”. This definition covers corruption not only in the public, but also private sectors (Transparency International, 2010). Luo (2000, p.200ff.) pointed out that corruption is illegal, but guanxi is legal. He compared it with tax evasion, which is illegal, whereas tax avoidance is legal. Moreover, “guanxi” mostly builds on long term favor exchange, complements law, while corruption frequently involves money, jeopardizes the market and investment. Furthermore, corruption, in general, is a transactional obligation (based on commodities) and not a permanent reciprocate relation (based on trust). Finally “guanxi” does not end with a favor, while a corruption deal often ends with a transaction.

Therefore, there are, indeed, differences between bribery and presents. Giving a gift, as an expected behavior in China, though, does not only show respect to the counterpart but is also one way to boost relationships. The value of the present, nevertheless, is constrained by “rules of moral legitimacy” (Steidlmeier, 1999).

Building Guanxi

Having a good understanding of the “guanxi” culture is one step towards a successful business in China, but an even more important step is being part of the Chinese social network.

Although, having good personal relation with local suppliers, buyers, partners and especially government officials lead to a competitive edge of the company, it is not necessary to build relationship to everyone. More important is to find the “right” person which certain competence and power (Chee and West, 2006,p. 88ff; Luo, 2000, p.250; Zürl,2006, 58.p).

There are three main categories of interpersonal relations in China: family members (jia ren), familiar members, such as friends, colleagues and neighbors (shu ren) and finally mere acquaintances or strangers (sheng ren) (Yang, 1993). Mostly foreign investors can find themselves in the last category, where the tie of the guanxi is the weakest (Chee and West, 2006, p. 88). Zürl (2006, p.42), additionally, asserted that Chinese usually don’t do business with “sheng ren”.

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However, it is in general not impossible to climb up to the next group (Chee and West, 2006, p. 88). Over all, the costs of establishing interpersonal connection compared to the benefits are quite low. Chee and West (2006, p. 93), therefore, even recommend to adapt “guanxi” in the corporate strategy. However, “it often takes months, perhaps even a year or more, to establish guanxi.”(U.S Commercial Service, 2009)

To create “guanxi” relation Luo (2000, p.246ff) has several suggestions. Besides sharing meal, entertainment and holiday together he advises to assist in education of the client’s or partner’s children. Since Chinese managers and authorities often get invited for dinner in China, much better approach to build relationship is thus to host them in your home country.

A straight forward way is to use existing connection to gain new ones by getting introduced. Very useful are business communities, commercial chambers and consulting firms who have the key to certain networks. Holzmann (2004, p. 135f), therefore, recommends to participate in fairs in order to set up “guanxi”, but warn not join the exhibition culturally unprepared.

The Austrian Foreign Trade Promotion Organization, in addition, supports Austrian companies in Chinese trade fairs, such as in IFAT CHINA, EPTEE, CWS Shanghai 2011. For Austrian business people this can be the first chance to establish good relationship with potential partners in China.

**The limit of guanxi**

Even though having good guanxi can ease political and legal problems. It’s important to bear in mind that there is a threshold between bribe and gifts as well as favor (see above). In addition, ethical dilemmas (see Fan, 2002) need to be considered as well.

Guanxi is an interpersonal relation. Therefore, if a sales person leaves the company the enterprise faces the risk of losing connection with certain customers. In addition, sales and other employees sometimes grant their counterpart far too generous conditions in order to set up guanxi, although the established network does not always guarantee the best offer. Professor Wilfred Vanhonacker, a China expert, thus, suggests opening a competitive bidding process to guarantee fair prices and to use team based selling when guanxi is not so important for the business. He also advises to set some incentives for the sales people to establish their loyalty and to change the sales team after certain time (Chee and West, 2006, p 91-92).
Although some believe “know who” is even more important than “know how” investors need to keep in mind that guanxi is essential, but only one of the few factors for successful operations in China. If the product is not suitable the best guanxi won’t help. Guanxi just opens you the door!

5.5.3. Mianzi- Face

Understanding the concept of “mianzi” is another crucial requirement for a successful operation in China. Face can be seen as reputation or social standing. Thus, “mianzi” does not only help foreign investors to establish and maintain “guanxi”, but is also an important tool for negotiation and human resource management (Chee and West, 2006, p.69ff).

In the western culture one can usually “loose” and “save” face. In China a third metaphor exists, as to “give” face, to improve someone self confidence by flattering or showing respect (Seligman, 1999, p.198).

Lose face- take someone`s face

Seligman pointed out (1999, p.198) that there are several ways to make someone loosing face. For example to insult someone in the public, to question straight someone`s dignity, not given someone the respect he or she “deserves” or simply refuse someone`s request. Zürl illustrated an example (2006, 42. p): “When a Chinese business partner asked his German counterpart to accommodate his daughter during her one year study in Heidelberg, the German refused his request with the justification that his house is too small. Finally the Chinese businessman signed the contract with another firm that offered his daughter a guest room”.

Losing control over yourself such as fit of rage (Chee and West, 2006, p.71) not only disturbs the harmony, but also makes losing the own face. Chee and West, further, stressed out that refusing to accept a gift or an invitation, criticizing someone in front of others and simple sharing a bill in a restaurant can make the counterpart losing his “mianzi”.

They finally recommend using an intermediate (a friend, another business partner etc.) to recover the harmony situation when accidently taking someone`s face (2006, p. 69-72).

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33 Own translation
Give face

Simple methods to enhance someone’s face is to call the business partners or government authorities by their formal positions, such as Manager Li, Chairman Wang or even Bureau Director (Seligman, 1999, p.206-207). Instead of highlighting someone’s position, it is also possible make yourself “look smaller” to give someone “mianzi”. As Seligman described (1999, p.207): “The Chinese who writes a letter to a university professor and signs it “Your student” is doing precisely this. He may never met the professor, still less taken a course from the person...But setting himself up as the “inferior”- the “student”- he is conferring prestige on the teacher-that is, giving face.”

Other ways include praising someone in front of his/her supervisor or doing favor to a stranger, who is introduced to you; enhance the “mianzi” of the introducer. Finally dressing up well, having a nice housing, power and intelligence but also paying respect to others can boost your own face (Chee and West, 2006 p. 65).

5.5.4. Difference between the Austrian and Chinese culture

Professor Hofstedte analyzed the differences between national cultures on the basis of the survey of IBM in more than 40 countries. He, further, defined four dimensions of national culture: power distance (“accept and expect that power is distributed unequally”), individualism (“the degree to which individuals are integrated into groups”), masculinity (“refers to the distribution of roles between the genders”), uncertainty avoidance index (“deals with a society's tolerance for uncertainty and ambiguity”) and long term orientation (“it describes societies' time horizon”) (ClearlyCultural, 2009).

![The 5D Model of professor Geert Hofstede](image)

Figure 5-3: Cultural differences between Austria and China. Source: Hofstede (2009)

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34 Extended it to 50 and 3 region (Hofstede, 2001)
The two graphs generated with the data of Hofstede clearly shows that in the Chinese culture power distance and long term orientation are much higher while individualistic behavior is significant lower than in the Austrian society. Austria, further, ranks higher than China in the masculinity and uncertainty index (Hofstede, 2009).

**Power distance**

The high power distance indicates that the Chinese people, in general, are accepting the unequal distribution of power. This behavior partly stem from the Confucianism (see above). The duty of the ancient sovereign was the wellbeing of its subjects. The subjects’ duty, on the other hand, is loyalty and obedience. Thus, it is recommended for foreign manager to show empathy and ask after the private life of the Chinese employees (Waldkirch, 2009, p.98). The importance and acceptance of the authority also reflects in other business activities, such as exchanging business cards on the first meeting, high income inequalities and especially in a hierarchical organization structure (Deresky, 2001).

**Long term orientation**

Chinese wants to establish trust and relation in order to do business. Building trust, however, can be quite time consuming. The general Chinese opinion is that only a good interpersonal relationship guarantees a long term success (see guanxi). Another implication of long term orientation is the setting of 5 or 10 year economic plans, importance of education and frugality.

**Individualistic - collectivistic**

The Chinese lives in a networked society. An individual is always part of a group. The main focus is therefore the wellbeing of other members in the group. Thus, decision making can take much longer than Austrians used to (see negotiation). Additionally, team’s incentives might be more effective in China than individual’s within a company (Dahl, 2000). Despite strong collectivism the fluctuation in China is, nevertheless, quite high (see chapter labor market)

**Masculinity –feminine cultures**

In a masculine culture, people tend to be more competitive, ambitious and materialistic. China has similar characteristic as Austria in this dimension (ClearlyCultural, 2009). The slightly lower value mirrors that relationships are quite important in the collectivistic society.
Uncertainty avoidance

As a result of the higher uncertainty avoidance in Austria, Austrian tends to standardize processes (Staehle, 1999, p. 504 cited in Klotz et al., 2007, p.43). Contracts are used to get rid of uncertainties; while for the Chinese contracts have different meanings. Lower uncertainty avoidance also results to more people orientated instead of detail orientated. Thus, Chinese business partner prefers renegotiation instead of an inflexible agreement (Chee and West, 2006, p. 126; Zinzius, 2006, p.51).

5.5.1. Cross cultural negotiation

According to Walter Grimm, an executive of the Austrian consulting company Cisema GmbH : “Knowledge of the Chinese language and negotiation culture is the most important requirement for closing a deal.” (Manner and Bösiger, 28.6.2007, p.28)

Several studies, indeed, suggest that culture effects negotiation style. For example Abramson et al (1993) found out that during negotiation cultural differences influence the way people cognitively construct situations and behave. Dr. Catherine Tinsley from Georgetown University, on the other hand, classified five elements effecting Chinese negotiation frames: social linkage in a larger group, harmony, roles in the relationship network, reciprocal obligations and face (Lewicki and Sheppard, 1997, p. 209ff).

Characteristic of Chinese negotiation

Since the interpersonal relationship is quite important for the Chinese, their negotiation style is more relation orientated. Thus, questions are preferred to threats (Adler et al.1992). In a relation orientated culture, the language also appears to be more indirect and have a higher context (Hall, 1976). That means some content are left unsaid, instead letting the culture explain.

In order not to loose mianzi and to disturb the harmony, Chinese negotiators tend to hide their feelings. Hence, sometimes it is for foreigners very difficult to interpret their body language (Graham and Lam, 2003).

35 Own translation
In a collectivist culture negotiator, in general, focuses more on the long term relationship and the wellbeing of the group. Consequently, negotiator will hardly be changed to establish trust in long term cooperation. In addition, the process is much slower, since a group decision will be made. Greater power distance, further, can be quite time consuming, since it is more likely that approval from supervisors are sought, (Lewicki et al, 2007,p.236ff), especially when bargaining with SOE or institution (Chee and West,2006,p.129).

Nisbett (2003) reported that the Chinese approach on discussion is to talk about all issues at once instead of splitting it up. Concessions are made only at the end.

Chee and West (2006, p.126) and similar Zinzius (2006, p.51) points out that the signature on the contract often does not necessary always mean the end of the bargaining; sometimes it” just starts”. The Chinese partner often makes use of the negotiation process prior the contract to get more familiar with the other counterpart (Sieren, 2011, p.101). Some recommendations for cross cultural negotiation can be found in the chapter 6.

5.5.2. Summary and conclusion of the cultural environment

Still today the Chinese traditional culture, strongly influenced by Confucianism, affects social and business activities. In general, having enough “mianzi” establishes “guanxi” and guarantees access to certain group and business networks; since a person with “face” is respected and trusted. Consequently, it is recommended to mind the rule of “mianzi” in order to maintain harmony, again a key factor for a smooth business operation. According to Hofstede, China’s culture differs from Austria`s, mainly, in power distance acceptance, long term orientation and collectivism. These factors reflect in other business activities as well, such as negotiation and human resource management.

Even though this chapter covers some important aspects of culture influencing doing business in China, it’s still essential to know that there is no such thing as a “typical” Chinese or Austrian. Thus, it’s important not to generalize people. Especially the younger generation in China is not so deeply rooted in the traditional culture anymore; individualistic and critical behavior instead of collectivistic and obedient is observed. In addition, even though there are some adaption of Hofstede´s cultural theory over the years it is often being criticized that the data are obsolete and not representative. The information were collected from IBM employees and gathered more than 30 years ago.
5.6. Chapter summary and conclusion

Still today the state has a strong influence on the market. Foreign companies, thus, are not only complaining about being discriminated from public bidding process, but also regulations that make operating in China even harder. Even though China has become one of the strongest economies there are ambivalent opinions about its future economic development, since other factors such as: the yuan, inflation, labor market and the fear of the China`s asset bubble have strong influences on the economic environment.

Although China has been constantly improving its legal framework for the last two decades, foreign investors and Sino-experts are criticizing the dependency, transparency and uncertainty of the Chinese judicial system. The different interpretation of contracts among the cultures can be quite frustrating for western investors as well. However, an even more serious matter is the violation of intellectual property rights costing foreign companies millions of losses.

Prior operating in China foreign entrepreneurs mainly consider political, economic and legal issues, but often neglect cultural differences as one of the main risk of doing business in China. Still today the Chinese traditional culture, strongly influenced by Confucianism, affects social and business activities. According to Hofstede, China’s culture differs from Austria`s, mainly, in power distance acceptance, long term orientation and collectivism.

Despite big challenges, in 2011 already more than 500 Austrian companies were operating in China. Not only FDI but also the trade volume between Austria and China has increased significantly over the years. The outlook is also quite promising. The value of trade is expected to double in the next five years. Especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, environmental protection and in the service sector, there are still big potential for closer cooperation.

6 Risk management

This chapter provides some basic risk management and preventive strategy for selected problems in China.
6.1. Risk management-political risk

Basically, there are several ways to hedge against political risks. Some can even be insured by the Österreichischen Kontrollbank (Wirtschaftsblatt Sonderthema, 28.6.2007, p.48) and MIGA, an organization of the World Bank, providing insurance for foreign investors in China. MIGA covers political events and actions of the host governments that cause lost, such as expropriation, currency inconvertibility and transfer restrictions and political violence (Multilateral Investment Guarantee Agency, 2011, p. 56).

Further strategies for dealing with political risk, in general, include working close with the home government together or forming business networks to increase bargaining power in order to “force” the Chinese authorities to abide the rules of a fair open market. In addition, an emergency response plan needs to be created to make sure that operation won’t be affected even during public, environmental crisis and social riots. For example to implement remote employment during crisis and to train local staffs to take over when expatriate workers leave the country. It is also recommended not to build R&D, production and supply chains facilities in one single Chinese province or region to diversify the risks. Finally due to high uncertainty in the Chinese market, especially in the long run, it is worth to have an exit strategy (Bremmer and Zakaria, 2006, p.23ff)

6.2. Risk management-corruption

In general, each foreign company has different ways to prevent corruption. One way of doing that is better monitoring of key employees, to make sure that they abide the regulation. Anti corruption policy and guidelines within the companies is another important strategy. Employees, in addition, must be sensibilized that taking or giving a bribe will not only have internal consequences but also external, since it’s a violation of Chinese law. It is thus essential to offer proper training to staffs, especially those who are operating in countries prone to corruption like China. Any suspects in corruption need to encourage to be reported without having to fear of any consequences. Finally closer investigation of the business partner and contracts36 is an effective tool to avoid corruption (Reznicek, 2010; Jarolim, 2009).

36 especially the part of financial and nonfinancial compensation
To deal with corruption in China, Mr. Steidlmeier, professor of business policy at Binghamton University, further, suggests explaining your constraints to the Chinese partner during negotiation, such as anti corruption regulation in your home country or company guidelines. Other recommendation includes pointing out corruption under Chinese law is a serious crime and providing alternatives which are more justified as business reasons instead of cash (Steidlmeier, 1999).

Mr. Goldammer, lawyer and partner of Taylor-Wessing37, finally, advises being very careful when taking a loan, since banks are still interrelated with the government. He explained that civil servants are due to undercompensation more prone to corruption (Kalscheuer, 2011, p.17).

6.3. Risk management-cultural negotiation

Lewicki et al (2007, p. 236) proposes not to make too much adaption when dealing with cross cultural negotiation, since it takes too long to fully understand the foreign culture. But advise, at least, to try to understand the counterpart’s culture. Weiss, in addition, suggests using bargaining strategies based on the familiarity with the other culture. If negotiators have low familiarity, agents and mediators are quite useful, while adaption of the other negotiation approach is more adequate for moderate culture understanding. Finally high familiarity is required for fully adaption of the counterpart approach (Lewicki et al, 2007, p. 249ff).

Chee and West (2006, p. 122ff), furthermore, warn not to underestimate the Chinese counterpart and advise foreign business associate or negotiator reading the “The Art of War” and “The 36 Stratagems” as preparation. Both books illustrate strategies used in Chinese politics, war, as well as in civil interaction. They, additionally, stress out the importance of negotiation outside the conference room, like in a bar or restaurant to ease the tension and create relation. Finally, the authors recommend sending a person in high position as chief negotiator to show respect to the counterpart and importance of the business, since China tends to have a higher power distance acceptance culture.

37 leading international law firm
6.4. Risk management–labor market

Since there are difficulties to find well qualified employees, international firms should work closer with local universities, including granting scholarships and providing internships for talented Chinese students (Gulnerits, 28.6.2007, p. 37). Training centers are also recommended to shape skilled employees. Therefore, for example the “cooperation on the establishment of the International Welding Training Center Austria’s agreement” was signed with the city Chengdu in 2011, to guarantee qualified human resource in the future (Andesner, 2011, p.25). Zinzius (2006, p.115), further, suggests cooperation with headhunting company and providing incentives to employees to bring new staffs in the corporation, but warns to check the documents of the applicants very precisely to minimize the risk of fraud.

The boss of TDK\textsuperscript{38}, Takekhiro Kamigama (2011, p.56) believes that developing a good company culture and improving the working condition prevent high fluctuation. He also recommends employing local managers instead of expatriates, but warns foreign investors not to leave all secret information by a single person. In addition, individual professional training programs (Zinzius, 2006, p.115), fringe benefits such as granting credits for employees (Fröndhoff, 20.02.2007) but also freezing bonuses in an extra firm account are helpful to keep the staff (Gulnerits, 28.6.2007, p. 37). Waldkirch (2009, p.98), further, suggests foreign managers to pay attention of the Chinese employee’s wellbeing, since they are usually loyal to persons, but not to the firms. However, this kind of Confucian’s care can be quite confusing for foreign managers, because it is not expected in western countries to intervene in employees’ private life. Thus, the CEO of Global Procurement Services, Wilfried Krokowski proposes expatriates to spend more time with the local staff after work and finally highly recommends developing human resource management strategy one or two year before the factory is even completed in China (Gulnerits, 28.6.2007, p37).

Higher productivity basically offsets the increasing labor cost. Therefore, firms need to invest in new equipments and technologies (Kamp, 2011d, p.60), although there is a risk of knowledge loss. Furthermore, since income in the west and north of China is significant lower than the coastal areas and in the south, production can be shifted to lower wage regions (The Economist, 9.1.2010, p. 66). Consequently, in the last few years GM, Honda, Motorola and Intel have moved parts of their production and research facilities to inland locations.

\textsuperscript{38} a worldwide leading electronic components company
(Bloomberg, 27.3.2006). However, transport costs to the harbors on east coast and additional delays can offset the cost advantage.

### 6.5. Risk management-law

Although many laws and regulations have been enacted by the central government, there are problems of enforcement. Mostly local authorities are using personal instead of legal interpretations. Thus, having the right connections with officials do not only facilitate the bureaucracy, but is also useful to gain access to resources and market. Since nearly all businesses, in general, are under the control of the local government and the national ministry in the region, it is essential to find out who is really making the last decision. Often it is reported that the head of an institution is not always the most powerful person but mostly the one, who has personal relations with high officials, has the dominate influence (Luo, 2000, p.250; Zuerl, 2006, p.58). In general, rules are not inflexible in China, thus, Himmelmann and Hungerbach (2005, p. 20) advise to negotiate with public authorities for exceptions, because certain regulation can be avoided or changed if it’s “good” for public interest.

When legal disputes with the Chinese partner occur, Holtbrügge and Puck (2008, p.17.) warn again taking legal action, due to the loss of Chinese counterpart’s face and the lack of success in front of the court. Zinzius, therefore, (2006, p.154f) suggests inviting a third party, a mediator or using guanxi to bargain out of court instead of legal suit. Sieren, finally (2007, p.101f) assures connections with banks and officials are the most effective tool to enforce the right when doing business in China.

As a thumb of rule, prior operating in China, firms should undertake extensive research into the relevant laws, especially regarding their sector (U.S Commercial Service, 2009).

### 6.6. Risk management-intellectual property

Protection of intellectual property should begin within the company. Chee and West (2006, p.140-141), thus, suggest providing decent training for employees about this delicate issue. In addition, firms need to encourage consumers to report imitation. They, further, advise to undertake a due diligence investigation prior engaging with the Chinese partners and to combine resources with other firms in the same sector in order to develop additional
prevention strategies. Finally the authors stress out that cooperation with copy cats is an effective tool to protect further technology losses.\footnote{Cadence Design Systems, provider of software, license certain technology to a Chinese copy cat}

Foreign investors, moreover, need to find and close security hole within the company. For example, computers and mobile phones, for instance, are often used to steal firms’ secrets. Preventing corruption within the company is also effective against losses of know-how (Berke, 2011, p 68ff). A general rule of thumb is to make sure that no single person has full access to all information. In addition, secrecy clauses are essential in labor contracts to protect corporate secrets (Sepp, 2007, p.4).

Although Chee and West (p.141, 2006) warn that the patent office itself can be a security hole, the German Chamber of Commerce and Industry and the Austria Wirtschaftsservice GmbH highly recommend additional registration of intellectual property, brand and logo in China, since a registration of the product outside does not guarantee a full protection in China (IHK für München und Oberbayern, 2011; Wirtschaftsblatt Sonderthema, 28.6.2007, p.29). Even so until 2007 still 95% of Austrian enterprises did not register their product in China due to the costs (Wirtschaftsblatt Sonderthema, 28.6.2007, p.33ff). Entrepreneurs, further, need to bear in mind that the procedure and time of property registration varies across the country. While in Shanghai it takes only 29 days 4 procedures in Nannin it takes 66 days and 12 procedures in average. In Lanzhou, a city in Northwest China it even takes 78 days (World Bank Group, 2008, p.15).

Another very effective tool again piracy is the registration of trademark with customs. Custom officers can hold, confiscate and destroy suspected goods (U.S Commercial Service, 2009). However, this method is time and money consuming.

The German Chamber of Commerce and Industry, finally, suggests precise observation of the market, especially own market shares, revenues, but also checking for unusual prices of similar products. Implementing a tracking and tracing system makes sure that goods won’t be exchanged with copies (Sepp, 2007, p.3).
6.7. Chapter summary and conclusion

Firms operating in China face several risks. Nevertheless, with proper risk management most of the risk can be hedged. This chapter dealt with special risk management in China including: preventing political, cultural and legal risks and others which arise from the labor market, corruption, intellectual property rights and negotiation. Of course, there are far more methods to hedge against the risks, however they would be beyond the scope of this thesis. Even though some risks cannot be fully hedged foreign investors need to bear in mind that proper risk management and preparation is still crucial for successful operations in China.

7 Market entry

After accessing of the environment and risk management this chapter focus on the market entry. The choice of location is the initial step followed by market entry modes decision. The literatures for instance (Dunning, 1988) emphasize the importance of location.

7.1. Collecting information

Proper due diligence of the market (market size, potential, product acceptance and risk) and environment (geographical, cultural, legal, political and social) is very crucial, especially in China. Besides market research, investors can also obtain valuable information from the Austrian trade commission in China, Austrian trade promotion organization, the Austrian foreign ministry, other business partners, consulting firm, trade fair and corresponding literature. However, investors need to bear in mind that information is not always reliable due to constantly change, especially of the legal and political environment.

As important as accessing the external environment, companies need to analyze their internal strength and weaknesses before entering the challenging market. Especially when firms realize that they do not meet the requirements or are not willing to commit significant amount of time and resources in China, market entry must be delayed or even stopped (Dress et al, 2008).

7.2. Does location matters?

Depending on the entry mode, size and objective of the company, foreign investors choose different locations. For example marketability is for firms with the only intention of
manufacturing not as important as access to resources or low production cost. Especially producer of manufacturing plants and steal related goods are more concentrated in north east region, where steel and coal industry are located. Marketing oriented enterprises, on the other hand, will choose location near the customers (Zinzius, 2006, p.76). Thus, for distributing luxury goods big cities with higher income such as Shanghai, Beijing, are preferred. Consequently, many boutiques of Swarovski and Frey Wille are in these metropolises.

Due to geographical environment, procurement and distribution, especially to Western China, can take several weeks or months. Thus, 47.66% of the questioned firms answered that good infrastructure is very essential when opting for a location in China; whereas, indeed, less than every fifth believe manufacturing cost plays a crucial role for location choice. Other issues include: the differences in requirements between the regions such as initial capital, application procedure and how provinces, actually, carry out and interpret laws. Hence, choosing a proper location really has a significant influence on the future business. The research of Pan and Chi (1999), thus, reveals that the financial performance of MNC in open coastal cities such as Shanghai, Beijing, Tianjin etc. are better than those in SEZ despite lucrative incentives. The reasons are better infrastructure, bigger and more lucrative market in the coastal areas. Indeed, only 2.8% of the Austrian interviewed firms choose location based on tax incentives, while on the other hand ever second think that market potential is the most essential criterion for company’s location.
7.3. Where is the best place to do business?

![Map of China showing business regions](image)

Illustration 7-1 Doing Business in China: Where is it easy, where not. Source: (World Bank Group, 2008, p. 3)

The research of the World Bank actually shows that provinces on the east and south east coast and Chongqing are the most attractive regions for doing business, while in north west and south provinces doing business is harder (World Bank Group, 2008). The study mainly focused on business indicators such as “starting a business”, “registering property”, “getting credits” and “enforcement of contracts” gives a good explanation why most of the respondent Austrian firms are located in Shanghai (38%), Beijing (34%) Guangdong (14%) Jiangsu (9%) and Zhejiang (6%).

7.3.1. Starting business

The costs and time starting a business differ significantly between the regions. While in richer cities such as Shanghai, Beijing and Tianjin the cost of starting a business is less than 4% of provincial GDP per capita in the city Guiyang in Southwest China it is more than 26 %. The research of the World Bank also reveals that in Guangzhou, Hangzhou and Nanjing, business can be started in a month, whereas it nearly takes two months in Taiyuan and Yinchuan (World Bank Group, 2008, p.11). Even though Austria is famous for its bureaucracy; to
establish a new company “only” 28 days and 8 procedures are required in 2011, while in China it takes 38 days and 14 steps in average (World Bank Group, 2010, p. 147ff). In the OECD countries, however, merely 15 days are required in 2008 (World Bank Group, 2008, p. 4ff).

Figure 7-2: Cost of starting business and time it takes to start business. Source: (World Bank Group, 2008, p.11)

7.3.2. Property registration

Figure 7-3: Property registration. Source: (World Bank Group, 2008, p.15)

Number of procedure and time of property registration differ across the country. While in Shanghai it takes only 29 days 4 procedures in Nanning it takes 66 days and 12 procedures in average. In Lanzhou a city in Northwest China it even takes 78 days in 2008. While in average it requires 52 days and 9 steps to register property in 2008 (World Bank Group,
2008, p. 15), in 2011 China improve its efficiency only 29 days and 4 procedures. In Austria, on the other hand, it takes 21 days and only 3 steps (World Bank Group, 2010, p. 147ff).

7.3.3. Financing


Figure 7-4: Creating and registering collateral in China. Source: (World Bank Group, 2008, p. 19)

While chapter 5.3.7. dealt with financing in general, this chapter focuses on obtaining a loan in different regions across China. Receiving a credit, however, mostly requires collateral. The diagram above shows the different time and cost demanding across the country to create and register collateral. Therefore, receiving a loan in the southeast is half as time and money consuming than in the northwest and southwest of China. Especially in Fuzhou, Nanjing, Guangzhou, Shanghai, Jinan and Beijing it tends to be easier to register and create collateral and thus simpler to obtain credits (World Bank Group, 2008, p. 19-20).
7.3.4. Contract enforcement

As already mentioned in the chapter “legal environment” enforcing of contracts in court varies significant between the regions. It requires about 230 days enforcing contracts in the courts of south east coastal area whereas it takes up to one year to solve this case in north eastern and north western regions. Moreover, the cost of enforcing a contract is 11.5% of the claim value in the southeast, which is less than half as high as in northwest and northeast of China (25%) (World Bank Group, 2008, p. 23).

7.4. Entry mode

This chapter deals with the entry modes of foreign investors in China. While pros and cons of the most important entry modes are discussed there won’t be any particular recommendation made. First of all, there is no best market entry strategy. Each entry mode has benefits and drawbacks depending on the company’s strengths and weaknesses. Second a deeper investigation of entry mode strategy would be out of the scope of this thesis.

Entry mode decision is not only a decisive step for further business development but also attracts lots of attention among international business scholars. Basically, investors can choose between equity based entry modes, where local company is wholly owned or partially (wholly owned subsidiaries or joint ventures), and non equity, such as licensing, contractual agreement and exporting.
In general, transaction cost (Taylor et al, 1988), ownership and control issues (Erramilli, 1991; Hennart and Reddey, 1997), strategic goals (Kim and Hwang, 1992), cultural differences (Tihanyi et al, 2005; Kogut and Singh, 1988) country risk (Quer et al, 2007), but also experience (Chang and Rosenzweig, 2001) influence the entry mode. However, in case of China political and legal environment additionally have big impacts on entry modes (see chapter 5-foreign investment catalogue).

7.4.1. Austrians companies in China

According to my survey, the most common form of entry mode is wholly owned subsidiary with 43.93%, followed by export 30.84%. 23.36% have a representative office in China and 19.63% interviewed Austrian companies operate in China through joint ventures. Licensing/Franchising (3.74%) and other entry modes only play a minor role. Most Austrian enterprises, however, are doing business in China through several entry modes. They are having either a shared company or a wholly owned company or both in China, while their headquarters are exporting. Only 18% of Austrian companies are exporting without having physical presence in China.

7.4.2. Most common and important entry modes in China

Export

As already mentioned China is Austria’s 9th largest import partner. The export volume in 2010 accounts for 2.5 billion euro and the value is expected to rise significantly in the next few years (Statistik Austria, 2011; Chinadaily, 5.6.2011).

The most basic mode of market entry is exporting, using either a direct or indirect method. Direct export is supported by agent, sales representatives or distributors. While distributors buy and resell the products to local wholesalers and retailers; agents or sales representatives represent the foreign supplier in the Chinese market. The activities for an agent, besides sales, include advertising, custom clearance and dealing with legal requirements (U.S Commercial Service, 2009).

Indirect export involves commitment of foreign or domestically based export intermediaries. Basically, the exporter has no control over its products in the foreign market, since it is transferred to intermediaries (Holtbrügge and Puck, 2008, p.98).
In general, export as an entry mode is faster and not so capital intensive than wholly owned subsidiaries. Especially for smaller sales volume, export is more suitable than building production plants in China (Himmelmann and Hungerbach, 2005, p. 181). Other benefits include: realizing economies of scale, getting to know the Chinese market step by step and less sensitive of political and market risk (Holtbrügge and Puck 2008, p.96f). However, exporters are not presence in the Chinese market and have less access to customers, further they face long delivery times, high duties and complex customs (Himmelmann and Hungerbach, 2005, p.181).

Basically the transport from Austria to China takes 6 to 8 weeks, but it can take the same time to clear through customs. Additional 3 weeks are required just to prepare for the customs. Especially exporting of food is more complicated, so it requires a certificate of health, which can be obtain by the Austrian Agency for Health and Food Safety for 2000€ (Mayr, 2011,p. 56f).

**Representative Office**

Representative office, as often the first step of market entry, is easier to set up than subsidiary or joint ventures, since it is constrained by Chinese regulation only to contact, consulting and relationship activities as well as market observation. Therefore, these offices basically are not allowed to close contracts, directly bill customers and to do maintaining services (U.S Commercial Service, 2009; Zinzius, 2006, p.95). Since establishing and running a representative office is quite cost intensive sharing the working environment with other firms such as company pools are recommended especially for smaller firms. On the one hand, companies can benefit from the networking effect, but on the other hand, the risk of knowledge spillover arises.

**Joint ventures**

Generally, the foreign partner brings in capital, technology and machines, while human resource, land and building stem from the local counterpart. Profits and losses are shared according to their participation (Holtbrügge and Puck, 2008, p.100).

Foreign joint venture partners, basically, enjoy the benefit of limit investment and a fast entry to the Chinese market. Other advantages include: accessing to the local partner guanxi, distribution and procurement network and human resources. However, the backsides are loss of control of investment, intellectual property and know how issues, conflicts of interests and cultural differences (Himmelmann and Hungerbach, 2005,
Consequently, the joint venture of French food and beverage producer, Danone and its Chinese partner Wahaha finally broke up in 2009 due to conflict of interests (Handelsblatt, 30.9.2009).

**Finding a partner**

An essential step is to find a suitable joint venture partner. Foreign investors need to check the business and operational criteria of the local partner first. This includes: proper due diligence of production plants, human and financial resources, procurement and distribution network as well as infrastructure. Does the Chinese counterpart have experience with the market, guanxi to political and economical institution? After the initial inspection it is important to find out about the partners attitude, especially regarding the interests and objective of the joint venture (Holtbrügge and Puck, 2008, p.101f; Zinzius, 2006, p.43ff), since conflicts between partners are the main reasons for failure of cooperations (Holtbrügge and Puck 2008, p.101).

**Wholly owned subsidiary (WOE)**

In recent years WOE becomes the most common form of market entry in China. The advantages include: greater control over the company and intellectual property as well as to avoid import restrictions (Holtbrügge and Puck 2008, p.109f; Himmelmann and Hungerbach, 2005, p.171ff). In compare to export, investors of a WOEs are closer to the market and customers. Michael Peduzzi, CEO of Trodat, thus, stressed out the fact that: *Penetrating the Chinese market from Austria was not successful for us as well, it was then, when we established a wholly owned subsidiary.*” (Manner and Bösiger, 28.6.2007, p. 28) However, this form of entry mode involves high resource and time commitment, especially at the beginning. Even though the founding of WOE is relative unproblematic, some business activities (Broadcasting, real estate etc.) are still restricted. Moreover, foreign company has to build up their own guanxi, procurement and distribution network. (Himmelmann and Hungerbach, 2005, p.171ff). In particular, the former is quite time consuming.

**Future trend**

The research of Pan et al (1999) indicates that equity joint ventures in China are more profitable than WOSs and cooperative operations. This explains why joint ventures are the most popular form of entry mode in the last two decades; but the trend seems to change over years. In 2004 still every second of all foreign investment are joint ventures, while WOSs
already account for 40%. However, 70% of all new foreign investments are set up as WOS (Holtbrügge and Puck 2008, p.111).

According to Holtbrügge and Puck (2008, p112ff), foreign joint venture partners tend to buy out their Chinese counterparts. Over the time the benefits of the local partner diminish, since guanxi and knowledge of the country were already established. Other reasons include: liberalization of restriction for WOS, better legal and political environment, protection of know-how, barely tax incentive after some years and different interests. Thus, since 2010, the former joint venture, Andritz-Kenflo Foshan Pump Co. Ltd. has become a 100% subsidiary of the Andritz Group (Andritz- Financial Report 2010, 2011, p.57).

7.5. Chapter summary and conclusion

Prior investing to a foreign country proper due diligence of the market and environment is a crucial requirement for successful operation. Especially in China sophisticated investigation and research is very decisive due to the heterogenic market and different business environment across the country. In general, it is recommended to start looking for a location as soon as possible, since bureaucracy can seriously delay the business process. Moreover, negotiation with local authorities on exemption clause and additional subsidies can be quite time consuming as well. Besides finding a location, foreign investors need to opt for an entry mode. Even though Austrian companies seem to prefer wholly owned subsidiary as entry mode in China, basically one can say that no entry decision is really superior in compare to the others, since all have pros and cons. Factors which, however, influence the entry mode are strategic goals, cultural differences, country risk, legal environment and also experience.

8 Case study-Andritz in China

Andritz Group is an Austrian company founded in 1852 and headquartered in Graz. It is specializing in plant, systems and services for the hydropower, pulp and paper, steel and other industries, such as solid/liquid separation, feed and biofuel technology (Andritz AG, 2011).

In 2010 Andritz, employed more than 14600 people, around the world focuses on the following five main business areas: Andritz Pulp & Paper, Andritz Hydro, Andritz Environment & Process, Andritz Metals and Andritz Feed & Biofuel. While in 2001 the company had 55 employees in China, this number rose to 1300 in 2010. The work scope of the Chinese staff include: manufacturing, sales, procurement, automation, engineering, design
and service. In 2006 China accounts 7% of the sales, 4 years later the sales double and China has become the most important market after the continents Europe, North America and South America (Andritz- Financial Report 2008 and 2010, 2009 and 2011; Andritz 2010, 2011)

8.1. **Reason for internationalization towards China**

Andritz starts as a single site in Austria in 1852. Over the time, it expanded to Europe, then to North America, and finally to Asia and South America. Mr. Schmölzer, President of Andritz Technologies Ltd, stressed out: “It is very fundamental to our survival and growth. We go where our customers are and we make the investments to support them. The reason we established a presence here as early as we did was to support the forecasted growth of the Chinese market.” (Puhr, 2007, p. 24)

8.2. **Market entry**

This chapter analyzes the market entry strategy of Andritz Group in China, beginning with the incremental entry mode, followed by choice of location.

8.2.1. **Entry Mode**

Supported by missionary sales people in China, Andritz first began its business in China with export. To increase market shares and to differentiate from upcoming and traditional competitors, Andritz worked very close with the customers and focused on high quality products (Puhr, 2007, p. 24).

The second crucial step of market entry followed in 1997 with the founding of the joint venture company Andritz-Kenflo Foshan Pump Co., Ltd. Andritz invested technology and 60% of the capital to fabricate stock pumps in the new joint venture. The local partner, Kenflo Pumps, is a leading supplier of liquid ring vacuum pumps and water pumps in China (Puhr, 2007, p. 24).

The market entry was big challenge. Mr. Schmölder remembers “We had to fight for orders against several local heroes and the traditional high-end suppliers from abroad. Initially, customers in China were skeptical that we could manufacture high-quality products in China. It wasn’t easy, but we didn’t expect it to be.” (Puhr, 2007, p. 24)
8.2.2. Location choice

The joint venture was founded in Foshan, Guangdong, since Andritz`s local partner was already located there.

8.3. How does Andritz-Kenflo Foshan Pump Co., Ltd. establish itself in China?

“Start small, grow fast” was the strategy. The strategy was supported by recruiting good employees, paying high attention to manufacturing tools and techniques, and strict quality control. Thanks to this strategy, sell of pumps rose from 135 in 1997 to 2700 units in 2006. Many local competitors could not keep up with the quality and, hence, vanish from the market (Puhr, 2007, p24f).

Internalization goes on (Puhr, 2007, p.25)

Andritz is using its strategic position in China to export to India and other Southeast Asian countries. One fifth of the manufactured pumps are already distributed among these countries.

Already building up a solid market share and reputation Andritz continues to penetrate the Chinese market with a wholly-owned subsidiary, Andritz Technologies Ltd, in 2002 near the existing joint venture plant in Foshan. At the beginning Andritz Technologies only manufactured equipment for the Environmental Business but soon open its scope to other business areas and divisions in the Pulp & Paper Business Area. Products include: centrifuges and filter presses for industrial and municipal water treatment, screens, agitators, and stock prep equipment, vertical pumps and water turbine core components, components for board machines, and conveying systems for automated baling lines.

In 2007 a new joint venture Andritz-Wolfensberger Special Alloy Foundry Co. with the Swiss foundry specialist was set up to secure Andritz need of high quality stainless steel casting .The total investment was 7 million euro and Andritz hold 65% of the shares.
8.4. Assessment and opportunities of Andritz in China
(Schmölzer, 2007, p. 36)

8.4.1. The opportunities Andritz expect in China

• Andritz will offer the solution of the new Chinese trends such as energy saving needs and green technology
• Benefits from economical impulses from countries bordering China, such as Pakistan, Uzbekistan, who are preferring China based business
• Strong growth of the Chinese economy
• Continuous population growth in the next decade
• New international events will be brought to China
• China and South East Asian countries will continue to invest at high rate

8.4.2. The assessment of Andritz in China

• No major economic conflicts arise
• No outbreak of wars and large pandemics
• Even though labor cost increase, productivity of the labor force is expected to rise
• Political relation of China and the main power will remain stable

8.5. Reason and requirements for Andritz success in China
(Schmölzer, 2007, p.39)

• Carefully market research
• Base the business in the beginning at least 30% on export
• Having strong international brand and image
• Strict quality control
• Carefully select of joint venture partner
• Implement and use state of the art technologies
• Use domestically manufacturing equipment
• Good human resource management
• Adapting products to local needs
• Focus on core business
8.6. Which main risks does Andritz Group really face in China?

Due to different assessment and exposure of the risk, the Andritz group faces variable risk in China. While Andritz-Wolfensberger Special Alloy Foundry Co., Ltd. regards local competition as the main risk operating in China, the division Andritz Hydro China of Andritz Technologies Ltd faces risk arising from social instability and violation intellectual property right. Additionally, both agree that the Austrian and Chinese cultural differences are a main obstacle when doing business in China (survey, 2011). The Group, as the whole, nevertheless, faces currency risk, even though it is minimized by derivative financial instruments. A change in exchange rates may cause delays in project decisions by customers. In addition, since the shareholder’s equity of the Group in China is not hedged it faces the total currency risk (Andritz- Financial Report 2010, 2011, p.19).

8.7. Risk management corruption and labor market?

This chapter briefly analyzes two example of Andritz’s special risk management in China. Especially the Group’s human resource management in China serves as a model of a good risk management.

8.7.1. Corruption

The Andritz Group is subject to a variety of legal compliance risks, including compliance anti-bribery laws in Austria and China where it conducts business. A Compliance Committee was, thus, created by the Group to supervise the compliance efforts. In addition, number of compliance policies, such as anti-bribery laws and Global Code of Conduct are implemented (Andritz-Financial Report 2010, 2011, p. 20).

8.7.2. Labor market and human resource management in China

Recruiting and developing human resource is an important process of the company. More than 70% have a university degree and all salaried staff speaks English. Most of the hourly workers receive vocational training. Even though the fluctuation rate in China is very high, in metropolis such as Beijing, Shanghai and Guangdong it is between 25% and 30% (Waldkirch,
Andritz-Kenflo Foshan Pump Co. Ltd, however, manages to keep most of the employees. The turnover rate is below 2% (Puhr, 2007, p.25).

**How did Andritz achieve such a high loyalty in China?**

Besides, vocational training, base salary was increased by 3-8%. Every fifth salaried staff was promoted. Housing and retirement fund was implemented and all employees receive social insurance. Employees’ satisfactions are guaranteed by surveys and supervisors’ evaluations, performance reviews and social activities. Andritz, however, faces difficulties finding sufficient skilled staffs and providing vocational training that fits the fast growth requirements (Schmölzer, 2007, p.29).

### 8.8. Chapter summary and conclusion

The Austrian Andritz Group, with more than 14600 employees, produce technically sophisticated machinery and plant worldwide. The company soon realized the potential of China’s market and entered the market with export activities. After establishing good reputation and network the second step followed. Together with a local partner Andritz-Kenflo Foshan Pump Co., Ltd was founded, as a joint venture, in Guangdong. Already building up a solid market share, reputation and knowledge, Andritz penetrated the Chinese market with a wholly-owned subsidiary, Andritz Technologies Ltd. Andritz adventure in China carries on with a new joint venture “Andritz-Wolfensberger Special Alloy Foundry Co.” for supply purposes.

In recent years, China has become one of the key markets for the Group and it sales in the world’s second economy already accounts 14% in 2010. The enterprise has 1300 employees in China.

Critical success factors of Andritz in the past and in the future include: focusing on innovation, quality, good human resource management and state of the art supply chain management. Andritz is expecting further big prospects in China, especially due to strong growth of the Chinese economy, high investment rate as well as trend of energy saving and green technology. Using China as a strategic position to continue internationalization is another huge opportunity. Even though the chances are quite promising, Andritz faces several risks when operating in China, including cultural difference issues, local competition, fluctuation of currency, violation of intellectual property rights and social risk.
The case study again shows that the existing theories do not fully explain why Andritz is operating in China, since they are mainly based on the competitiveness of the home country. Eclectic Paradigm, derived by Dunning clarifies to some extent why Andritz is operating China. The Group owns good human resources, organizational skills, knowledge, technology and brand which, indeed, minimize the operating cost in the foreign market. However, the theory does not consider important factors of the host country such as political, economic, legal and cultural issues. It, further, neglects growth and “survival” motive as well as the advantage to be close to customers.

9 Summary

Several theories of internationalization are trying to explain the incentives of firms operating overseas. Generally, one can say that no single theory is perfectly suitable to clarify why Austrian companies set up overseas subsidiaries or joint ventures in China. Some are too general and primary based on the competitiveness of the home country and others neglect important factors of the host country such as political, legal and cultural issues. The empirical approach, however, reveals other insights. The results clearly show that being close to the customers and serving the Chinese market are the main triggers why foreign firms operating in China, while cost factors, indeed still important, is not a crucial reason anymore.

The second largest economy is one of the fastest growing nations in the world and, thus, offers enormous opportunities for Austrian companies, especially in construction, environment, energy and health sectors. To date, in 2011 Chinese consumption rate is still quite low, nevertheless, will change in the forthcoming future, since a promising number of middle class will be developed over the next decade.

However, Austrian investors should keep in mind that China`s market is not as easy to penetrate as one might believe. 57.01% of the respondent Austrian firms already regard local competition as one of the main threats for their business. Besides, fierce competition, heterogeneity of the market, economic impacts, legal and cultural issues as well as political influences need to be considered to successfully operate a business.

As a big and mountainous country, transportation is quite inconvenient in China. Moreover, the important harbours are on the east and south east coastal area and infrastructure, indeed, have been improving significantly, is still not fully developed (U.S Commercial Service,2009).
Energy shortage and environmental problems, indeed, are other big challenges in China. Foreign investors, thus, need to do proper due diligence of the location ex ante to prevent higher production costs ex post due to black outs and high transportation expenses.

Still today, the state has a strong influence on the market. Foreign companies often complain being discriminated from public bidding process. In addition, particular Chinese regulations make operating in China even harder. Foreign investors, further, face political risks such as corruption and social unrest. In sum, my results reveal that Austrian firms show less concern about political instability (6.54%) and social unrest (6.54%), however, are worrying about corruption (20.56%).

Political influence is not the only risk Austrian investors face. Even though China has become one of the strongest economies there are ambivalent opinions about its future economic development. Based on my survey 57.01% of interviewed Austrian enterprises, however, believe in China’s strong economy performance and predict that China is the most important country for future growth. Only 10.28% are actually worried about economic risk when operating in China. Thus, in 2011 already more than 500 Austrian companies were operating in China. Not only the FDI but also the trade volume between Austria and China has increased significantly over the years. The outlook is also quite promising. The value of trade is expected to double in the next five years. Especially in areas such as infrastructure, green energy, hi-tech, machinery and equipment, environmental protection and in the service sector, there are still big potential for closer cooperation. Despite the optimistic view of Austrian enterprises, investors need to consider factors such as financing, yuan, inflation, labor market and China’s asset bubble having strong influence on the economic environment.

Even though China has been constantly improving its legal framework for the last two decades, foreign investors and Sino-experts criticizes the dependency, transparency and uncertainty of the Chinese judicial system. The different interpretation of contracts among the cultures can be quite frustrating for western investors as well. Consequently, every 4th of the respondent Austrian firms are regarding legal risk as a main problem for their business in China. However, an even more serious matter in China is the violation of intellectual property rights costing foreign companies millions of losses. Thus, more than 41% of the questioned firms are worrying about intellectual property rights when doing business in China.

Prior operating in China, often foreign investors mainly concentrate on political, economic and legal issues, but often neglect cultural differences as a main risk. The results of the
interviewed firms, however, reveal that, in fact, every second Austrian companies show concern about the problems arise by cultural differences.

Still today the Chinese traditional culture, strongly influenced by Confucianism, affects social and business activities. In general, having enough “mianzi” establishes “guanxi” and guarantees access to certain group and business networks. More than 77% of the Austrian representatives already realize the importance of “guanxi” when doing business in China. Consequently, it is recommended to mind the rule of “face” in order to maintain harmony, again a key factor for a smooth business operation. According to Hofstede, China’s culture differs from Austria’s mainly, in power distance acceptance, long term orientation and collectivism. These factors reflect in other business activities as well, such as negotiation and human resource management.

Other important decisions companies have to make, prior entering the Chinese market, are entry mode strategy and location choice. Thus, again proper due diligence of the market and environment is a crucial requirement for successful operations. In general, it is recommended to start looking for a location as soon as possible, since bureaucracy can seriously delay the business process. Besides, negotiation with local authorities on exemption clause and additional subsidies can be quite time consuming as well. Even though Austrian companies prefer wholly owned subsidiary as entry mode in China, no entry decision is really superior in compare to the others, since all have pros and cons. Factors which, however, influence the entry mode are strategic goals, cultural differences, country risk, legal environment but also experience.

10 Conclusion

As predicted in Hypothesis 1: “The existing literature does not offer plausible explanation why Austrian companies operating in China” the empirical study and the case study research clearly show that existing literature does not fully explain why Austrian firms are operating in China. Some theories are too general and primary based on the competitiveness of the home country and others neglect important factors of the host country such as political, legal and cultural issues. The results of the empirical approach clearly reveals that serving the Chinese market and being close to the customers are the main triggers why foreign firms operating in China. The outcomes of the case study research are quite consistent with the survey. Even though OLI-theory by Dunning can give some explanation why Andritz operates
in China it neglects fundamental reasons, again such as political, legal and cultural issues, but also growth and “survival” motive as well as the advantage of being close to customers.

I also could fully find support for **Hypothesis 2: Austrian firms do not operate in China mainly due to cost reasons.** Even though 28.8% of the interviewed Austrian business associates regard lower cost as one of the main reason doing business in China “cost factor” is not a crucial reason anymore why Austrian penetrate the Chinese market either with joint venture or wholly owned subsidiary. The findings show that the “potential of the future market” (79.6%), and “current market” (76.2%) are the main motivations for physical presence.

Besides testing the hypotheses, I analyze the requirements, risks and entry modes of Austrian companies in China.

**Which main requirements do foreign companies need in order to be successful in China?**

True to the maxim: “**Duo yige guanxi, duo yitiao lu**”, which means the more guanxi one`s have the more doors are open, having “guanxi” (77.57%) seems to be the main requirements for successful Austrian business operation in China, followed by loyal employees (61.68%) and technology knowledge 54.21%, while time(24.3), right location (24.3), and money(18.69%) is less important.

The reason why guanxi is a very important requirement for doing business in China is because it can reduce uncertainty, especially in a society where the law system is still not very sophisticated developed. In addition, guanxi is helpful to smooth the bureaucratic process. Still today government officials have the influence to grant projects and to assign resources.

**Which risks do Austrian companies mainly face?**

Even though the requirements are fulfilled there are still sever risks Austrian firms face in China. People who still believe that Chinese manufacturers only supply low tech goods, thus, are not serious competitors for foreign producers are pretty wrong. My finding shows that 57.01% of questioned Austrian enterprises experience local competition as the main risk when doing business in China. On the other hand, only 20.56% regard foreign competition as a threat.

Furthermore, cultural differences (46.73%) and languages barriers (45.79%) seem to be bigger concerns than property right issues (41.12%) and corruption (20.56%). Finally
Austrian business people perceive political instability (6.54%) and social risks (6.54%) as only minor problems when operating in China. Interestingly, “cultural differences” was mentioned as the second biggest threat only after “local competition”. The data of Hofstede clearly shows that in the Chinese culture “power distance” and “long term orientation” are much higher while “individualistic behaviour” is significant lower than in the Austrian society. Austria, further, ranks higher than China in the masculinity and uncertainty index (Hofstede, 2009). These factors, indeed, reflect in other business activities. For example, while contracts are used to get rid of uncertainties in the western society, for the Chinese contracts have different meanings. They want to establish trust and relation first in order to do business. The general Chinese opinion is that only a good interpersonal relationship guarantees a long term success, which again characterizes the Chinese society.

**What is the most common form of entry mode of Austrian enterprises in China?**

After assessing all the main risks it is important to opt for the entry mode. The most common form of entry mode among the interviewed firm is clearly wholly owned subsidiary with 43.93%, followed by export 30.84%. 23.36% have a representative office in China and 19.63% questioned companies operate in China through joint ventures. Licensing/Franchising (3.74%) and other entry modes only play a minor role. Most Austrian companies, however, are doing business in China through several entry modes. They are having either a shared company or a wholly owned company or both in China, while their headquarters are exporting. Only 18% of Austrian companies export without having physical presence in China.

A reason why wholly owned subsidiary becomes so popular among Austrian firms is that foreign joint venture partners tend to buy out their Chinese counterparts. Over the time the benefits of the local partner diminish, since guanxi and knowledge of the country were already established. Other reasons include: liberalization of restriction for WOS, better legal and political environment, protection of know-how, barely tax incentive after some years and different interests (Holtbrügge and Puck, 2008, p.112ff).

**Further managerial implication**

Although China`s market and economy are expected to grow with high rate, a successful operation for foreign investors is, however, not always guaranteed due to strong external
influences, such as legal environment, cultural issues, political instability, language barriers, fierce competition and the challenge of economic environment.

Nevertheless, businessmen should not give up operating in China for several reasons. First, China slowly moves away from protectionism due to pressure from abroad. Second, China is aware of its social, political, legal as well as economic problems and is working on it. Third, the new Chinese policy aims to increase welfare and sustainable development with greener environment bringing other promising opportunities for Austrian investors. Finally proper prevention, preparation and risk management, including: exit strategies, setting up guanxi, SWOT analyses are very useful to minimize the effect of external influences. Even so, if enterprises are not willing to commit enormous of time, patience and resources, then they probably have to rethink their entry decision.
## Survey: Chances, Requirements and Risks of Austrian Companies operating in China.

Responsible:  
Tuan Trieu Ha  
Email: tuan1@gmx.at  
Universität Wien

All information provided will be kept in strict confidence and will only be used for research purposes!

### I. Brief information about the company

#### I.1. What’s your position in the company (make a cross or highlight the field)

- □ Board of directors/executives
- □ marketing
- □ sales
- □ administration
- □ other____________________

#### I.2. Branch of the company

- □ Information and Consulting
- □ Bank and Insurance
- □ Commerce
- □ Industry
- □ Tourism and Leisure industry
- □ Transport
- □ other____________________

#### I.3. total employees of the company

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>in Austria</td>
<td>__________________________</td>
<td></td>
</tr>
<tr>
<td>in China</td>
<td>__________________________</td>
<td></td>
</tr>
</tbody>
</table>
II Chances and risks operating in China/doing Business with Chinese

II.1. What is the company’s motivation operating in China/ (several answers are possible)
- potential of the current Chinese market
- potential of the future Chinese market
- costs factors
- customer accessibility
- because of import restriction
- supply purposes
- others

II.2. Do you think that China is the most important country for future growth
- yes
- no
- not sure

II.3. Which risks does your company mainly face when operating in China (several answers are possible)
- languages barriers
- culture differences
- entry barriers
- political instability
- corruption
- social risks
- legal risks
- protection of intellectual property rights
- local competition
- foreign competition
- economic environment
- currency risk
- others
Market entry and location choice

III.1. Which form of market entry did your company choose in China?
- Franchising/licensing
- Joint Ventures
- Export
- wholly owned subsidiaries
- representative office
- other _________________________

III.2. In which provinces is your company located? (several answers possible)

____________________

III.3. What are the most important criteria for choosing location? (several answers possible)
- Production costs
- Good infrastructure
- Market potential
- Tax incentives
- Access to human resources
- others______________________

IV. Reasons for successful operations

IV.1. Which main requirements do foreign companies need in order to be successful in China? (several answers possible)
- good risk management
- good relationship (guanxi)
- market research
- loyal employees
- technology knowledge
- time
- money
- good distribution channel
- strong brand
- right location
- others______________________

IV.2. How does your company differentiate from others?
- quality
- low price
- experience
- human resources
- technology
- focusing on niche market
A2 Results of the survey: Chances, requirements and risks of Austrian Companies operating in China.

From June to the end of August 800 surveys were sent to 500 Austrian companies with Chinese business activities. 107 companies finally responded. As you can see on the first questions companies from several branches were contacted and representatives from different positions participated in the poll.

V. Brief information about the company

I.1. What’s your position in the company?

---

40 Austrian companies with foreign ownership were also interviewed as long as they were directly involved in business activities with China.
I.2. Branch of the company

![Branch of the company chart]

I.3. Total employees of the company in Austria and China

![Total employees chart]

II. Chances and risks operating in China/doing business with Chinese

II.1. What is the company’s motivation operating in China (several answers are possible)

![Motivation chart]

From the opinion of the investigated Austrian firms, the main motivation for them operating in China either with joint venture or wholly owned subsidiary is the “potential of the future market” (79.6%) and “potential of the current market” (76.2%). Customer accessibility (30.5%), cost factors (28.8%)\(^{41}\) and supply purposes (22%) are further important reason for

\(^{41}\) Only companies with physical presence were considered, since purely exporting enterprises won’t benefit from cost factors anyway, unless it is 20.5%.
doing business in China with physical presence. The results certainly clear the prejudice that Austrian firms are operating in China due to costs issues.

II.2. Do you think that China is the most important country for future growth

Despite high inflation, overheated economy and relative poor performance in the “Index of Economic Freedom” and “Ease of doing business” index more than 57% of interviewed Austrian representatives believe that China is the most important country for future growth. This result is quite consistent with international polls. According to the Annual Global CEO Survey of 2011,\textsuperscript{42} China was named as the most “important country for future growth” in front of the United States. Another study from Advisory Partners reveals that 80% of the 600 questioned firms from Great Britain, France and Germany (with revenues more than 40 million) consider China as the best opportunity doing business followed by India.

II.3. Which risks does your company mainly face when operating in China (several answers are possible)

\textsuperscript{42} 1201 CEOs were questioned
People who still believe that Chinese manufacturers only supply low tech goods, thus, is not threat for foreign producer are pretty wrong. The survey clearly shows that local competition is the main risk Austrian enterprises face in China. On the other hand, only 20.56% regard foreign competition as a threat. The results also clear another stereotype that China is becoming westernized and doing business in China is similar to anywhere nowadays. Indeed, cultural differences, but even languages barriers seem to be big obstacles when operating in China. The respondents actually show more concern about cultural and languages differences than property right issues and corruption in China. Finally, political instability and social risks only appear to be minor problems.

III Market entry and location choice

III.1. Which form of market entry did your company choose in China?

The most common form of entry mode is wholly owned subsidiary with 43.93%, followed by export 30.84%. 23.36% have a representative office in China and 19.63% questioned companies operate in China through joint ventures. Licensing/Franchising (3.74%) and other entry modes only play a minor role. Most Austrian companies are doing business in China through several entry modes. They are having either a shared company or a wholly owned company or both in China, while their headquarters are exporting. Only 18% of Austrian companies export without having physical presence in China.

III.2. In which provinces is your company located? (several answers possible)
Most of the respondent Austrian firms are located in the east and south east coast of China including: Shanghai (38%), Beijing (34%), Guangdong (14%), Jiangsu (9%) and Zhejiang (6%). According to the research of World Bank, the coastal areas are the most attractive regions for doing business.

III.3. What are the most important criteria for choosing location? (several answers possible)

When opting for location the most important criterion of the surveyed companies is market potential. Due to geographical environment procurement and distribution, especially to Western China, can take several weeks or months, thus good infrastructure was named as the second most essential factor. The fact that access to human resources is more important than production cost and tax incentives together clearly shows that foreign firms operating in China, indeed, have trouble to find suitable employees. Other criteria include: near customers and partners, as well as supply reasons.

IV. Reasons for successful operations

IV.1. Which main requirements do foreign companies need in order to be successful in China? (several answers possible)
True to the maxim: *Duo yige guanxi, duo yitiao lu*”, which means the more guanxi one`s have the more doors are open; having “guanxi” seems to be the main requirements for successful business operation in China, followed by loyal employees and technology knowledge.

**IV.2. How does your company differentiate from others?**

Due to strong local competition and price sensitive consumers the interviewed enterprises mainly seem to concentrate on quality and technology instead of low costs when operating in China.

**Limit of the survey**

Because of the small response rate, the poll, unfortunately, cannot be seen as representative. Moreover, frankly speaking, the questions are not very specific, but more general. Future research, thus, should consider these two weaknesses as well. However, the survey, certainly, shows a certain direction of Austrian companies` concern and motivation in China. Additionally, the results are quite consistent with surveys in Germany, researches from the World Bank and basically the existing current literature.
A-3: China’s economic data

<table>
<thead>
<tr>
<th>China’s economic data 43</th>
<th>2009</th>
<th>2010</th>
<th>2011e</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>9.2%</td>
<td>10.3%</td>
<td>9.3%</td>
</tr>
<tr>
<td>inflation</td>
<td>-0.7%</td>
<td>3.2%</td>
<td>5.0%</td>
</tr>
<tr>
<td>unemployment (%)</td>
<td>4.2%</td>
<td>4.3%</td>
<td>-</td>
</tr>
<tr>
<td>export (billion)</td>
<td>1204</td>
<td>1581</td>
<td>-</td>
</tr>
<tr>
<td>import (billion)</td>
<td>954.3</td>
<td>1327</td>
<td>-</td>
</tr>
<tr>
<td>public debt</td>
<td>18.80%</td>
<td>18.90%</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Own illustration, figures are taken from CIA Factbook (2011), World Bank Group(2011) and Scotia Economics (2011)

A-4: Important Austrian-China investment

<table>
<thead>
<tr>
<th>Important Austrian-China investment</th>
<th>year</th>
<th>name of company/institute</th>
<th>description of project/investment</th>
<th>location</th>
<th>value in €</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>1967</td>
<td>Voest</td>
<td>LD (Linz-Donawitz) process steel mill</td>
<td>Shanxi</td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>1978</td>
<td>Elin and Voith</td>
<td>hydroelectric power</td>
<td>Hunan</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>2006</td>
<td>Zumtobel Group</td>
<td>Beijing Capital Airport Expansion Project Headquarters</td>
<td>Beijing</td>
<td>3mio</td>
</tr>
<tr>
<td>2006</td>
<td>2006</td>
<td>Office of Chinese Language Council International, the Beijing Foreign Studies University and the University of Vienna</td>
<td>Confucius-Institute</td>
<td>Vienna</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>2011</td>
<td>Coop Himmelb(l)au</td>
<td>designed dalian international conference centre</td>
<td>Dalian</td>
<td></td>
</tr>
</tbody>
</table>

43 Important remarks: numbers might vary depending on the source of statistics
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Details</th>
<th>Location</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Architect Hans Hollein</td>
<td>designed SBF Fund Tower</td>
<td>Shenzhen</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>Xi'an Aircraft Industry</td>
<td>acquire more than 90% of Austria's FACC</td>
<td>Upper Austria</td>
<td>100 mio</td>
</tr>
<tr>
<td>2009</td>
<td>Austria-China</td>
<td>China Austria Technology Park</td>
<td>Vienna</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>Austria-China</td>
<td>Austria-China Welding Training Center</td>
<td>Chengdu</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>AT&amp;S</td>
<td>new plant</td>
<td>Chongqing</td>
<td>500 mio</td>
</tr>
<tr>
<td>2011</td>
<td>RHI</td>
<td>tunnel kiln</td>
<td>Dalian</td>
<td>13 mio</td>
</tr>
<tr>
<td>2010</td>
<td>Lenzing</td>
<td>increase production plant</td>
<td>Nanjing</td>
<td>55 mio</td>
</tr>
</tbody>
</table>


A-5 Balance of Trade from 2001-2010 (in thousand EUR)

![Graph showing trade balance from 2001 to 2010](image)

Source: own illustration, figures are taken from Statistik Austria (2011)

On the first sight it seems that Austria’s trade deficit mainly stems from Chinese import. However China’s import to Austria from 2001-2010 only accounts approximate 33 billion euro while the world’s import (excluded China) within the same time is about 940 billion euro Statistik Austria (2011).
A-6a: **Expert survey**: Mr. D., Austrian Sales Manager of a market-oriented technology enterprise from Austria, in the area of reprocessing thermoplastic production wastes

1. **Does it matter if you are mentioned by name as interview partner?**
   
   **Yes**

2. **Does it matter if your company is mentioned by name as interview partner?**
   
   **Yes**

1. **On the previous survey you mentioned “language” as a risk you face when operating in China.**
   a. **Why are language differences in China harmful for the business?**
      
      *A lot of dialects in China, meetings in Chinese and only “relevant” parts in English → Chinese discuss in Chinese*
   b. **Can you tell an exact example where you /your company actual face problem due to languages differences? Is English an alternative? What about interpreter?**
      
      *Interpreter in our case is sales agent, that’s OK, English is an alternative sometimes – in regions far away from capital sometimes not*
   c. **How do you/ your company usually deal language differences (how to get rid of this problem)?**
      
      *We have a sales agent in China who is always present when persons from Austria travel to China*

2. **On the previous survey you mentioned “legal environment” as a risk you face when operating in China.**
   a. **Why is legal environment in China harmful for the business?**
      
      *Patents are not even worth the paper of the print. All technology is copied and sold as own invention.*
   b. **Can you tell an exact example where you /your company actual face the risk of legal environment?**
      
      *At the moment some companies tried to copy our patents, nobody made it work right now that’s the good side, the bad side is that the system may get a bad attitude if people see a copy not working properly*
   c. **How do you/ your company usually deal with issue (how to get rid of this risk)?**
      
      *We try the best way to keep our patents and secrets*

3. **On the previous survey you mentioned “corruption” as a risk you face when operating in China.**
   a. **Why is corruption in China harmful for the business?**
      
      *A lot of people expect the so called TPC (third party commission)*
   b. **Can you tell an exact example where you /your company actual face the risk of corruption?**
      
      *Production managers or others want to have some extra money in the pocket*
c. How do you/ your company usually deal with corruption (how to get rid of this risk)?
   *In some projects you have no chance to avoid, we try to be very clear from the starting point on*

4. On the previous survey you mentioned “culture differences” as a risk you face when operating in China.
   a. Why can cultural differences be harmful the business.
      *Week long negotiations*
   b. Can you tell an example where you /your company actual face cultural risk?
   c. How do you/ your company usually deal with cultural risk?

5. On the previous survey you mentioned “good relationship (guanxi)” as a requirement for success when doing business in China.
   a. Why is guanxi so important in China? Is “Vitamin B” in Austria also a requirement for business success?
      *It’s the same as anywhere in the world*
   b. Can you tell an exact example when guanxi is important for you/your company?
   c. How do you/ your company usually do to build and maintain guanxi in China?

Date of the Interview: ___21.9.2011___________________

A-6b:2. Expert interview: Mr. W., an Austrian architect, who realized many projects in China

1. Does it matter if you are mentioned by name as interview partner
   - yes

2. Does it matter if your company is mentioned by name as interview partner
   - yes

3. On the previous survey you mentioned “corruption” as a risk you face when operating in China.
   a. Why is corruption in China harmful for the business?
      *Corruption is like an unfair competition. Corruption is everywhere harmful
Corruption will block your future steps of business. It is crime and the problems will come back. Commission based on a consulting contract is a little bit different.
All depends on the situation, important is clear and open and fair for all.*
   b. Can you tell an exact example where you /your company actual face the risk of corruption?
      *Foreigner companies are not always involved in the corruption. Many architecture competitions are not fair, the result and the working process*
smells often like corruption. Nobody will confirm it, but the result is often very very clear! General we cannot play the game, it is often a game behind us. Chinese clients and companies and government departments are playing the game. We are only small fishes as architects.

c. How do you/ your company usually deal with corruption (how to get rid of this risk)?
This game is in China never clear. Chinese People don’t like to play the corruption game with foreigners. They are afraid, because we don’t care for the money so much. But Chinese business people will sell for some $ all. They are not interested in a stable growing business. Only on full time is there target.

4. On the previous survey you mentioned “protection of intellectual property rights” as a risk you face when operating in China.

a. Why is this issue harmful for the business in China?
Because everybody is copying everything. They don’t care and the government also don’t care. State owned companies are often the worst.

b. Can you tell an exact example where you /your company actual face the risk of violation of property rights?
Luckily we have not so much problems, but before, some years ago with Chinese partners and clients. Architecture is often not so easy to copy many times. General you can use it only one time, because every task is totally different.

5. On the previous survey you mentioned “The education system is bad and wrong in China. Access to human resources, with highest education and motivation is important”

Since lack of creativity exist in China, is there a problem finding new good employees, especially in your branch? (in terms of time, salary compare Austria, Germany and fluctuation)
Yes, it is very difficult. It is not only the education on a very low level also the live experience of the people. Chinese people with 30 or 35 years have live experience like in Europe teenager and young guys with 16 or 18 years. I am daily shocked.
Important to manage a project is to be always in front of the problem, have enough reserve time, make decisions early and clear enough and check everything 3 times.

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Abstract

Since 2010 China has become the second biggest economy. Austrian firms realized the potential of the Chinese market very early. One of the pioneer businesses, already, in the 60s began with the export of a complete steel mill by the company Voest. Some years later Elin and Voith constructed a hydroelectric power station in Hunan. With a trade volume of 8 billion euro in 2010 China has become the largest trading partner outside Europe. Austria`s high technology industry is a good completion of China`s technology demand. Therefore, there is still promising potential for additional cooperation, especially, in areas such as infrastructure, green energy, hi-tech, machinery and equipment, paper and pulp, environmental protection as well as in the service sector. Thus, more than 500 Austrian companies from different sectors already represent Austria in China.

But what are the reasons and motivation of Austrians companies operating in China? Does existing literature offer plausible explanations? Is cost factor the main trigger? The findings suggests that most theories of internationalization seem to be obsolete and basically focus on the competitiveness of the home country, but neglect important factors such as political, legal and cultural issues in the host country. Furthermore, cost factor is, indeed, not a crucial reason why Austrian enterprises operate in China.

Abstract


Was sind die entscheidenden Faktoren für das China Engagement? Geben die vorhandenen Literaturen plausible Erklärungen? Spielen geringere Kosten eine wesentliche Rolle? Die Ergebnisse zeigen, dass die gegenwärtigen Theorien vornehmlich auf die Wettbewerbsfähigkeit im Heimatland beziehen und sie daher die Einflüsse im Gastgeberland
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Vertiefungsrichtung: Finanzdienstleistungen,

seit 10/2006 Universität Wien,
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10/2006 - 01/2010 Universität Wien,
Bakkalaureatsstudium Betriebswirtschaftslehre
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Vertiefungsrichtungen: International Business

09/1997-05/2005 AHS-BRG Hamerlingstraße,
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Abschluss mit gutem Erfolg

Wehrdienst


Berufliche Erfahrungen

Seit 09/2011 Universität Wien,
Studienassistent am Institut für Finanzwissenschaften
Administrative Aufgaben, Unterstützung in Lehre und Forschung

07/2011 Eurasia-Pacific Uninet / Universität Salzburg Projekt
Betreuung der Teilnehmer der Chinese-Austrian-EU Summer School 2011

02/2010 bzw. 07/2010 Impex Handelsgesellschaft.m.b.H.,
Praktikum,
Verantwortung für Warenbestellung und Customer Relation Service,
(Heizungs- und Lüftungstechnik)

01/2009 – 06/2010 Privatnachhilfe in Englisch und Mathematik

08/2008 - 10/2008 Universität Wien,
bzw. 02/2009  Berater,  
Studierendeberatung am Studentpoint,

03/2008 - 07/2008  **Artex Art Services GmbH**,  
Studentische Hilfskraft,  
Beratung und Aufsicht in Museen

09/2007 bzw. 04/2008  **Universität Wien**,  
Berater,  
Beratung Studierenden und Interessenten am Konfuzius Institut

Berater und Promoter  
Beratung und Promotionstätigkeit, vorwiegend Konto- und Kreditkartenberatung

06/2006 - 07/2006  **GRZ IT Center Linz GmbH**,  
Ferialpraktikant,  
vorwiegend Bürotätigkeit

05/2006 - 06/2006  **Institut für statistische Analysen Jaksch und Partner GmbH**,  
Studentische Hilfskraft,  
Daten durch Telefonumfrage erheben

07/2005 - 08/2005  **Magistrat Linz**, Tiefbauabteilung Straßenmeisterei,  
Praktikum,  
Straßen-Stadtplanung

**Stipendien, Förderungen und Auszeichnungen**

seit 6/2010  **e-fellows.net-Stipendiat**  
Förderung Studierende mit hervorragenden akademischen Leistungen und Wirtschaftsinteressen (https://www.e-fellows.net)

seit 2/2010  **Mitglied bei „students4excellence“**  
ein Fördernetzwerk für die besten Studierenden aller Studienrichtungen Österreichs (https://www.students4excellence.com)

2010 bzw. 2011  **Universität Wien**,  
Leistungsstipendium für das Studium **BWL** für das Studienjahr 2009 und 2010

08/2010 - 12/2010  **Universität Wien**  
Joint Study Stipendium, für ein Auslandsaufenthalt in Singapur.  
Stipendienvergabe nach akademische Leistungen und Empfehlungsschreiben.

2008  **Raiffeisen Landesbank Oberösterreich**, Begabtenförderung der RLB für das Studium **BWL**

2008  **Universität Wien**,  
Leistungsstipendium für das Studium **Sinologie**. Eine einmalige Auszahlung des Stipendiums aufgrund von hervorragender akademischer Leistungen für das Studien Jahr 2007
Soziales Engagement

Seit 4/2011  Amnesty International Österreich, Planung und Organisation von Aktionen innerhalb des StudentInnen Netzwerkes,

08/2007-08/2011  Universität Wien Betriebswirtschaftszentrum, Betreuung von Studierenden aus dem Ausland im Rahmen des Buddy Study Programms-Universität Wien


09/2008 - 02/2009  Universität Wien Betriebswirtschaftszentrum, Tutor für Erstsemester in der Fakultät Betriebswirtschaftszentrum der Universität Wien, Betreuung und Beratung von Erstsemestern

Auslandserfahrung

12/2010 -02/2011  Cargo Planet Logistics, Praktikum, Logistik, Rechnungswesen, Compton-Kalifornien (USA)

08/2010 -12/2010  Singapore Management University, Auslandssemester in Singapur

08/2008  Summer School Sprachschule, Shaoxing-China

08/2003  Summer School Sprachschule, Brighton-England

Besondere Kenntnisse und Fähigkeiten


EDV  MS-Office Visual Basic (Basis Wissen) SPSS (Statistik Programm) SQL(Datenbank) HTML/ JavaScript

Hobbys/Interessen

Sport Tischtennis, Laufen, Schwimmen und Squash, Reisen Bevorzugte Reisegebiete: USA und Südostasien