COMPETENCE CENTER CHINA

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for Swiss SMEs

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Localization in China

INTRODUCTION

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Topic Introduction

Localization, understood as the adaptation and customization of strategy, value-configuration and product considerations to the target market circumstances, presents a major challenge for SMEs in their internationalization. They struggle with what Hymer (1960/76) called the "liability of foreignness", and with increased complexity and risks when undertaking international business ventures. As a result, companies might choose the wrong strategy, expand with the wrong product into the wrong market at the wrong time, or badly prepared (readiness), or fail to adapt their value-presence to effectively compete with local and global incumbents. Besides obvious management implications, this can involve all aspects of the value chain, from localized research, sourcing, production to marketing (4Ps) and sales.

Evidence suggests that while resource constraints (finance, network, managerial knowledge) are the biggest hurdles for SMEs in their internationalization efforts, operational problems in adapting (attitude, cognitive or executive competence & style) the business model to local peculiarities remain the biggest hindrance to success once embarked on an international venture. For Swiss SMEs in particular, a study conducted in 2013[1] found that the price of their product or service is considered a major obstacle in going international, followed by legal regulations, the costs of going abroad as well as the lacking management support. By far the biggest weakness is identified in too high cost structures, followed by insufficient market research as well as lacking knowledge of the local language and regulations. It becomes evident that the gap to fully localized products and businesses is still considerable, and hence is the business potential if it can be narrowed.

In going international, companies large and small are faced with the trade-off between global integration vs. local responsiveness. Business history has shown that companies ought to localize their business model to remain locally competitive, while they could at the same time leverage their international presence to benefit from scale effects. To strike the right balance is at the core of successful business ventures.

This is of importance and relevance, above all, for Swiss SMEs. Switzerland is a highly internationally integrated economy (the KOF globalization index regularly lists Switzerland as one of the top-10 globalized economies). For such countries, both from a macro-economic as well as from a firm perspective, successful internationalization projects are of great importance. Two thirds of our exports are generated through exports. According to Credit Suisse (2014), Swiss industrial SMEs earn two out of every five Swiss francs from exports, while 69% of all Swiss SMEs and 87% of all industrial SMEs are involved in at least one form of cross-border activity. What is more, the number of Swiss SMEs getting active in international projects is on the rise. Therefore, while internationalization of businesses is a global development, the international exposure of Swiss companies together with narrowing margins owing to a strong franc and heightened competitive pressure at home provide particular pressure to find business opportunities abroad in pursuit of a sustained successful operation. These opportunities are increasingly found in Asia, and particularly in China.

The Chinese market is for Swiss and European SMEs on one hand a culturally distant market (and distance still matters), but provides substantial business opportunities for several industries. Needless to say, markets within China may also vary considerably. Production is still lucrative despite rising costs, and social development gives rise to en enormous middle-class in the years to come. We see a development from marketing to the Chinese consumer to manufacturing for the Chinese consumer, turning the Chinese business landscape into an own ecosphere altogether. These changes and disruptions in the different markets demand an adaptable, agile business, requiring companies to rethink their underlying strategies.

SMEs therefore see themselves confronted with the challenge to optimally configure their business and product/service to the current Chinese market requirements in order to minimize the localization gap vis-à-vis their local competitors.

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[1] Swiss International Entrepreneurship Survey 2013

Case 1

When one of the largest Swiss dairy producers entered the China market little less than a decade ago, it saw itself facing the manifold challenges of localization in the early hours already.

Attending a trade fair, it quickly became obvious to the sales manager that local distributors not only barely could speak English, but mainly did not understand the specific attributes and features of the imported products, and certainly failed to agree with the price difference compared to the locally produced dairy products. Cultural, language and adaptation barriers had to be overcome, so sales and management of the channels became a real challenge. The company had to ask itself the following questions:

- How to build brand awareness and recognition with or even through local distribution partners that sell at the same time a great variety of different products from other brands?
- How to ensure the level of quality required by the brand in a country 9000km away and in a different language?
- How to communicate values to end-consumers in China and to ensure that the message of authenticity of the products and the brand gets across?
- In short: how to handle China?

The company concluded that in their industry and with their high-quality Swiss product, a mix would probably be best. They decided to keep the products clearly Swiss, but to localize distribution and supervision of the market. An actual presence in the country seemed already then inevitable and crucial for business development.

The company worked with a local trading partner handling import and distribution. For the presence in China, for communication, control and coordination of the brand and the products, the company hired an experienced Chinese product manager through a service provider. By doing so, the company could start their China operations immediately and in an efficient manner. Materials could be translated into Chinese, layout and product pictures were kept back in Switzerland.

Through their own representative, the company gained immediate insights in the Chinese consumer and distribution market. Also, they now could tailor the localization strategy not only based on the understanding of the products and brand by a local employee, but integrate at the same time valuable knowledge of the business environment in China.

The combination of a distribution partner with a skilled local representative in China was a smart and farsighted decision. And the results prove them right: what started with 2 pallets for the first order has become a strong market presence of 2 containers per month.

Case 2

A medium-sized Swiss medical device producer entered China in early 2012 with their Swiss-made products. Based on similar market entries in other countries, the company opted for a wholly owned subsidiary with a fully-fledged infrastructure, a performing team and a strong market presence on their own in China.

Distribution was built through regional sales managers, various channels were sought, tested and used and market penetration slowly but surely started.
The team was led by local management, under direct supervision of the HQ and negotiations were all held in Chinese. Products were imported, declared, labeled and stored/distributed by the team of the subsidiary in China.

Over time, dealing with that many distributors through a local sales force became increasingly difficult and opaque, occupying a tremendous amount of time of Swiss management for the supervision and most importantly, lacking the expected and promised results. At the same time, online and social sales platforms such as *Tmall* and *weidian* rapidly gained in market share compared to traditional sales channels such as brick and mortar retail shops and medical device chains. This resulted in a much higher HR occupation by the local staff than ever anticipated and became another burden to handle.

Early 2015, the Board of the China subsidiary convened and decided to further localize their setup in China, in the following way: drastically reduce sales channels, outsource as much as possible, only keep key functions in-house, and sell directly from Switzerland to third parties.
As a result, the brand has now straight-forward, clean and lean structures with one large retail distributor, one online distributor and a third distributor taking care of the professional channels.

All of them purchase directly in Switzerland, but are in constant contact with the specialized local team, that can now much better take care of the three channels. Marketing support, online and offline is provided and handled still by the local team in China, pricing and discounts are in line with their global corporate policies.

Within one year, the changes have put into place, agreements have been adapted or terminated, local operations in China are kept slim and efficiency has improved by impressive factors. This shows that localization and its requirements can change in time, and the courageous re-orientation of this company is rewarded by a quickly growing profitability.

Recommendation

Localization encompasses many aspects, from language, adaptation of processes, marketing features, over sales & management structures up to a time component.

Companies increasingly begin to understand that business models that are successful in home markets cannot simply be copied to the fast-changing Chinese business environment. Competition and the role of the state are market factors, the culture shapes consumer behavior. Doing business in China is considered rather a marathon than a sprint. This needs to be understood when entering or doing business in China. Adaptations and agility are of utmost importance in both understanding the currents of the market and in reacting in time to these shifts. In such a fast moving market like the Chinese, a solution which some years ago was evaluated and chosen as the best, might in the meantime be outdated already. This means that Swiss SMEs have to localize not only the speed of their decision making processes, but also revise regularly their sales organization, question every single bit of the operation to see whether or not at that very moment it is the optimal solution in place.

We are convinced that successful localization in a market like China requires constant reviewing from inside and outside, so that no aspect gets forgotten and Swiss SMEs can reap maximum benefits in this challenging market. After all, we are positive since the Swiss SMEs in China appear to be doing very well and view the future still positive, mostly because they were able to adapt and adjust in time.

While these questions deal mostly with strategic decisions, implementation is another issue altogether. Issues such as misconduct of local management, of IP violations etc. have proven to be headaches in several cases. As this would explode the scope, we will take up such issues in future Newsletters.

Get in touch

Did you experience a similar kind of challenge in your China venture(s)? Get in touch!

The Competence Center China for Swiss Small and Medium sized companies is a joint initiative of sim (selective international management) Co. Ltd., ZHAW School of Management & Law and Swiss SME China (the representative of SKV in China).

For further questions about Localization in China, please do not hesitate to contact
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