

## **China Market Entry Strategies: A Case Study on Sister State and Sister City Relationships in Queensland.**

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### **Abstract**

Since 1987 the Chinese economy has moved from being the 32<sup>nd</sup> largest economy in the world to 6<sup>th</sup> currently and it is on target to become the largest by 2012. The implications for Australia are significant. However, entering the Chinese market is complex and much depends on understanding formal networks. This paper explains some of the complexities and, in particular, the principle of ‘guanxi’. The paper briefly examines how Australian potential business entrepreneurs can take accelerated advantage of guanxi through the formal Sister City and Sister State Arrangements in entering the Chinese market. A brief case study is provided of each of the two such arrangements to illustrate how they operate.

## **China and economic growth**

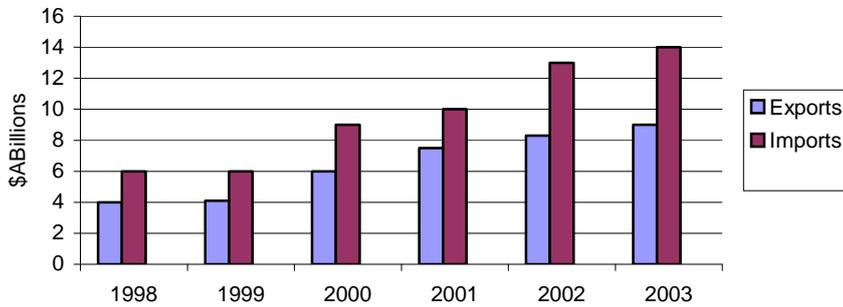
Since the 'open doors policy' of Deng Xiao Ping in December 1978 China's economy has changed markedly from a Soviet-style, centrally-planned economy to that approaching a market orientation but remaining identified as 'a socialist market economy' (<http://news.bbc.co.uk>). The nation is now the sixth largest economy, the fastest growing and estimated to become the largest economy in the world by 2012 ([www.answers.com](http://www.answers.com); [www.adsale.com.hk](http://www.adsale.com.hk)). This represents a significant move forward from the 'open doors policy' when China was ranked as only the 32<sup>nd</sup> largest economy ([www.china.org.cn](http://www.china.org.cn)).

The results of the adoption of the new socialist market economy has been a quadrupling of GDP to US\$1,439 billion ([www.dfat.gov.au](http://www.dfat.gov.au)) where each of its 1.3 billion people, residing in the third largest land mass in the world, now have on average a purchasing power parity of US\$5,000 per year ([www.china.org.cn](http://www.china.org.cn)). From 1978 to 2004 China has received US\$500 billion in Foreign Direct Investment (DFAT 2005) and has been experiencing over 9% compound GDP growth per year over the last decade (OECD 2004).

## **Australian trade and China**

The trade dynamics of both China and Australia has changed significantly over time and the growth of exports and imports has accelerated significantly over the past 6 years as indicated in figure 1.

**Figure 1: Australia and China trade**



Source [dfat.gov.au](http://dfat.gov.au)

In 2004 Australia’s merchandise exports to China were \$11 billion and now represent the country's second largest export market, following Japan. In addition, Chinese imports were A\$17.9 billion and represent the second largest import country (DFAT 2005). However, two factors are important to consider. Firstly, the export items represented are generally low value-added commodities, as illustrated by Table 1, which are subject to price taking and not price making.

**Table 1: Value of Exports 2004**

	<b>\$A million 2004</b>
Iron ore	2,453
Copper	156
Nickel	142
Other ores	390
Wool	1,245
Cotton	211

Source [www.dfat.gov.au](http://www.dfat.gov.au)

The second aspect is that there is an increasing deficit balance-of-trade with China. The call is for increasing efforts of industry and government agencies to assist organisations in their international marketing endeavours.

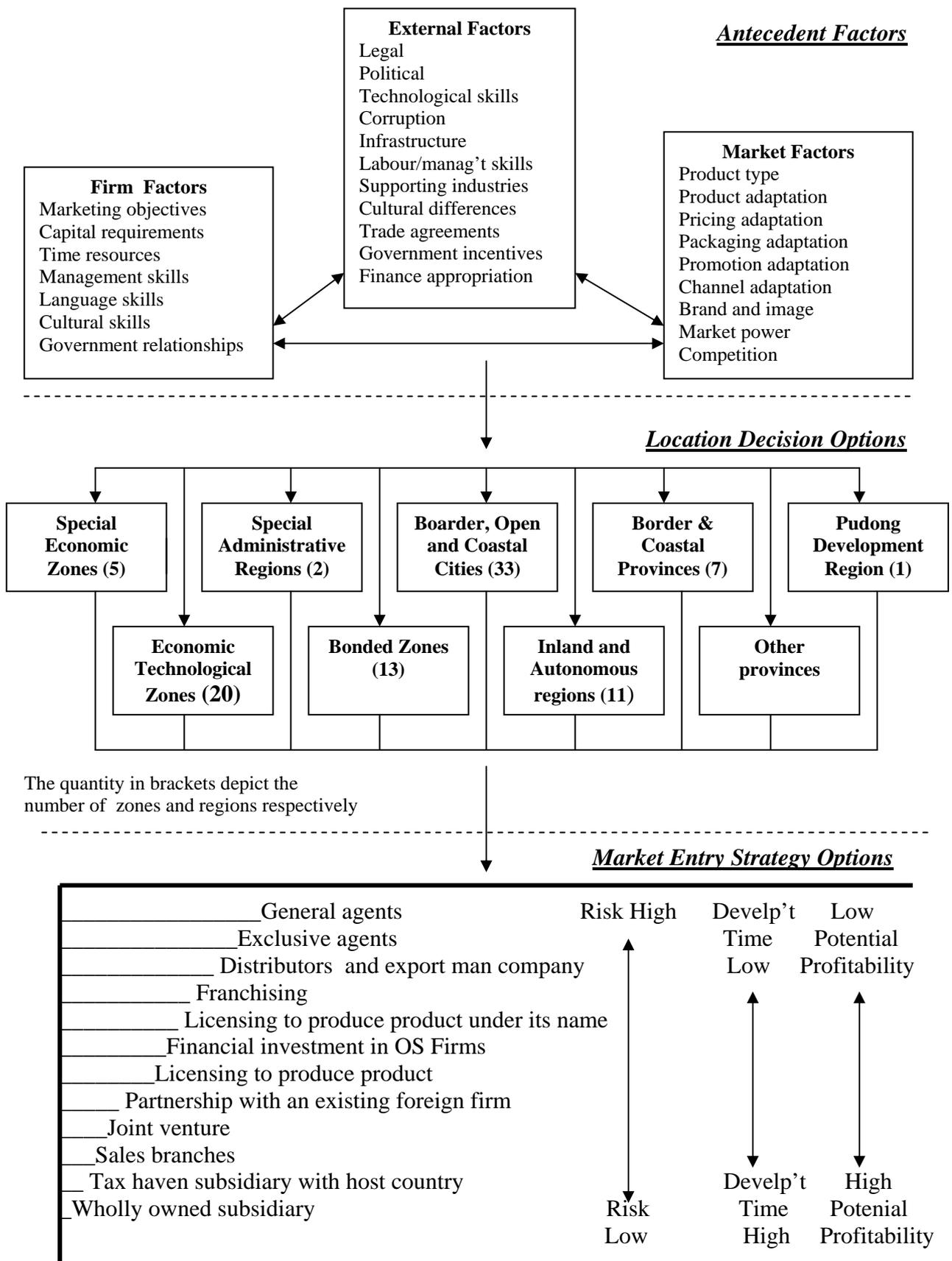
### **Traditional market entry strategies**

In general, market entry strategies for most products and services is relatively uncomplicated in domestic markets, being based on the time-worn understanding of obtaining the correct marketing mix elements. These elements are generally considered to comprise the 4 P's (Product, Price, Place and Promotion) combined with an understanding of political and legal forces, economic climate and competitive structures (Kotler, Brown, Adam, Armstrong, 2004). These factors are generally known and relatively easy to interpret. Again, on the positive side, domestic marketers work within a western framework comprising homogenous societies where needs, wants and market demands are relatively well-known and reasonably stable and where culture rarely poses an impediment to understanding and interpreting markets.

With respect to international marketing there are usually substantial disparities in societies where needs, wants and demands are seldom clear. This requires an even greater degree of understanding, wisdom and research in all areas of marketing than in domestic market situations. However, additional appreciation needs to be given to many other critical areas such as international cultural forces, economic systems, political and legal factors, distribution structures, geographical

infrastructures and technological factors (Cateora & Graham, 2002; Doole & Lowe, 2004; Kotabe, Peloso, Gregory, Noble, Macarthur, Neal, Reige, Helsen, 2005). This is especially true for organisations entering China. However, China additionally presents a much more complex market structure due to its mixture of regional and centralised government policies. To assist this understanding the following conceptual model is shown in Figure 2.

**Figure 2: China Market Entry Approach – Conceptual Model**



Developed from: Samli, Still & Hill, 1993; Cateora & Graham, 2002; Doole & Lowe, 2004; Onkvisit, S & Shaw, 1993; Czinkota & Ronkainen 1998, Chan, 1999.

## **China and market complexities**

As indicated in Figure 2 the Chinese market is not a homogenous unit but a highly complex set of market groupings and regions. China now has a plethora of special regions, zones and provinces, each with their own particular economic status, governance and market systems. It now operates with multi-level, multi-channel, omni-directional and diversified management, manufacturing and marketing structures ([www.adsale.com.hk](http://www.adsale.com.hk)). Firms entering this highly complex socialist market economy are faced with enormous obstacles in establishing a presence. This is further exacerbated by extensive cultural barriers, which impact on the social, legal, language and regulatory practices of firms. Although the list is substantial, a detailed examination of all of the complexities is beyond the scope of this article. However, one key factor that will be examined in understanding the Chinese market is the time-honoured principle of *Guanxi* as it acts as an overriding cultural barrier to trade.

*Guanxi* is often translated simply as 'relationships' ([www.chinese-school.netfirms.com](http://www.chinese-school.netfirms.com)) however, it represents a highly complex system that combines trust, connections, and networks. *Guanxi* is directly related to 'how social capital is produced and reproduced with close-knit networks of relationships (Araujo & Easton 1999, p.82). It exists across the whole fabric of society and business and permeates every avenue of life. In China there are no clear divisions between work, education, leisure and pleasure. Everything is

moulded together and expressed through relationships and connections.

Connections are of utmost value in endeavouring to establish a business. Within the business context it is understood to be a network of relationships among parties that cooperate together and support one another ([www.chinese-school.netfirms.com](http://www.chinese-school.netfirms.com)). The literature reveals that there is a frequent mention of the importance of guanxi in China business (Tung 1982, Redding, 1993, Hofstede and Bond 1988). Guanxi is legal and voluntary and does not have to involve money ([www.fathom.com](http://www.fathom.com)). There is a popular saying that in the West people do business and make friends but in China people make friends and then do business. Friendships and relationships always precede business, and that occurs through guanxi. This is echoed by Lo who claims there are four essential factors in developing guanxi: first, decency and respect of relationships; second, trust; third, dependability and reliability; fourth, contacts and emotional bonds ([www.chinese-school.netfirms](http://www.chinese-school.netfirms))

There are no documented rules or accounts kept of guanxi but they carry a measure of credit. Guanxi business and social credits operate like deposits in a bank that can be traded directly or indirectly with others. For example, in indirect relationships if Ms. Lee needs a favour from Mr Wang, who does not have any guanxi with him but has guanxi credits with Mr. Li (who in turns has credits with Mr Wang), then she can draw on the credits of Mr. Li as a favour from Mr. Wang. It is a reciprocal arrangement that must be honoured and significant credits can last over generations. However, business guanxi operates not only on a horizontal

plane but also at business, social and at government levels, where it operates both formally and informally.

The government of China has been created and honed through 2000 years of Confucian thought and practice. In the Confucian social order there are five relationships that comprise: emperor-subject, father-son, husband-wife, brother-brother and friend-friend (Leung, Wong and Tam 2005). Upon the relationship premise the principles of law are established. The principles are generally not operationalised through codified law nor are they essentially based on precedent and statutes. They operate principally through pragmatic ethical considerations involving relationships, in particular as they are directed through community, business and social relationships (Zheyuan, 2005), which in general lacks substantial transparency. Government officials in China, amongst their own people, are usually highly respected individuals, long-serving and extensively connected through guanxi business relationships.

For a foreign enterprise to enter China and form a business relationship, even if it is only exporting indirectly, it is necessary to establish connections with the right individuals and simultaneously acquire different levels of government approvals for virtually all activities. It is highly desirable, and generally essential, to commence the business train at a high government level. Government officials who have strong guanxi connections down the line of command can ensure a

relatively smooth, quick and safe passage and correct connections for the enterprise to succeed.

Australia is a small country and a niche player operating in one of the world's largest markets with a population of 1.3 billion people. Australian businesses most likely will have few Chinese language skills, possibly even less cultural skills and virtually no guanxi connections. Ninety six percent of all organisations are SME's represented by 11 companies ([www.actetsme.org](http://www.actetsme.org)). Because of their size they substantially lack financial resources, high levels of management and marketing skills and very few Chinese connections.

However, one approach that has proved to be successful for many Australian firms is to enter the Chinese market through the leverage opportunities fostered by Sister State Relationships (SSRs) and Sister City Relationships (SCRs)

### **Sister State and Sister City Relationships**

Sister State Agreements (SSAs) are ministerial high-level government-to-government arrangements designed to foster two-way trade, education, and cultural initiatives. There is little documented history with respect to SSAs but they appear to have emerged principally during the past two decades. There is no coordinating body for SSAs in Australia. Some are very loose cultural relationships whilst others are formal and trade strategic that are able to provide

substantial leverage for industry initiatives. For SSAs, it is estimated that there are about 60 such arrangements in the county (Gatfield 2000). Indications are that they have evolved out of SCRs. In that domain there is a reasonably substantial body of information.

The first documented SCA was between Keighley, West Yorkshire in the UK, and with Poix in France during the 1920s. The Mayor of Keighley, on a visit to France, was so distressed by the WWII devastations that he raised a large sum of money for social functions in Poix. This action was followed by a number of other SCAs between municipalities in UK and other French villages (Donaldson 1992). This type of action was repeated many times over and by 1988, between France and West Germany alone, there were over 3000 SCRs (Zelinsky 1990). Although the total number of SCAs is unclear, one estimation is that there are in excess of 11,000 twinnings worldwide (Donaldson 1992).

With respect to Australia the situation is clearer. According to the CLAIRE Report (1995) the number of officially recognised affiliations in Australia is in excess of 400. The greater proportion of affiliations is with the USA, UK, Japan, and NZ. However, the CLAIRE report is a decade old and the number is possibly much larger.

In many instances the community drives the SCRs. The motivation for formation is usually based on a host of different community and humanitarian objectives

including connections through history, sports and cultural ideologies (Gatfield 2000). The linkages are generally based in similarities not on differences. In the main, the issue of economic outcomes is of little significance. However, there are some SCRs that do carry an economic significance and one of these, Maroochy Shire Council and Xiamen, is examined and this is compared to one SSRs of Brisbane and Shanghai.

### **Xiamen and the Maroochy Shire of Queensland**

Maroochy is a relatively small municipal council on the eastern seaboard of Queensland, Australia, about 100 km North of Brisbane. It has a population of 136,000 and covers 1158 square kilometres. Maroochy has its own airport, hospital and University ([www.maroochy.qld.gov.au](http://www.maroochy.qld.gov.au)). Since 1994 it has had a SCR with Xiamen in the Fujian Province South East China. One of the key features of the SCR with Xiamen is trade and industry development. The Shire has for the past nine years participated in the China International Fair for Investment and Trade (CIFIT). The CIFIT is one of the largest investment trade fairs in the world creating a unique opportunity where, under one roof , 12,000 delegates from over 100 countries engage in trade relations with China. Maroochy operates a trade stand every year where commercial trade delegates and entrepreneurs operating in Maroochy can display their products and services. In so doing it offers a one-stop window for opportunities to provide capital, trade opportunities, business matching and legal assistance through trade

commissioners representing all the major regions of China. The number of delegates from Maroochy varies each year with the delegation last year comprising 24 individuals. Their products and services were diverse and included water treatment plants, dairy products, cane fibre supplies, medical supplies, stone quarry materials, education and legal services. Delegates paid for themselves and there was no direct cost to the Shire for operating the trade fair. It has been estimated that the total budget spent on the Chinese SRC is only 0.3% of the overall Shire budget (Zheyang 2005) but net flow of investment money into Maroochy is in excess of \$8.5 million over the period 2000-2004.

Of critical importance is not just the trade fair per se but the guanxi opportunities provided through the networks created exclusively through the SCR.

### **Queensland and Shanghai**

In a similar vein, in 1998, the State Government of Queensland established a SSR with Shanghai. As a result of the SSR a Trade Office has been established there which is managed by a trade commissioner and supporting staff. Shanghai is a strategic choice as it has the highest per capita income of all regions and leads the nations GDP growth (Gatfield 2000). There are frequent trade missions engaged between the two parties to support local industries. There is no economic data to substantiate the economic efficiency of the arrangement but research into its

suitability as a potentially effective trade partner against 11 other SSRs found it to be the strongest partner of those under review (Gatfield 2000).

### **Implications**

Due to market complexities for firms entering China and the encumbering high risk factors it is essential for organisations to enter via the fastest and safest route. One of the quickest and safest routes is the way of SCRs and SSRs. To quote one successful Australian entrepreneur who has entered China: 'SCRs are the escalator to the top floor of government'. It is government who will sanction most trade activities. Relationships or guanxi will have to be established and through the formal relationship networks a relatively smooth passage can be assured.

### **Future research**

This paper has largely been conceptual based largely on the literature. There needs to be additional research undertaken to establish through qualitative interviews and quantitative surveys the actual process undertaken by entrepreneurs who have successfully entered the Chinese market and have made a successful trade presence. This research needs to be undertaken within the domain of the efficiency and efficacy of the SSRs and SSAs in assisting trade relationships and formation.

## Conclusions

The growing focus of trade between China and Australia is critical if regional development and security is to be enhanced. Creating trade and business links is no simple task in China, and obtaining guanxi is a key component and it must be established between players. This is time consuming and a costly exercise for Australian entrepreneurs. However, through the mechanism of SCRs and SSRs, the lines and connections have been partially created. Australian firms entering under those relationships will be able to enjoy a faster and smoother trade passage with hopefully increased successful outcomes.

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